Company Law
Reform and Restatement

Report No. 9
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LAW COMMISSION

Report No. 9

Company Law Reform and Restatement

June 1989
Wellington, New Zealand
The Law Commission was established by the Law Commission Act 1985 to promote the systematic review, reform and development of the law of New Zealand. It is also to advise on ways in which the law can be made as understandable and accessible as practicable.

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1 June 1989

Dear Minister

I am pleased to submit to you Report No. 9 of the Law Commission, *Company Law: Reform and Restatement*.

The report proposes a basic law governing the creation, operation and termination of all companies. It recommends to you a draft Companies Act (comprising much of the Report) which, with two associated measures, would replace the 1955 Act and have substantially the same scope.

The associated measures are first the proposed Personal Property Securities Act recommended in our Report No. 8 and designed to replace Part IV of the 1955 Act relating to company charges, and second the proposed amendment to the Property Law Act 1952 set out in this Report and designed to replace Part VII of the 1955 Act relating to receivers. The separate form of these proposed measures is explained by the fact that they are not limited to companies.

The draft Companies Act also includes provisions relating to the liquidation of companies—a matter which is of course also covered by the present Act and must be dealt with in the law. Your reference to the Law Commission mentioned that the Department of Justice was conducting a review of the law and
practice of company liquidations and individual insolvency. Since that review has not been completed, we have thought it better to make suggestions for company liquidations rather than to put forward an incomplete legislative scheme.

The draft Companies Act and its associated measures maintain the distinction at present in the law between the basic company law and securities law, the law which governs those corporate bodies and individuals who offer securities to the public.

That is a useful distinction which we have not wanted to disturb.

Securities law is one part of the wider law relating to companies that has recently been and still is under review by a number of different agencies. The background of current activity underscores the public importance of the company in our commercial and legal systems. It has also reminded us in our work that if needed reforms are to be coherent, it is important for the underpinning legislation to be clearly based on enduring policy. We have sought in this Report to provide that underpinning.

Accordingly, we commend the draft legislation contained in this report—and that in our Report No. 8—to you for introduction in Parliament.

Yours sincerely

K J Keith
Deputy President

The Right Honourable Geoffrey Palmer MP
Deputy Prime Minister and Minister of Justice
PREFACE

1 This Report is a response to a reference given to the Law Commission by the Minister of Justice on 5 September 1986. The text of the reference is as follows

The Law Commission is asked to examine and review the law relating to bodies incorporated under the Companies Act 1955, and to report on the form and content of a new Companies Act.

The continuing work of the Securities Commission in the fields of takeovers, insider trading and company accounts will form part of this overall inquiry. Also related to this reference is the review being conducted by the Department of Justice of the law and practice of company liquidations and individual insolvency.

2 Following the reference, the Law Commission published a discussion paper on company law in December 1987 (Law Commission, Preliminary Paper No. 5) and a discussion paper on personal properties securities in May 1988 (Law Commission, Preliminary Paper No. 6). The submissions received in response have been thorough and thoughtful. We have benefited enormously from them in developing our proposals. In addition, a number of people generously gave of their time to comment upon drafts, make suggestions and generally act as
sounding boards for ideas. Their participation has greatly improved our proposals. Those who responded to the discussion papers and those who gave special assistance to us are acknowledged in Appendix A to this Report.

3 Review of the Companies Act 1955 is only part of the law reform process affecting company law which is currently underway. The work of the Securities Commission on insider trading and company takeovers has been or is being implemented in legislation which applies to companies which are listed on the Stock Exchange. The Securities Commission is also expected shortly to report upon reform of the law relating to company accounts. The Committee of Inquiry into the Sharemarket has confirmed the need for overhaul of the Securities Act 1978 and the Sharebrokers Act 1908, which particularly affect publicly listed companies. Investigation of companies at risk has been the subject of recent legislation to replace the Companies (Special Investigations) Act 1958. The Crimes Bill before Parliament has provisions dealing with fraud arising out of company activity. And the Minister of Justice has recently announced that a Serious Fraud Office is to be established largely to police serious corporate crime.

4 These initiatives underscore the significance of the company in our legal system and the need for the law to adapt to meet changing circumstances. They emphasise as well the importance of clear definition of the scope and policy of the basic law of companies, if overall reform is to be consistent and properly co-ordinated.

5 The Report is in the form of draft legislation with explanatory commentary. In providing a draft Act, the Law Commission has followed similar exercises in other jurisdictions, most notably Ghana and Canada. Reducing ideas to draft legislation helps to ensure that proposals are properly thought through. They make the Report a less lengthy document than would have been the case if proposals had been generally described. But the scope of a companies statute is huge and the draft Act is itself a substantial document.

6 There are two problems with a report in the form of a draft Act: reading legislation does not grip most people, particularly when the legislation is as lengthy as this draft Act; and the
policy issues may not be sufficiently apparent from the text of the draft Act, even to those who are expert in the field.

7 The format of the Report attempts to overcome these problems by providing both a detailed commentary to be read with the particular provisions of the draft Act, and introductory chapters which summarise the principal recommendations and the major policy themes in the proposals. The introduction and commentary summarise our reasoning. We have not attempted to write a treatise on company law and its reform. Given the size of the topic, such a project would have required a report of formidable length and involved a great deal more time. We also think it is unnecessary. The essence of the Report and our proposals is the draft Act.

8 The introductory material is divided into three chapters. Chapter I outlines the main policy approach. Chapter II sets out the principal recommendations of the Law Commission. Chapter III explores the general issues and themes of the reforms and may be of more interest to those familiar with the current law.

9 The commentary is contained in Chapter IV. The proposed new Companies Act makes up Chapter V. (A comparative table relating this to the 1955 Act is included as Appendix B.) And the proposed Property Law Amendment Act dealing with receiverships together with an explanatory commentary makes up Chapter VI.
I

Introduction

OUTLINE OF SIGNIFICANT REFORMS

10 The most significant reforms proposed are

- enactment of a new Companies Act to replace the 1955 Act
- abolition of the concepts of par value and nominal capital as part of a reform of the rules about share capital and the maintenance of capital
- the enabling of companies to buy their own shares and finance the acquisition of their shares (in reversal of the current law), subject to protections for shareholders and creditors
- redefinition of the distribution of power within the company by direct operation of statute rather than by a deemed contract
- expression in the statute of a standard form of company constitution which will apply unless expressly varied by the company constitutional documents
- a fuller restatement in the statute of the duties and powers of directors
- recognition of the circumstances in which the interests of existing shareholders need special protection
• a comprehensive system for protection of minority shareholders including
  – dissentient rights to buy-out where class rights are affected
  – improved standing to enforce through the Courts obligations owed to the company and directly to shareholders

• greatly simplified liquidation rules
• requirements for experience and independence in those conducting liquidations and receiverships
• restatement of the law relating to receiverships in the Property Law Act 1952
• removal of the law relating to company charges from the Companies Act and its incorporation in a comprehensive Personal Property Securities Act, as recommended in the Law Commission’s Report No. 8.

THE SCOPE OF COMPANY LAW

11 In New Zealand, as in other economies based on private ownership, the company form remains the major legal mechanism for economic development. The reason for its significance is the efficiency and flexibility of the company as a system for organising aggregation and use of capital.

12 Despite the importance of the company, company statutes such as our Companies Act 1955 are relatively unexciting. Inevitably they are largely technical. Company laws are in large part enabling in that they provide the processes for the creation of companies, their operation and termination.

13 Thus the Companies Act 1955 deals with

• *Incorporation* The Act sets up a system for incorporation by registration under the supervision of the Registrar of Companies.

• *The internal organisation of the company* The Act covers
  – the form and effect of the memorandum and articles of association
- the rights of membership in the company
- how the company can act
- share capital and debentures
- the registration of charges created by companies
- management and administration of the company
  (including the holding of meetings, reports to shareholders, accounts and audit, inspection of the company’s records, the powers and liabilities of directors and authorisation of reconstruction of the company)

- The winding up of the company.

14 To the extent that the 1955 Act regulates company activity, the regulation is designed to protect shareholders and creditors against abuse of the company form, rather than to achieve more general social objectives.

15 While this Report proposes major reform, it accepts that the general scope of the 1955 Act is the proper scope for a Companies Act.

16 The draft Act contained in this Report therefore lays down a basic law which allows companies to be set up, provides for their termination and sets out the processes for their internal organisation between formation and termination. It regulates company activity only to the extent necessary to protect against abuse of the company form. The concern of the draft Act is therefore with what may be called a “core” Companies Act.

17 A core company law is only part of the wider law which applies to companies. In the reform, we endorse and build on the distinction in our current law between securities law and company law (discussed further in paragraphs 130-134 below). Much less than one percent of companies raise capital from the public (the exact number is not known but listed companies account for only 209 of the approximately 150,000 New Zealand registered companies). For those companies, investor confidence and protection is principally safeguarded in other ways.

18 The reform proposals contained in this Report are put forward on the basis that the additional safeguards imposed in
the public interest under the Securities Act 1978 will be superimposed upon companies which offer securities to the public. The role of the Stock Exchange in regulating those companies is also significant. Both the Securities Act 1978 and the role of the Stock Exchange are under review. We consider that substantial reform of both the Securities Act and the Sharebrokers Act 1908 is required and that a comprehensive review should include

- examination of the extent to which diversity in company form should be restricted in the case of companies which offer securities to the public
- reassessment of the enforcement agency charged with securing compliance with securities law.

In accepting that internal regulation is the proper focus of a Companies Act, we have also taken the view that a Companies Act is not the appropriate vehicle for imposition of general social reforms such as a requirement of worker participation in management or the imposition of environmental goals upon companies. These matters should be pursued through specific legislation imposed upon all employers and business enterprises.

POLICIES FOR COMPANY LAW

The Law Commission has prepared this Report on the premise that a good system of company law should

- provide a simple and cheap method of incorporation and company organisation which is flexible enough to meet the needs of diverse organisations
- clearly identify the duties and powers within the corporate structure in an Act designed for use by directors and shareholders and not just lawyers and accountants
- provide for better accessibility to company law by setting up the Act as the statement of first recourse in identifying rights and duties within the company
- ensure that regulation to prevent abuse is appropriate (that is to say, directed at the abuse of corporate structure or limited liability) and is commensurate with the
risk of abuse so as not to frustrate the economic and social benefits of the company form

• maintain and build upon a distinction between the aims of company law and securities law: company law being concerned with the incidents, benefits and abuses of the corporate form; securities law having a wider concern with the integrity and efficiency of capital markets.

21 All Companies Acts are concerned with striking a balance between enabling use of the company form and regulating to prevent its abuse. Striking such a balance is a matter of judgment on which views will differ. The proposals made in this Report strike the balance the Law Commission considers to be appropriate for New Zealand conditions. They have been tested against overseas experience with more modern statutes, and against local experience with the 1955 Act. And we have sought to make sure that proposals for reform are tested against principle.

22 A major concern has been to ensure that the balance struck does not undermine the economic and social benefits of company form. These benefits are derived from five main characteristics

(a) Recognition of the company as an entity distinct from all its shareholders (legal personality). The achievement of legal personality has meant that a company can have continuity and perpetual succession despite the death or departure of individual investors. The financial standing of individual investors need not affect the enterprise or other investors. Legal personality has made possible enterprises of a scale unthinkable if constrained by human life or the financial resources of individual shareholders.

(b) The flexibility and adaptability of the company form. This has meant that the company has been an appropriate vehicle for enterprises which differ enormously: the corner dairy and the major industrial conglomerate and widely differing enterprises in between.
(c) Ease of transferability of investor interest. Transferability of investor interests is facilitated by their division into units of property, called shares. The share identifies a bundle of legal rights which vary greatly. Usually they include rights to the residual assets on winding up, to dividend payments and to vote on matters reserved to the shareholders. Transferability of these rights facilitates aggregation of capital because investors do not have to discount their investment for lack of liquidity. The benefits of transferability may be excluded or restricted by the company constitution, or may be largely circumscribed where there is no ready market for the disposal of the rights. But ready transferability of shares is a preferable option to more wasteful and disruptive methods of achieving liquidity (such as dissolution and buy-outs) and it is an essential precondition of organised stock markets, through which most large enterprises raise capital.

(d) Limited liability for investors. Not all companies have limited liability but its availability is a main explanation for the success of the company form. Since its establishment in 1855, its social benefit has been proved: every jurisdiction operating along capitalist lines has adopted limited liability. Although it is often cut down by contractual arrangements between creditors and the owners of small companies, it remains fundamental to our system of company law. The Law Commission proposes no reassessment of its place. It is important to appreciate that the benefits of limited liability lie not only in the limitation of risk to individual investors (which is an incentive for aggregation of capital) but also in enabling risk-taking. The taking of business risks is central to the success and social utility of the company.

(e) Specialised management, separate from ownership. While small companies do not usually require specialised management, it has been critical in the
efficient use of capital by larger companies. Separation of management from ownership, especially in large organisations, means that directors must be entrusted with wide discretionary powers to make business judgments in diverse and often unforeseeable circumstances.

23 These five characteristics are essential to our system of company law. They confer economic and social benefits. They also carry the risk of abuse. In particular, outsiders are at risk when dealing with the company because of its separate legal status; creditors are at risk from limited liability; shareholders are at risk from abuses of power by directors. Company law is largely concerned with containing the risk of abuse within acceptable bounds while not undermining the substantial benefits for investors and for society in general which these five characteristics provide.

24 In our review, we have been concerned to test existing regulation and proposals for reform against the characteristics, the benefits they confer and the abuses they give rise to. In some cases, reform proposals are prompted by an assessment that the balance in existing legislation or in judge-made law has been wrongly struck. In other cases, reform proposals directed at known abuses have had to be tempered in order not to defeat the benefits.

THE NEED FOR REFORM

25 Applying these policies, the Law Commission has come to the conclusion that New Zealand company law is in need of thorough overhaul.

26 The present Act gives rise to four main concerns

• a need for more accessible and intelligible law.

Under the present system, the powers and duties within a particular company require knowledge and understanding of the memorandum and articles of the company, the Act and the case law (in which some of the most important company law rules are to be found).
the fact that some significant rules of company law are based on policies which have become outdated or are out of step with modern practice

- the extent to which the system of the Act has been overtaken by or overlaps other legislation, most importantly the Securities Act 1978

- a perception in the community that our system of company law has been unequal to the task of preventing abuse.

These concerns are discussed further below. The major reforms proposed in this Report to deal with them are incompatible with the structure of the present Act. They include the proposals for simplification of the Act and the restatement in it of the major rules of company law at present found in the case law; substantial overhaul of the notion of share capital (with abandonment of concepts of nominal capital and par value); reassessment of the distribution of power within the company and the position of and remedies available to minority shareholders; and streamlining of the registration system to provide both a more useful method of registration and a better public service.

Thus the Law Commission believes that selective amendment of the 1955 Act is not sufficient, and that that Act should be replaced.

THE OPPORTUNITY

The New Zealand Companies Act was passed in 1955. At that time it was an almost exact copy of the United Kingdom Act of 1948. The following of English precedent has been a tradition of New Zealand company law since the first Act of 1860. With United Kingdom company law now increasingly influenced by European law, it no longer provides an obvious model for us.

Although the 1955 Act has been substantially amended over the last 30 years, it is now out of step with the more recent company statutes of the United Kingdom, Australia and Canada.
The last review of the New Zealand Companies Act was by the Macarthur Committee, which reported in 1973. That Committee did not attempt any reappraisal of the Act against fundamental principle, but rather concentrated on the strains then apparent in it. The main sources of the Macarthur Report were the United Kingdom Jenkins Committee Report of 1962 (Cmd 1749) and the Australian Uniform Companies Act of 1961. Both have long since been superseded by further reform in the United Kingdom and Australia. To the extent that the Macarthur Report remains unimplemented, it no longer provides a blueprint for systematic reform and is based on a number of assumptions now out of date.

We owe a special debt to the pioneering work in company law reform of the Canadian Dickerson Committee which reported in 1971. It recommended sweeping changes. The Canadian statutes which have followed it during the last 10 years have provided us with working models for reform.

The present reference has provided the opportunity to reappraise the basic principles of company law and their application. We have come to the conclusion that substantial change is required. Although the proposals made may seem revolutionary to some, they generally have working models in Canada and the United States. But the crucial elements of the company as we have always known it are confirmed in the reforms proposed. Deadwood has been pruned away but the essential elements of the company remain. They have been distilled from the existing legislation and the case law and restated in the draft statute to make them more accessible and useful.

IMPACT OF OTHER INITIATIVES AND EVENTS

Securities Law Review

Reform of any statute does not take place in a vacuum. Mention has already been made in the Preface of the reviews of securities law which are under way. Although the objectives of securities laws are, in our system, separate from company law objectives, they do have significant impact upon the operation of many companies. While we consider that maintaining a
distinction in the legislation between companies and securities law is desirable as permitting better focus, some overlap of the running of each system is to be expected. In a small country like ours, functional purity cannot be pushed too far without duplication and waste of resources.

35 In the draft Act, public enforcement of company law obligations is vested in the Attorney-General. If, as a result of the overhaul of the Securities Act, a permanent enforcement agency is established for securities law enforcement, it may be considered sensible to give that agency also the public enforcement powers conferred under the Companies Act. We do not make recommendations about securities law enforcement reform because it is outside the scope of our reference. But we record that our consultation for this Report showed considerable dissatisfaction with the present system of enforcement through the Registrar of Companies and the Securities Commission. Both the Registrar and the Securities Commission have important functions other than enforcement: the Registrar is responsible for the registration system and is also the Official Assignee; the Securities Commission has substantial law reform functions. We suggest that when enforcement is reviewed, consideration should be given to providing a single focus for any enforcement agency.

Harmonisation

36 Commercial law reform in New Zealand must take into account the 1988 memorandum of understanding executed between the Attorneys-General of Australia and New Zealand aimed at harmonisation of business laws.

37 Harmonisation under ANZCERTA (Australia and New Zealand Closer Economic Relations—Trade Agreement) seeks the creation of an environment conducive to the growth of trade in goods and services. Much of company law has little impact on trans-Tasman trade. Where it has, as for example in the law relating to company insolvency, we have been particularly conscious of the ANZCERTA implications. In other areas, where the effect on trade is not as clear, we have still approached the review on the basis that conformity is, in the area of business law, desirable.
38 For the reasons more fully set out in paragraphs 145-153 below, the Law Commission believes that the present Australian legislation does not provide an acceptable model for company law reform. It is outdated and dense in form. While we do not see harmonisation as requiring replication of the law in detail, the difference between what we propose and the existing Australian system goes well beyond detail. To follow the Australian companies legislation would preclude the major reforms proposed in this report of abolition of par value and nominal capital and the introduction of a better and more principled system of director accountability and shareholder remedy. It is the view of the Law Commission that there is little point in bringing in a new Companies Act if it does not achieve these reforms.

39 Australian company law is, moreover, in a state of flux. Proposals for substantive reform are under consideration but have largely stalled while current initiatives to have Australian company legislation consolidated in a Federal statute are pursued. A consolidating Bill was introduced in May 1988 and at the time of this Report has just been referred back to the House from the Senate.

40 The responses to the discussion paper generally opposed following Australian company law. They pointed out that the advantages of harmonisation of core company law were less important than harmonisation of trading law and the laws relating to capital markets. Core company law was seen as more appropriately a domestic matter.

41 In the core company reform, the Law Commission recommends that the reform proposed should proceed now, even though the result will be that New Zealand core company law will be quite different from the existing Australian legislation and the Bill currently being considered by the Australian Parliament. We believe that the draft Act is a substantial advance on both the existing New Zealand legislation and the existing and proposed Australian legislation. We would expect that harmonisation of New Zealand and Australian company laws in the future might work from the base provided by the Act proposed in this Report.
42 In the case of company insolvency, the benefits of harmonisation are more evident and we have generally sought to follow Australian reform initiatives, although the draft Act contains many differences from the Australian proposals.

*October 1987*

43 In the aftermath of the slump in the New Zealand stock market in October 1987, there has been widespread comment that the severity of the downturn in investor confidence was contributed to by ineffective legislation. That perception has weighed with us as a factor properly to be taken into account in law reform but we have been concerned that expectations of what company law reform can achieve should be realistic.

44 Much of the criticism levelled at our laws seems more appropriately directed at the Securities Act 1978 and the Sharebrokers Act 1908, rather than at the Companies Act. Some of the more extreme criticisms are misconceived or exaggerated. Our laws are not as lax as some would suggest, although their impact is not easily understood because they are only in part statutory. Although out of date, they cover very much the same ground as their counterparts in the United Kingdom, Australia and Canada.

45 The draft statute does propose substantial reform to the law relating to directors' duties and their enforcement. To the extent that these aspects of our laws have been a cause of public concern in the aftermath of the events of October 1987, the draft Act addresses them.

46 While not ignoring recent experience of the operation of our existing laws and the critical public comment on them, we have been particularly concerned to test proposals for reform against enduring principle in order to strike a balance which provides sufficient protection against abuse without unacceptably eroding the benefits of use of the company form. The draft statute has been developed as a package, referable to general objectives in overall reform.
EXPECTATIONS FOR REFORM

47 In developing its proposals, the Law Commission has kept in mind the warning of another body charged with company law reform. The Jenkins Committee, which reported in the United Kingdom in 1962, expressed the caution that company law

is not a field of legislation in which finality is to be expected. The law here falls to be applied to a growing and changing subject matter . . .

48 The Law Commission does not expect that the proposals made in the Report, if implemented, will meet all changing circumstances. Those who use the company form are adept at discovering ways around inconvenient legislation. Very often that circumstance will itself prompt a reappraisal of the law as being out of step with commercial reality. In other cases, if there is clear abuse of those the statute is supposed to protect, amendment will be appropriate.

49 What we have tried to do in our proposals is to set up a structure in the legislation which is referable to clear policy objectives. At present, many of the policies of the law in the area of company regulation are difficult to articulate. In those circumstances, tack-on amendment has often served to confuse the position and make the legislation impenetrable. It is hoped that the policies of the draft Act are apparent and that, if enacted, future amendment will be able to be tested against and made consistent with them.

TIMING AND TRANSITION

50 Thorough overhaul of the present Act is a matter of urgency. In particular, the existing law relating to directors' duties and shareholder protection is unsatisfactory. Further review of the laws affecting New Zealand companies, most notably the Securities Act 1978, is also urgent. Unless the future direction of basic company law is settled, there is a danger that other reforms will be delayed or will be carried on in a piecemeal way without a principled foundation.
51 For reasons canvassed in Chapter I and paragraphs 145-153, the reforms should proceed despite the fact that they diverge from current and proposed Australian legislation and are in advance of Australian reform.

52 There is little difficulty in applying to existing companies much of what is contained in the Report. The standards of conduct for directors, for example, are important reforms which it is appropriate to apply to existing companies. Similarly, the imposition of a solvency test before distributions can be made to shareholders can be applied directly to all existing companies.

53 The perfection of the reforms which remove restrictions on the capacity of companies will require a period of adjustment. This will enable those companies which wish to continue restrictions on their powers to confirm them by reregistration. We propose a period of three years for this adjustment.

54 Of more difficulty is the application of the reforms suggested for share capital and the company constitutional arrangements. Imposition of the presumptive constitutional arrangements could have serious consequences for vested rights. Automatic application of the new Act would have complex consequences. It would be extremely difficult to devise transitional provisions which would operate fairly in all circumstances.

55 Our preferred solution is to require reregistration of all companies within a period of three years.

56 We have concluded that the Companies Act 1955 is no longer suitable for the circumstances of New Zealand companies. Having made that assessment, it seems to us to be undesirable not to apply the new system to all companies and instead to carry on two systems. Such a result seems to us to be costly and confusing.

57 The Canadian reformers have faced this issue before us. They concluded that it was necessary for the new Act to be a single system after a period of adjustment. We agree with the Institute of Law Research and Reform of Alberta (Report No 36, “Proposals for a New Alberta Business Corporations Act” at page 165) that
On the whole, we think that the bullet should be bitten, and that each company should be required to file a new constitutional document. We recognise that such a requirement will impose cost on each company and that it will impose upon each company the need to do additional paper work and go through additional procedures, none of which will appear relevant to the day to day functioning of companies which appear to be operating satisfactorily under the Companies Act. Our reasons for recommending such an imposition are, firstly, that the interest of the commercial community and of the public generally will be served by the introduction of the proposed ABCA, and, secondly, that the one-time cost of filing new documents is a lesser evil than the long-term costs of trying to live indefinitely with constitutional documents which do not fit in with the legislation. The cost of the proposed ABCA should, in our view, be recognised, accepted, and met.

58 A substantial advantage in “biting the bullet” now for New Zealand is that reregistration also provides an opportunity to clean out the register and get it into better shape to facilitate computerisation. We envisage that under the draft Act many companies will not adopt constitutions which vary the standard provisions in the Act and that those which do so will have very much shorter constitutions than the standard articles of association currently provide. We are of the view that the registration system can be made much more useful for the future if this opportunity is now taken.

59 It will, of course, be necessary to set up a process by which those whose rights might be affected by a change to the company constitution are able to participate in the decision and can seek relief where their class rights would be affected. It is difficult to know in how many companies such a process would be required.

60 We have not tried to draft transitional provisions because it has seemed to us that until the policy direction is set, the exercise is wasteful. What we envisage, however, is that the transitional provisions would be by amendment to the 1955 Companies Act.
61 The transitional provisions should require the company within three years of the coming into effect of the draft Act to file with the Registrar an application for registration and any constitutional document to be adopted.

62 Shareholders should be required to vote by special majority on the application for registration and the form of the constitution, if any. Where the constitution proposed would have the effect of altering class rights, dissentient shareholders should have the right to apply to the Court under section 209 of the Companies Act 1955 for relief. The Court should expressly have the power to alter the constitution where it thinks fit.

63 The only sensible sanction for failure to register within the time specified is liquidation, on application of any shareholder, creditor or the Registrar. That may seem extremely harsh, but if we are not to operate two parallel systems of company law, it is difficult to avoid. Deeming provisions which would apply the standard constitution under the new Act are not an option because they may well cut across vested rights in a manner that is wholly unacceptable.

64 As to timing, we are of the view that a long period of time is simply an incentive to procrastination. For that reason, we consider that a period of three years will enable everyone affected to have sufficient time to adjust.

65 The new Act will, of course, apply immediately to all new companies. We think its provisions relating to director duties and accountability and the solvency test for distributions should also be imposed upon all existing companies at the time it comes into force.
II
Principal Recommendations

THE FORM AND SCOPE OF THE LEGISLATION

66 There should be a new Act to replace the Companies Act 1955.

67 The new Companies Act should be concerned with the formation, operation and termination of all companies. It should contain the basic law applicable by reason of shared principle to all companies. Legal requirements not derived from those shared principles or applicable only to some companies (for example, to listed companies) should be imposed through specific legislation and rules superimposed upon the general company law base.

68 The new Act should maintain and build upon the present distinction in New Zealand law between the Companies Act and the Securities Act. The recommendations for company law reform postulate the existence of an adequate and effective securities law.

69 The purpose of the new Act should be to facilitate the use, and minimise the possibilities of abuse, of the company form. It should not seek to achieve other social objectives, such as worker participation in management or environmental protection. As appropriate, these should be implemented by other specific legislation.
CLASSIFICATION OF COMPANIES

70 The present classification of companies into private and public companies should be abolished. It should not be replaced by a distinction between closely-held and other companies.

71 It is unnecessary to maintain separate classification in the Act for

- companies limited by guarantee
- unlimited liability companies
- no-liability companies

because all these forms can be catered for under the draft Act by adaptation of the constitution of the particular company.

72 The existing special provisions for mining companies should be dropped; and those for insurance companies should be removed from the Companies Act and relocated in legislation concerned with insurance industry regulation.

COVERAGE OF ACT

73 Matters currently covered in the Companies Act 1955 which are not referable to the use and abuse of company form should be removed from a new Companies Act and be dealt with in other legislation.

74 In particular

- the law relating to company charges (Part IV of the Companies Act 1955) should be contained in a new Personal Property Securities Act, as recommended in Law Commission Report No 8
- the law relating to receivers and managers (Part VII of the 1955 Act) should be contained in an amendment to the Property Law Act 1952 as recommended later in the Report
- if the provisions in the 1955 Act relating to partnership (section 456) are to be retained, they should be re-enacted in the Partnership Act 1908.
INCORPORATION

75 The one-person company should be explicitly recognised by permitting one shareholder and one director.

76 Company constitutions should be simplified by providing for a standard constitution in the statute so that only variations from it need be contained in a constitutional document. The division between the memorandum and articles of association of the company should be abandoned.

77 The system of allocation of company names should be streamlined both by providing a default name system by allocation and by restricting the discretion of the Registrar to refuse registration of names selected. Names would have to be selected in good faith for the purpose of identifying companies. Protection against undesirable names would be given by retention of a power to remove names from the register.

78 The discretion of the Registrar in incorporation should be restricted to ensuring compliance with the forms prescribed, rather than substantive compliance with the Act.

79 The initial statutory meeting should be abolished.

THE COMPANY CONSTITUTION

80 There should be a statutory standard constitution for all companies which would apply except in so far as expressly supplanted for a particular company by a written document. The overall constitution would operate in place of the present system of memorandum and articles.

81 The standard constitution, and any modification of it, should confer rights directly and not, as the 1955 Act provides, by deeming the constitutional documents to be a contract.

82 The standard constitution should
  • confer powers of management upon the directors
  • provide for only one class of shares with each share having an equal right to
    - vote
    - receive distributions
- receive the net assets of the company prior to removal from the register
  • confer voting rights upon shareholders in respect of
    - election of directors
    - change of the constitution
    - approval of mergers and sale of major assets.

83 Companies should be free to vary this allocation of power, so that they can be structured to meet particular aims and circumstances. (For example, closely-held companies may provide for shareholder management rather than director management or may, by creation of different classes of shares, entrench veto rights or the right to appoint directors.) Such variety is necessary if the law is to be responsive to the complex and diverse circumstances of individual enterprises. However, there should be mandatory overriding requirements for the protection of creditors and minority shareholders. The mandatory requirements imposed by the draft Act include the directors' duties, the solvency test, restrictions on director delegation and voting procedures where shareholder rights are affected. (The scope of the optional company constitutional document is described below at paragraphs 164-183.)

SHARE CAPITAL

84 The arbitrary and misleading concepts of nominal capital and par value should be abandoned. Instead more direct safeguards should be introduced for creditor and shareholder protection. In particular, the draft Act would
  • require adequacy of consideration on issue of shares
  • impose a solvency test to be satisfied before the company can make distributions to its shareholders
  • require equal treatment of shareholders in issue of shares and distributions except where the constitution of the company expressly authorises otherwise
  • permit company share repurchase and allow companies to assist in the purchase of their shares, subject to safeguards for solvency and shareholder protection
• abandon the terminology of “ordinary shares” and “preference shares” and permit diversity in the share structure of the company where the company’s constitution varies the normal incidents attached to shares.

MANAGEMENT OF THE COMPANY

85 Where the management of the company is given to the directors (as it will be under the standard constitution), shareholders should be protected against abuse by

• providing for the matters the directors must take into account before exercising any general powers of management

• imposing particular duties when directors exercise powers which have direct effect upon the shareholders’ proprietary interests or where directors have a conflict of interest

• providing for shareholder determination wherever class rights (rights to vote or to share in distributions) are affected or there is a fundamental change to the company (by merger or by sale or acquisition of a major asset) and for the dissentient minority to require that they be bought out in such cases, unless the company constitution expressly excludes it

• giving a remedy to shareholders and creditors seeking to prevent a proposed breach of the company constitution or the Act

• providing for liability of directors to the company and to shareholders for breach of duties owed to them

• providing for liability of directors upon insolvency, where the directors have been in breach of duties imposed as a protection for solvency

• providing for more effective remedies for breach of duty.

86 More effective enforcement of the obligations under the company constitution and the Act should be secured by
• giving all shareholders standing, with leave of the Court, to bring a derivative action on behalf of the company
• removing the power of the general meeting to ratify director wrongdoing
• recognising the circumstances in which shareholders have standing to bring actions for duties owed directly to them and to require compliance with the constitution
• providing for Court supervised funding by the company of derivative actions brought on its behalf
• providing for the Attorney-General to have standing to bring derivative actions on behalf of the company or representative actions on behalf of shareholders
• providing for better rights of inspection and investigation of company records by shareholders and the Attorney-General
• providing a procedure for injunctive relief for shareholders and creditors to restrain proposed action in breach of the company constitution or the Act.

87 The duties of directors should in most cases be owed to the company itself. In some cases, however, the draft Act explicitly recognises duties owed to existing shareholders. The explicit recognition of the interests of existing shareholders is intended as a rejection of the equation of the company with its “collective shareholders”.

88 The company should be empowered to purchase insurance against liability of directors for negligence, provided the cost of such insurance is disclosed to shareholders annually in the same manner as payments to directors. The prohibition on indemnity by the company or for purchase of insurance in cases of dishonesty should be continued.

89 Significant new features of the system proposed include
• an emphasis on class rights, being the rights to vote and to receive distributions both during the life of the company and prior to its removal from the register
  Class rights should include (unless the constitution expressly provides otherwise) the right not to
be diluted by the creation of equally ranking shares (protected against by shareholder pre-emptive rights on issue) and the right to participate on a pro rata basis in company share repurchase.

- voting by affected interest groups for alteration of class rights, so that those affected vote together
- a buy-out requirement where a change to class rights or a fundamental change to the company is passed by a special majority, so that dissentient shareholders who voted against the change can seek to have their shares purchased (subject to safeguards for the company)
- a requirement of shareholder approval of major transactions (those transactions which result either in the acquisition of assets equivalent to the greater part of the assets of the company before the acquisition or which amount to the disposition of the whole or the greater part of the assets of the company)

They require shareholder approval in the manner of a change to the constitution and trigger dissentient rights (the right of the minority to be bought out, see paragraphs 202-207).

90 In the case of alteration to the constitution, alteration of class rights or major transactions, the majority required for shareholder approval should be a special majority of 75 percent of those entitled to vote.

91 Directors should be permitted to delegate powers of management but must monitor and supervise those to whom powers are delegated.

92 Directors should be under a duty to maintain company information in confidence. Directors who use such information without company approval and without paying adequate value to the company for the information should be liable for any loss suffered by the company. Where the confidential information materially affects the value of the company's shares, the directors should be liable to any shareholder they deal with for the difference between the value given and the actual value.

93 Nominee directors should be permitted to disclose confidential information to their nominating shareholder only
where the relationship is disclosed to shareholders. Nominat-
ing shareholders who make use of the confidential information should be liable to the company or to any shareholder dealing with the nominating shareholder in the same manner as if the nominating shareholder were a director.

94 Where the company constitution confers powers of man-
agement upon shareholders and not directors, they should be subject to the same general duties imposed upon directors in exercising powers of management. However, shareholders exercising the voting rights reserved to them under the stan-
dard constitution should be seen to be exercising proprietary rights and may act in their own interests.

COMPANY ADMINISTRATION

95 All existing companies should have the capacity of natural persons unless, within three years, they file a constitution con-
taining restrictions upon their powers. Third parties should not be affected by any restriction upon the powers of a company unless they have actual knowledge of that restriction.

96 Companies should not be required to have a seal.

97 Subject to variation by the constitution, the Act should provide that obligations which bind the company may be entered into by the sole director or two or more directors of the company or by any person acting on behalf of it.

98 Companies should not have to issue share certificates (although subject to their constitution they may do so), but must provide a statement of a shareholder’s rights whenever reasonably requested to do so.

99 Telephone meetings of shareholders and directors should be provided for, and resolutions in place of meetings should be permitted where all entitled to take part in the meeting consent in writing.

100 There should be provision for annual shareholder meet-
ings. Shareholders exercising 5 percent of the voting rights in the company or the Court, on application by any shareholder, should be able to call special meetings. Shareholders should be
given improved rights to have proposals included in the agenda for the next meeting of the company.

101 The legislation should no longer require the company to have a secretary.

ACCOUNTS AND AUDIT

102 The Eighth Schedule to the 1955 Act, which provides for the form of company accounts, should not be re-enacted. The primary obligation should be upon directors to ensure that the financial statements of the company give a true and fair view of its affairs. Without limiting that primary obligation, financial statements should be required to comply with any regulations made under the Act. (This should facilitate legislative adoption from time to time of accounting standards should that be thought desirable.) Compliance with any such regulations should not, however, absolve the directors from their primary responsibility.

103 Companies should continue to be required to prepare balance sheets and profit and loss accounts, as at each balance date of the company. They should also be required to prepare statements of cash flow.

104 Audit should be required in any accounting period if requested by a shareholder or director of a company or at any time where ordered by the Court for cause. (It is envisaged that all companies which offer securities to the public will be required under the Securities Act to have audited accounts.)

DISCLOSURE BY COMPANIES

105 Shareholders should have better rights to information about the company. The draft Act provides for

- an annual report which includes the financial statements of the company, any auditor’s report, a statement of any change in accounting policies, a description of any changes to the company’s business, disclosures of director interest and charitable or political donations
...a special report containing relevant information where the company is subject to an offer to acquire 20 percent or more of its shares.

specific notification of certain actions taken by the directors required to be notified to shareholders under the draft Act (as, for example, on selective repurchase of shares).

106 The company should be required to make an annual return to the Registrar of Companies confirming or amending the information that must be maintained on the register. The present requirement for public companies to make disclosure of their annual financial accounts should be discontinued. (In the case of publicly listed companies, public disclosure of their annual accounts will, it is envisaged, be required under the Securities Act and the Stock Exchange Listing Requirements.)

107 The company should be required to maintain and make available for public inspection:

- its constitution (to the extent that the standard provisions of the Act are modified)
- its share register.

108 In addition, the company must make available for inspection by shareholders:

- minutes of all shareholder meetings and resolutions
- copies of all written communications with shareholders for the preceding three years
- the interests register of the company (recording director notification of conflict of interest and dealing in shares).

COMPANY RECONSTRUCTION

109 The present provisions of the 1955 Act requiring Court supervision of company reconstructions should be retained only as a backstop. In normal cases, the company should be able to reconstruct itself by special shareholder vote with dissentient right safeguards where class rights are affected or the
reconstruction involves a major transaction. Where the creditors are affected, their approval will have to be obtained under the provisions of the draft Act relating to compromises.

110 The existing section 208 should not be re-enacted in a Companies Act. If it is thought desirable to retain a power of compulsory acquisition for takeovers, that should be provided for in takeovers legislation.

COMPROMISES WITH CREDITORS

111 Compromises with creditors approved by a special majority of classes of creditors should continue to be binding on all but the involvement of the Court should be modified to a review role.

RECEIVERS

112 The bulk of the statutory provisions relating to receiverships should apply therefore to non-company businesses as well as companies and should be restated and relocated in the Property Law Act 1952.

113 In general, the qualifications and sanctions applicable to receivers should mirror those applicable to liquidators, including a requirement that appointees be independent and experienced.

VOLUNTARY ADMINISTRATION

114 A system of voluntary administration of companies in or apprehending financial difficulty is desirable but may be best addressed in the review of insolvency law being undertaken within the Department of Justice. The question of preferential claims in insolvency affects personal as well as corporate insolvency and should be addressed in that review.
LIQUIDATIONS

115 The present rules on winding up of companies are unnecessarily complicated. They should be simplified and streamlined. The new rules should

- require independence and experience in those appointed as liquidators
- provide one set of rules for all liquidations (voluntary or court-ordered)
- require minimal mandatory Court involvement in liquidations.

116 Other features of a new liquidation regime would include new rules about monopoly suppliers, voidable transactions and defaults by liquidators.

117 We recommend the setting up of an assetless companies fund on a trial basis. Draft legislation for such a system is included. The fund would be under the control of a supervisory board to provide funding of investigation and proceedings to benefit creditors or shareholders of companies where there are insufficient assets to permit a liquidator to do so otherwise.

REMOVAL FROM REGISTER

118 The termination of the existence of a company should be by removal from the register either after a liquidation has been completed or where the Registrar is otherwise satisfied that the company is defunct (as where, for example, it has paid off all creditors, ceased trading and has distributed all its assets).

ROLE OF THE REGISTRAR OF COMPANIES

119 The investigative and enforcement powers of the Registrar of Companies under Part I of the 1955 Act should not be continued in a new Act. The function of the Registrar of Companies under the Act should be to provide an efficient system of incorporation and public disclosure.
120 In a core Companies Act, enforcement and investigation should normally be for the shareholders affected, but the Attorney-General should have a supplementary role where the public interest is affected. In abnormal circumstances, the provisions of the Corporations (Investigations and Management) Act 1989 will be available. The vesting of the investigation and enforcement powers in the Attorney-General should be reassessed when enforcement of the Securities Act 1978 is reviewed.
III

Major Themes and Issues

THE NEED FOR MORE ACCESSIBLE AND INTELLIGIBLE LAW

121 The Law Commission, by its statute, has an obligation to advise the Minister of Justice on ways in which the law of New Zealand can be made as understandable and accessible as is practicable. We are required to have regard to the desirability of simplifying the expression and content of the law, as far as that is practicable.

122 In the conduct of the review, we have been aware that the need to simplify expression and content of company law is itself a major goal for reform. So too is the need to make company law more accessible and usable by collecting together in the statute the main rules. The 1955 Act, besides being complex and dense in form, contains only part of the law relating to company regulation. Some of the major company rules are not contained in legislation at all but have to be discerned from the case law, which in many important respects is difficult and unclear.

123 We have worked on the principle that those needing to know what their rights and obligations are should not be driven immediately to seek legal advice. The Companies Act should be the statement of first recourse. Directors and shareholders
and not simply their professional expert advisers should be able to use it.

124 If intelligibility and accessibility are goals, it is inefficient and unacceptable that standards imposed upon all companies (as in the case of directors' fiduciary duties) should not be referred to in the statute.

125 The draft Act is, as far as possible, in simple language. In a few cases we have not been able to avoid the use of technical words in order to achieve precise legal effect.

126 The structure of the draft Act has been planned to give an initial map of the matters fundamental to the company before the more detailed provisions are addressed. Matters of administration of the register and of the company have been placed towards the end of the Act or in schedules so that the essential elements of the working company can more readily be appreciated. We have tried to collect together all the rules affecting particular subjects in separate parts, with cross-referencing to other parts where the source of the substantive rule is to be found. Although some duplication is inevitable in such an approach, we think it will aid those who need to find out promptly what their rights and obligations are.

THE NEED TO REASSESS POLICY

127 Some of the assumptions of principle on which the law (as found both in the legislation and in the cases) is based are now outmoded or misapplied. For example, the line of authority which identifies the company with the collective shareholders predates the decision of the House of Lords in *Salomon v Salomon & Co Ltd* [1897] AC 22 but has not been systematically reassessed. Similarly, admitting "future shareholders" as an element to be taken into account in determining the best interests of the company (as was done in *Greenhalgh v Arderne Cinemas Ltd* [1947] 1 All ER 512) has implications for traditional theories which have not entirely been worked through. Majority control of a company's right to litigate, enshrined in the rule in *Foss v Harbottle* (1843) 2 Hare 461, has not been reassessed in the light of director independence in matters of management from the general meeting (Quin & Axtens Ltd v
Salmon [1909] AC 442). There are tensions also between lines of authority to the effect that the voting of shares is a property right which can be exercised in the self-interest of each shareholder and indications that the law is developing a concept of fiduciary duty of majority shareholders to the minority. Whether these cases can be reconciled or whether any of them (and if so which) are wrong is a matter of debate.

128 These are matters of central importance to the system of checks and balances imposed by company law. They have practical impact every day on New Zealand companies. Legislative statement of basic principles and their consistent application is an important theme of the Report.

MATCHING THE STATUTE WITH PRACTICAL EXPERIENCE

129 Many assumptions of company law need to be tested against practical experience. We have considered it important, for example, to take stock of the efficacy of the rules developed as a protection of capital against the experience of recent years with such developments as the $2 company and the wide authorisations given to directors by shareholders. The impact of recent legislative reforms, most notably the 1983 reforms removing the necessity for companies to have objects and the impact of section 209 on the traditional duties and remedies available in internal company disputes, challenge some venerable assumptions about the rights of shareholders, the curative role of the general meeting, the question of Court supervision and remedy and the standards against which breaches of duty are to be measured.

THE IMPACT OF THE SECURITIES ACT 1978

130 The Companies Act 1955, and in particular the crude distinction it draws between private and public companies, was conceived long before the Securities Act 1978 and has required reassessment in its light.

131 We have viewed the draft Companies Act as being mainly concerned with the constitutional rights and duties of
shareholders and directors under a significantly consensual regime. Provided that minimum standards set by the Act are met, the Act should be flexible enough to permit diversity in corporate structure.

132 The Securities Act 1978 is concerned with the public interest in the integrity of the securities market. It is concerned not only with actual shareholders but with potential shareholders and security investors. The public interest in the integrity of public securities markets justifies the imposition of higher standards of disclosure and less flexibility than is desirable for core company law, applying to all companies. Companies which offer securities to the public will have to comply with the additional standards imposed under the Securities Act 1978. Those that do not will have greater flexibility to order their affairs and greater privacy.

133 The distinction between the scope of the two Acts has implications in particular for the amount of public disclosure suggested in a revised Companies Act, for the distinction between private companies and public companies, and for the extent and situation of powers of enforcement in a public agency.

134 There are areas of overlapping concern between company law and securities law. While, for example, a comprehensive code for takeovers and for the prohibition of insider trading requires regulation of conduct and parties outside the traditional ambit of company law, these topics are also the concern of company law to the extent that they arise out of abuse of power within the corporate body. It is for this reason that the draft Companies Act contains statements of the duties owed to shareholders by directors of offeree companies in takeovers and general duties of directors who deal in their company’s shares. Those duties are designed to protect shareholders from abuse of director power. Such abuse is a concern in all companies, whether or not they offer securities to the public and are subject to the Securities Act. But the proposals made in the draft Act are made in the expectation that companies subject to securities market regulation will have additional and more onerous standards imposed upon them.
ROLE OF THE COURT

135 We have taken account of the need in reviewing the Companies Act to reassess the role of the Courts. Under the present Companies Act, the Court is required to perform a number of routine functions which are not essentially adjudicative. They include the role of the Court in company compromises and in authorising inspection of company records. In the draft Act Court intervention is generally required only where there is a dispute.

136 Outside the somewhat specialised area of liquidation the Court has three functions under the draft Act

- imposing penalties for transgression of the procedural requirements of the Act
- granting remedies to dissentient minorities in cases of fundamental change or in cases of unfair treatment
- determining civil claims for breach of the Act or constitution.

137 Original jurisdiction in the draft Act is vested in the District Court. The remedial and adjudicative functions, and powers ancilliary to them (such as inspection of company records), are vested concurrently in the High Court and the District Court. The division of responsibility follows the recommendation of the Law Commission in its report on Court structure (Report No 7). That would mean that all matters would start in the District Court but could be removed to the High Court by reason of their complexity or importance. We have considered whether to retain the exercise exclusively by the High Court for jurisdiction which is substantially supervisory, in the same manner that the supervisory jurisdiction of the Court under the Judicature Amendment Act 1972 is reserved to the High Court. We have come to the conclusion that the jurisdiction conferred upon the Court under the draft Act does not easily divide in that manner. Civil liability in many cases may result in the Court having wide remedial powers under the draft Act which are consistent with a supervisory jurisdiction.
138 The role of the Court in determining disputes among shareholders, directors and the company is essentially supervisory. The Courts are not called upon to second-guess what the directors or the majority have decided upon as being in the best interests of the company, as long as the decision is made on reasonable grounds. That is the approach that has been regularly applied by the Courts in company law cases. It is similar to the jurisdiction the Courts are accustomed to exercise under the Judicature Amendment Act 1972, which applies not only to administrative bodies but to certain functions of incorporated bodies (including companies). In the United States, the supervisory nature of the Court's jurisdiction is known as the “Business Judgment Rule”, around which much jurisprudence has developed. But a similar policy has resulted in very much the same judicial role in the United Kingdom, Australia and New Zealand.

139 The Law Commission agrees that it is proper to permit a substantial area of discretion to those who manage a company and who must be entrusted with discretionary powers. The test for intervention, where a decision is made in good faith, is one of reasonableness. No more precise test is practicable.

140 In the case of conflict of interest transactions, an alternative to the supervisory jurisdiction of the Courts is a role for a disinterested majority of directors or shareholders. This is not an option we have favoured. The reasons are the difficulty of determining disinterestedness, the frequent identification of majority shareholders with management (even where they would not be tainted themselves with the strict conflict of interest) and the belief that the assessment of what is reasonable or in good faith is a proper function of the Court.

141 The efficacy of shareholder check upon directors has been doubted by a number of commentators. In Australia, the National Companies and Securities Commission must be notified of many actions taken by company management. In particular circumstances it must give its consent to proposed action, and in other cases it has standing to object to the Courts.

142 No submissions received in response to the discussion paper suggested a role for a regulatory agency in approving company actions. The time delays such a course would impose
upon company activity and the costs to the community in maintaining such a system do not seem to us to be justified for all companies. Moreover, such a system runs counter to the basis upon which the Court’s supervisory jurisdiction has traditionally been exercised by permitting substitution of the discretion of the regulator for the discretion of the directors. A review of the Securities Act 1978 may consider whether there should be an extension to the powers and rights of intervention of the Commission in company decision-making in cases where companies offer securities to the public. But a consent procedure for all companies in areas of company decision-making seems to us to be unwarranted and too intrusive.

143 We are of the view that the Courts are the appropriate objective decision-making body in cases of action taken to remedy corporate wrongs and in cases of supervision of company action for reasonableness. These are functions commonly exercised in our legal system by Courts.

144 We have been conscious of the fact that recourse to the Courts for breach of duties owed to the company and to shareholders is unacceptably difficult and expensive under our present system. The draft Act substantially modifies procedural restraints upon shareholder access to the Courts and introduces a number of mechanisms including reverse onus of proof, requirements that directors give reasons for their actions, funding for litigation and better disclosure to improve the access of minorities to impartial assessment by the Courts. Although it is outside the scope of this Report, we consider that further consideration should be given to providing in the Rules of Court a summary procedure to enable speedier access to the Courts in enforcing the provisions of the Companies Act.

HARMONISATION WITH AUSTRALIAN LAW

145 In the Commission’s view there is little point in bringing in a new Companies Act if it does not address the principal reforms of abolition of par value and nominal capital and the introduction of a better and more principled system of director accountability and shareholder remedy.
146 Reform of par value and nominal capital has been mooted in Australia, the United Kingdom and New Zealand for many years. It makes sense. The consequences of reform will be maintenance of capital upon lines which are purposive. The tests of solvency proposed, involving both a balance sheet and “equity” limb, are designed to give creditors more real protection than the formalistic accounting conventions in current use. Australian company law is still based on the traditional system of nominal capital and par value. The proposals made within this Report therefore represent a departure from the current Australian legislation.

147 The importance of reforming our system of director accountability and shareholder remedy has already been discussed. The current Australian legislation, although an improvement on the New Zealand 1955 Act, is not much of an advance upon our existing system. Its adoption would certainly not address many of the present major deficiencies. Thus, although the Australian National Companies Code provides, in section 222, a legislative statement of the duties of officers of a corporation to act honestly and with care, that statement is not an adequate identification of the duties owed by directors. Its enforcement by criminal sanction is contrary to our proposals to secure director accountability and has been criticised in Australia. Above all, the Australian Code does not attempt a reappraisal of directors’ duties and powers and a reassessment of the distribution of power within the company such as is proposed in this Report.

148 Because we believe the two reforms of capital maintenance and director accountability are the main initiatives justifying introduction of new companies legislation, the existing Australian legislation cannot be regarded as a model for New Zealand reform. There are, in addition, a number of other criticisms which can be made of the Australian legislation:

- adoption of the Australian system would require reassessment of our present distinction between companies and securities legislation

The distinction is well understood in New Zealand, permits better focus for legislative objectives and is one which the Law Commission has built upon in its proposals for reform.
the Australian Code is complex and difficult legislation. Adoption of something like it would run counter to a major aim of the reform—to make company law intelligible to non-lawyers. The submissions we received in response to the discussion paper expressed concern about the form of the Australian legislation.

149 Australian company law is, moreover, in a state of flux. A number of the suggestions made for reform in this Report (for example, to permit company share repurchase) are the subject of reform proposals in Australia. The eventual shape of those reforms is still not clear. There is at present before the Australian Parliament a bill to consolidate Australian company law into a Federal Act. It does not greatly alter the existing code but simply seeks to re-enact it as a comprehensive national company system. It faces major constitutional objection. Company law reform is likely to wait upon the outcome of achieving a Federal statute.

150 There is little to be gained from moving our company law into line with the Australian legislation, if the future direction of that legislation is not clear. In those circumstances it has seemed preferable to concentrate upon getting our own system into better shape. We are conscious of the experience of the United Kingdom in implementing integration of its company laws with those of the European Community: Professor Gower has suggested that the poor shape of United Kingdom companies law has meant that it has had little positive effect upon EEC directions (LCB Gower, Principles of Modern Company Law, 4th ed p 56).

151 The responses to the discussion paper indicated that very few regard integration of core company law as being a priority for trans-Tasman legal harmonisation. In the case of insolvency law there are good reasons for New Zealand to follow the direction taken by the Australian Law Reform Commission in its recent Report. Similarly, when review of the New Zealand Securities Act is undertaken there may be compelling reasons why growing integration of securities markets makes harmonisation a substantial priority.
The benefits of harmonisation of core company law are less easy to assess. No one has suggested to us a single register for companies. Australian and New Zealand companies can readily register as overseas companies in the other jurisdiction. It is difficult to see how divergence in core company law would affect trans-Tasman trade. In the case of companies which seek listing on each other's Stock Exchanges, the securities laws of the other jurisdiction and the listing requirements of the local Stock Exchange will simply be superimposed upon the underpinning company law.

For all these reasons, the reform proposals made in the draft Act should be pursued, even though they will mean that New Zealand's core company law is in form quite different from the current Australian legislation. Harmonisation has never been taken to mean that the legislation in both countries must be identical. Although there will be a substantial difference in form if the Law Commission's recommendations are accepted, the essential elements of the company law of both jurisdictions will remain comparable. The reform proposals made in this Report are in large measure a reassessment of form according to enduring principle which is common to both Australian and New Zealand company law tradition.

**Allocation of Power Within the Company**

Under the 1955 Act, the distribution of power among the organs of the company, that is to say the shareholders and the directors, is left to the articles of the company. The system is given statutory recognition by section 34 of the Act which provides that, subject to the provisions of the Act

...the memorandum and articles shall, when registered, bind the company and the members thereof to the same extent as if they respectively had been executed as a deed by each member and contained covenants on the part of each member to observe all the provisions of the memorandum and of the articles.

This somewhat enigmatic section describes an unusual contract. As the statutory platform for identification of allocation of responsibility and duties within the company, it is
entirely unsatisfactory. It does not assist in making the obliga-
tions in a particular context easy to understand. It creates the
fiction of a contractual regime which is then overlaid by statu-
tory provisions which impose obligations and powers outside
the “contract”, including the power to alter the contract with-
out the consent of all.

156 Section 34 descends directly from the United Kingdom
Act of 1856. It marked the transition between the old deed of
settlement constitution and the modern constitution based on
memorandum and articles. In its present form, section 34 is an
anachronism which is misleading. Through the popularity of
Table A articles (the standard articles contained in the 1955
Act), powers of management are usually conferred upon direc-
tors. The Law Commission believes that the intelligibility of
company law would be greatly assisted by the adoption of the
Table A standard provision as a statutory presumption. Direc-
tor management would therefore be conferred by statute
directly, except where the constitution makes express provision
for another arrangement.

157 Moreover, section 34 on its own terms is quite unsatis-
factory. As has been said of its equivalent provision in the
1948 United Kingdom Companies Act, it

\[ \ldots \text{has been so overlaid with judicial interpretation} \]
\[ \text{that, on any count, it no longer means what it says.} \]
\[ (L C B Gower, Principles of Modern Company Law, 4th} \]
\[ \text{ed p 320) \]

158 The ambit of section 34 is uncertain. In particular, its
relationship with the principle of shareholder majority rule
undermines the extent to which the contract it purports to
confirm can be enforced by the shareholders deemed to be
parties to it.

159 The draft Act sets out a system of allocation of power
within the company. That system is expressed as presumptive
only, enabling greater flexibility to be achieved where that is
desired. Mandatory provisions of the Act (such as the duties
imposed upon directors and application of the solvency test for
distributions) cannot of course be excluded by the constitut-
ational document. The procedure for alteration of shareholder
rights in section 88 is a mandatory minimum standard (more
stringent requirements can be set), but the rights are generally subject to the constitutional documents (see paragraphs 164–183).

160 The decision-making organs of the company are the shareholders on the one hand and the directors on the other. What is proposed in the draft Act is to confirm by statutory presumption the normal provision that powers of management are to be exercised by the directors. The powers reserved to the shareholders are powers to make decisions affecting their proprietary rights.

161 The system proposed confers upon directors an original statutory jurisdiction to manage, unless it is excluded. In those circumstances no residual power of decision remains to the general meeting. For that reason, the draft Act makes explicit provision for shareholders to pass at meetings non-binding resolutions relating to the directors’ powers of management.

162 The Law Commission has considered whether the shareholders acting by unanimous resolution should be able to exercise any of the powers of the company. The Canadian statutes make such provision. We have concluded that an explicit power in these terms is generally undesirable as cutting across the allocation of power in the constitution. The interests of shareholders and the company do not entirely coincide. The system of the draft Act for protection of creditors by imposing duties on directors could be undermined by a general power in the shareholders to exercise the directors’ powers (the type of difficulty is referred to in paragraph 210). In the case of closely-held companies, the company constitution can provide for unanimous shareholder resolution, if that is thought desirable. In those circumstances, however, the draft Act will impose directors’ duties upon the shareholders.

163 Where unanimous shareholder resolution is effective as a waiver of rights, it will be available as a matter of general law. Express provision for it is unnecessary. Where the board is in a state of deadlock, we consider that the Act will provide sufficient machinery to enable appointment of directors (if necessary by the Court under section 117 (3) or relief on the application of an affected shareholder under section 135).
THE SCOPE OF THE CONSTITUTIONAL DOCUMENT

164 Under Part 4 of the draft Act, a company may (but need not) adopt a constitutional document. If a company does not adopt a constitutional document, it is governed entirely by the provisions of the Act.

165 A constitution may set out rights attached to shares where they differ from the rights set out in section 26(2). If shares are to be non-transferable, the constitution must say so (section 29).

166 The constitution may make provision for more shares than have been issued or may place restrictions on shares which can be issued by directors under section 33.

167 As section 36 makes explicit, the constitution may exclude or limit pre-emptive rights or, under section 37, may permit the issue of shares other than in accordance with pre-emptive rights.

168 The board’s ability to authorise distributions to shareholders can be restricted by the constitution (section 42).

169 A company may only acquire its own shares under section 49 if the constitution expressly permits it to do so. Acquisitions must be pro rata, unless non-pro rata acquisitions are expressly permitted by the constitution (section 50(1)(b)(ii)) and the procedure set out in section 51 is followed.

170 The constitution may set out circumstances in which the board is entitled to refuse or delay registration of a share transfer (section 63(4)(c)).

171 The constitution may reserve powers to the shareholders and specify the manner in which they are to be exercised, although the powers to approve alteration to the constitution, a major transaction, an amalgamation or voluntary dissolution must be exercised by special resolution, whatever the terms of the constitutional document.

172 The constitution may set out procedures for alteration of shareholder rights which are more stringent than those in the Act. Where it does so, the procedures adopted cannot be
amended or altered without interest group approval under section 88.

173 The constitution may expressly confer management powers on shareholders or other persons (section 98), although where it does so they will be subject to the duties imposed by the Act upon directors (section 80). The constitution may expressly permit certain types of major transaction without the shareholder approval generally required under section 99, and subsequent dissentient rights.

174 Under section 100 the general delegation of powers by the board which is permitted may be restricted by the constitution. Section 100 sets out the powers the board may not delegate.

175 While interested directors are not generally forbidden to vote on the board, the constitution may provide a stricter rule (section 111). In the case of companies which are trusts, such a provision would be usual.

176 The constitution may make provision for the appointment and removal of directors, other than the usual rule for appointment and removal by ordinary resolution of shareholders (sections 117 to 120).

177 Proceedings of the board may be regulated by the company constitution rather than the provisions of the Second Schedule to the Act (section 123).

178 The constitution may impose restrictions on remuneration and other benefits to directors (section 124).

179 If a company is to be able to indemnify or insure directors or employees in respect of costs incurred in successfully defending proceedings brought by the company, the constitution must expressly authorise such indemnity or insurance (section 125).

180 The usual procedures by which companies can enter into contracts may be varied by the constitution (section 140).

181 The constitution may require the appointment of auditors (section 167) and may vary the manner of appointment (section 169) although shareholder right to require an audit in
each accounting period, and upon cause to apply to the Court at any time, cannot be taken away by the constitution.

182 The procedure prescribed for meetings of shareholders cannot be varied by the constitution. We have thought it sensible to impose a standard system in this connection so that there is less scope for confusion.

183 In addition, anything not expressly referred to in the draft Act can be dealt with in the constitution to enable specialisation of companies. In particular, the company constitution may specify limitations on its powers and this will be particularly important for charities.

DIRECTORS' DUTIES: WHAT ARE THEY AND TO WHOM ARE THEY OWED?

184 The present law relating to the duties of directors is inaccessible, unclear and extremely difficult to enforce. Its reform is a matter of urgency.

185 The powers entrusted to directors have never been untrammelled. Courts have always insisted that directors exercise their powers in good faith, in the best interests of the company and for the purpose for which they were conferred. And directors will be liable if they act without proper care, although the standards of care applied by the Courts have not usually been high.

186 These duties are not contained in the 1955 Act. They have to be gleaned from a large volume of complex case law. In the discussion paper, the Law Commission suggested that it was time to distil the general principles from the cases and express them in the statute, to make them more accessible. Such a statement of general principle was recommended by the Macarthur Committee and has been adopted by the Canadian and Australian Acts. The response to the discussion paper indicated overwhelming support for similar reform.

187 In addition to the common law duties, the Act currently contains some statements, negatively expressed, which impose liabilities on directors to creditors and minority shareholders
in cases of reckless trading and minority oppression respectively (the current sections 320 and 209). The Law Commission is of the view that it is more helpful for directors who wish to know what their responsibilities are to have these obligations expressed positively as statements of general duty.

188 The current law in this area suffers from confusion as to whether “the best interests of the company”, which is the concept which underlies director accountability, requires assessment of “the company” as the collective shareholders or as the enterprise itself.

189 The notion that “the company” can be equated with the collective shareholders is derived from the old joint stock company concept which predates the perfection of corporate personality through the case law. Since it has been held that the collective shareholders include future shareholders, identification of the company with the enterprise may have been largely achieved in law. The uncertainty does, however, mean that there is considerable scope for directors to rationalise decisions which are against the interests of existing shareholders.

190 We have not thought it necessary to be dogmatic about these questions of theory. We have preferred instead to regard the issue as principally directed at the right to remedy. The draft Act therefore identifies those areas where existing shareholders may have their proprietary interests affected by management decisions, which can then be justified in the name of the continuing enterprise or future shareholders. The concern arises particularly where decisions affect class rights (that is to say, the rights to distributions and voting); in cases of fundamental change to the organisation (through acquisition or sale of a major asset or restructuring of the company); in repurchase of the company’s shares and in the provision of financial assistance to purchase shares. In all these cases the draft Act provides for special duties or rights to participate in the decision imposed as a protection for existing shareholders and gives them the right to enforce the duties directly.

191 The draft Act recognises a number of powers exercised by directors where shareholder interest is particularly at risk. They include the powers to

• issue shares
• refuse registration of transfer of shares
• make distributions to shareholders
• repurchase the company’s shares
• assist in the financing or acquisition of the company’s shares.

192 These are areas where the interests of the shareholders do not completely coincide with the interests of the company. Shareholder interest needs special protection because the management powers impinge upon exercise of the residual proprietary rights of the shareholders and their constitutional position in the company’s scheme. The draft Act imposes particular duties upon directors exercising these powers, to protect the shareholders affected. Significant protections are the requirement in section 39 that before issue of shares the board must resolve that the consideration and terms are fair and reasonable to the company and existing shareholders, and the provision in section 36 that shareholders have pre-emptive rights to share issue, unless pre-emptive rights are expressly excluded by the constitution. These measures are designed to reform the position at common law where the Courts refused to consider the adequacy of consideration on share issue, thus permitting stock-watering (Re Wragg Ltd [1897] 1 Ch 796) and held that the creation of equally-ranking shares affected only “enjoyment” of rights and not the class rights of shares, thus permitting dilution (White v Bristol Aeroplane Co [1953] Ch 65).

193 Apart from these particular duties, the draft Act imposes general duties in relation to all actions of directors. These restate the common law basic duties of good faith and care and also clarify and reform the general duties of directors in relation to company confidential information, dealing in company shares, and self-interested transactions. In the case of self-interested transactions, the case law has proved too strict and has been modified by articles and statute with results which are unsatisfactory; the law relating to company confidential information is unclear and its application to nominee directors and their nominating shareholders urgently requires reform; and the law relating to director dealing in shares has been plagued by ambiguities as to the circumstances in which the directors owe duties directly to shareholders. The draft Act
• requires self-interested transactions to be disclosed to shareholders and to be fair to the company
• treats nominating shareholders as directors where they receive company confidential information through their nominee and where they deal with the company
• requires directors to maintain in confidence company confidential information
• provides for the liability of directors to those with whom they deal in the company’s shares when in possession of confidential price-sensitive information

The Securities Amendment Act 1988 covers similar ground, but only in relation to companies whose securities are publicly offered.

194 We appreciate that if directors are given competing responsibilities, accountability becomes extremely difficult: one interest can be played off against another. The draft Act therefore sets up a hierarchy which subordinates duty to other interests (for example, to existing shareholders, employees and to creditors) to the directors’ fundamental duty to act in the best interests of the company. The hierarchy makes explicit the equation of “the company” with the enterprise itself.

195 The hierarchy of duties set up by the draft Act is, it should be emphasised, for the purposes of company law only. It does not preclude the imposition of direct and primary obligation to other interests through other Acts. Obligations to employees, for example, which might be thought to go beyond the best interests of the company, should be imposed directly through employment legislation.

THE ROLE OF SHAREHOLDERS

196 The Law Commission has not attempted to extend the concept of “shareholder democracy” to enable a greater role for decision-making by the general meeting. Indeed, a number of powers of the company which at present require the approval of shareholders in general meeting (most notably the powers to reduce capital and approve the issue of shares through setting nominal capital) can be exercised in the draft Act by the directors.
197 We have formed the view that it is necessary to acknowledge that

- the general meeting has not historically operated to protect shareholders from director abuse of their powers of management but rather has often been used as a cypher by directors to absolve themselves of responsibility
- there are more effective methods for the protection of shareholders from abuse of management powers than the general meeting.

198 Shareholders exercise discipline over director management in a number of ways

- they can vote their shares to remove directors
- they can sell their shares
- they can use the general meeting as a forum for questioning director management
- they can dissent and require buy-out in matters of fundamental change or variation of their class rights
- they can apply to the Court for inspection of company records and to enforce breaches of the Act or constitution
- they can hold directors liable for any breaches of duty owed directly to them as shareholders or can bring derivative action in the name of the company to enforce duties owed directly to the company
- they can seek the relief of the Court where unfairly treated, even though there has been no breach of the Act or the constitution.

199 All of these are important shareholder checks upon director management. The draft Act is designed to ensure that they are not restricted.

200 For this reason, the draft Act provides presumptively for removal of directors by ordinary resolution and for free transferability of shares. Where transfer of shares is refused, directors must give reasons for the refusal.
201 In the case of use of the general meeting as a platform for questioning management, the draft Act provides that all shareholders (whether or not entitled to vote) may attend and be heard at any general meeting of the company and may vote upon a non-binding resolution relating to the management of the company. Under the draft Act, shareholders have enhanced powers to require resolutions to be put to the next meeting of the company. Although the power to requisition special meetings is, in line with other jurisdictions, proposed to be limited to those holding 5 percent of the voting shares of the company (at present the Act provides for 200 shareholders or those exercising 10 percent of the voting rights), any shareholder can apply to the Court for an order directing the calling of a special meeting where cause is shown.

202 The right to buy-out is new. It is to a certain extent foreshadowed in the remedies available to the Court under the existing section 209, where the Court can require the company or other shareholders to purchase the shares of any shareholder unfairly prejudiced by the conduct of the company. But the draft Act will confer the right to such a remedy upon a dissident shareholder where there is an alteration of class rights or a fundamental change to the company, whether or not the action taken by the company is unfairly prejudicial to the shareholder.

203 While the buy-out procedure is not available in Australia or in the United Kingdom, it has long been a feature of United States corporation statutes (first occurring in Ohio in 1851) and has been a feature of the Canadian statutes introduced following the Dickerson Committee Report in 1971. It is designed to ensure that in the case of fundamental change to the nature of the enterprise and to the class rights enjoyed by the shareholder, a dissenting minority shareholder does not inevitably have to accept the majority decision. The shareholder will instead have the option of leaving the company.

204 We think that the buy-out right is a more useful remedy and obviates the need for the sort of minority shareholder protection provided by section 208 of the 1955 Act. Shareholders at present entitled to require acquisition of their shares
under section 208 have more ample rights to buy-out under the draft Act.

205 The risk of director manipulation of buy-out rights, for example by promoting unreasonable amendments to the constitution, is protected against in the draft Act by the general duties which attach to the actions of directors and the oppression remedies.

206 The buy-out provision recognises not only that there is a level of change to which it is unreasonable to require shareholders to submit but also that in many cases the presence of a disgruntled minority shareholder will be of little benefit to the company itself.

207 The buy-out remedy is especially important in the case of companies where there is no ready market for the shares. In contrast to the North American appraisal remedies, the company can apply to the Court for relief where buy-out would be unfair to it. This provision is designed to protect against minority oppression of the majority. In such cases, the Court is given wide powers equivalent to those available to the minority in cases of oppression to achieve a fair result.

208 The draft Act does not seek to protect minority shareholders by requiring more decision-making to be taken by the general meeting. The Law Commission considers that the range of duties and remedies provided by the draft Act provides a much more effective method for protection of minority shareholders.

209 There are, moreover, difficulties in ensuring that minority shareholders are not oppressed by a complacent or interested majority in general meeting. If more power over company action was given to shareholders, elaborate rules would need to be devised to ensure that

- shareholders have sufficient information to make informed judgments upon matters referred to them
- interested shareholders are disqualified from voting.

210 The greater the role for the general meeting in management of the company, the greater the need to develop a concept of fiduciary duty owed by the majority to the minority. This is
a developing area of law which, carried too far, may undermine the concept of the share as property and may make company decision-making and enforcement of obligation procedurally complex. (As L S Sealy has pointed out, assessing the good faith of a board of directors is one thing; assessing the good faith of a majority of shareholders, perhaps running into the hundreds, is quite another thing. (L S Sealy "Directors’ ‘Wider’ (Responsibilities—Problems Conceptual, Practical and Procedural" (1987) 13 MULR 164.))

211 It is for reasons such as this that the standard constitution entrusts the management of the company to the directors and reserves shareholders’ decision-making for matters which directly impact upon their property interests. In exercising their votes on these property matters, shareholders are entitled to act in their own self-interest because they are not exercising powers entrusted to them for the benefit of others (the basis of the fiduciary duties imposed upon directors). This is explicitly recognised by section 80.

212 It should be noted that, for the purposes of use of company confidential information, self-dealing and insider trading, a majority shareholder with an appointed director on the board is treated as if a director and so to that extent is subject to fiduciary duties (section 96). Similarly, where the constitution of a company confers management powers upon shareholders, the exercise of those powers will be subject to the duties imposed upon directors (section 80).

213 The powers which are presumptively reserved by the draft Act to shareholders and which may be exercised by them in their own self-interest are

- appointment of directors
- amendment of the constitution
- alteration of class rights (which includes a change to the manner prescribed for alteration of class rights)
- fundamental change to the company by merger or sale or acquisition of the greater part of its undertaking, or liquidation or removal from the register.
CREDITORS

214 Creditors are protected in the draft Act by a number of provisions. In particular

- all company distributions are subject to compliance with a solvency test (section 42)

  The solvency test is one of the pivotal provisions in the Act. It is designed as a substantial protection for creditors. It comprises an “assets over liabilities” limb based on “realisable” assets and a second limb requiring ability to pay debts as they fall due.

- directors are liable if they take unreasonable risk with the solvency of the company or where they trade knowing the company to be insolvent (section 105)

  This provision restricts the scope of the existing section 320, which is considered to go too far in undermining the position of the company as a vehicle for the taking of business risk.

- directors are empowered to take into account the interests of creditors to an extent not inconsistent with their fundamental duty to act in the best interests of the company (section 103)

- the fundamental duty to act in the best interests of the company acts as a limit upon gratuitous disposal of company property and inadequate value in exchange for property (section 101, and in relation to financial assistance section 58)

- where the solvency test is breached and distributions made from the company, directors will be personally liable for distributions and payments made.

215 Creditors will have standing to restrain a proposed action by the company or its directors in breach of its constitution or the Act (section 126). But a creditor cannot claim damages for breach of the Act while the company is solvent. Upon insolvency, the statutory regime imposed for the orderly realisation of the assets of failed companies will prevent an individual claim.

216 The Law Commission considers that these protections are as far as the Companies Act should go in protecting the
interests of creditors. It is, of course, always open to a creditor to contract for higher protection.

217 In particular, we are of the view that it is wrong in principle to impose fiduciary duties upon directors which are owed directly to creditors of the company. Any such extension of directors' duties would unacceptably dilute the scheme of director accountability under the draft Act.

218 We have tried to set up a hierarchy of the interests directors should take into account in exercising their powers. The interests of creditors are a relevant consideration but are subject to the fundamental duty to act in the best interests of the company and the duty to act for the benefit of existing shareholders. (See sections 101–103.)

219 Directors owe a specific duty to the company not to take unreasonable risks of breaching the solvency test (section 105). Where that duty is breached, liability is owed to the company and may be enforced by the company or by a shareholder suing derivatively or, after insolvency, by the liquidator. Creditors will not have standing to obtain a remedy for breaches of the solvency duties owed to the company. To provide such a remedy would be to undermine the statutory system for liquidations. On the other hand, the draft Act makes it quite clear (by its recognition of the company as an entity distinct from its shareholders) that breach of the solvency duties owed to the company cannot be ratified even by unanimous shareholder resolution, because the shareholder interest does not wholly equate with the interests of the company.

220 This is an area of law which has recently been considered in New Zealand and Australia in Nicholson v Permakraft (NZ) Limited [1985] 1 NZLR 242 and Kinsela v Russell Kinsela Pty Limited 1986 4 CLC 215. The draft Act is consistent with these cases but in so far as they may suggest that in cases of near insolvency creditors are owed and can enforce duties directly against directors, the draft Act would depart from them.

221 For similar reasons, we do not favour extension of the shareholders' oppression remedy to creditors. The matter was raised for discussion in Preliminary Paper No 5 and was generally opposed.
222 The draft Act would set the duties owed by directors to the company in cases of near insolvency at the standard of unreasonable risk provided for in section 105.

MINIMUM CAPITAL

223 The subject of a statutory minimum capital, whether paid up or not, arises whenever company reform is under discussion. The Macarthur Committee was of the view that the imposition of a minimum capital of not less than $2,000 would provide some deterrent for the formation of grossly undercapitalised companies. The Jenkins Committee favoured a statutory minimum paid-up capital in principle, but came reluctantly... to the conclusion that its purpose would be too easy to evade and we cannot, therefore, recommend it. (At paragraph 27.)

224 The New Zealand Society of Accountants urged us to reconsider the question both because it would prevent at least to some extent undercapitalisation in cases where the scale of the enterprise meant that the application of limited liability was not of social benefit, and also because it seemed to the Society that such a provision would do something to stem the proliferation of companies on the register.

225 The imposition of minimum capital does not provide any protection against undercapitalisation. What is an appropriate minimum capital for an enterprise depends upon what it does. If a substantial minimum capital requirement were imposed, it would penalise small traders without recognising the actual risk in a particular case. If the standard were set at a low level, it may be questioned whether it would be of any use.

226 The Law Commission considers that the dangers of undercapitalisation are better faced up to by imposing obligations upon directors who incur liabilities in the name of the company in such circumstances. The duties imposed upon directors in the draft Act in section 105 are an attempt to face up to this problem directly.
227 Recourse to corporate form by individual traders in small businesses has long been accepted by the law. The popularity of company form for small business has been particularly pronounced in New Zealand. We propose, in fact, to carry this to its conclusion by permitting one-person companies with single directors. It is a well-known fact of commercial life in New Zealand that small traders may incorporate and that the commercial community has accepted the spread of risk effected by the ability to obtain limited liability. (In many cases, of course, the proprietors of such a company are required to guarantee its debts so that the benefit of limited liability and the consequences of undercapitalisation are reduced.)

228 We consider that it is not appropriate for New Zealand conditions to impose an arbitrary and ineffective penalty upon small businesses wishing to incorporate. The aim of cleaning up the register has no application to operating companies, however small.

PRIVATE COMPANIES

229 The draft Act abandons the distinction between private and public companies. None of the submissions received in response to the discussion paper in which the existing classification was questioned favoured its retention.

230 The Securities Act 1978 now makes the distinction drawn on the basis of ability to issue prospectuses unnecessary. And the proposals made in this Report to enable all companies to have one director only, to act by written resolution without the need for meetings, to make loans to directors, to resolve not to appoint an auditor and to remove the requirement for public companies to file their annual accounts with the Registrar, largely remove the basis for the present distinction.

231 At present, private companies are exempt from the statutory provision for shareholder removal of directors. That seems an undesirable exemption and the Law Commission does not propose to continue it. It will, of course, be open to all companies to structure their voting arrangements to achieve director entrenchment, where that is appropriate to the circumstances of a closely-held company.
CLOSELY-HELD CORPORATIONS

232 While the Law Commission had little difficulty in concluding that the present distinction between private companies and public companies was arbitrary and unnecessary, it considered seriously whether the distinction should be replaced by a division in the Act between provisions applying to closely-held companies and others. Closely-held companies are expressly provided for in the United States. The Australian Federal Government in 1988 introduced a Close Corporations Bill.

233 The main objectives of any close corporation law are to provide flexibility, particularly in relation to

- control of share transfer (the identity of particular shareholders in an enterprise being of greater significance in such companies)
- management structure (most closely-held corporations depart from the model in which the directors manage the company)
- informality in operation both in management and shareholder decision-making
- security of tenure in management or employment
- ease of dissolution (to permit realisation of investment in circumstances where sale of shares is not realistic)
- control over fundamental change.

234 The Law Commission considers that the draft Act provides the flexibility required by shareholders of closely-held corporations in all these circumstances. In all of them, the presumptions of the draft Act can explicitly be replaced by the constitution of the particular company. The only structural requirement that the company cannot opt out of is the need for at least one director. It seems to the Law Commission that this requirement is hardly onerous enough to justify the provision of a different system for closely-held corporations.

235 In terms of the operation of the company, the principle of director management can be displaced by the constitution. The provisions relating to director and shareholder meetings explicitly provide for resolutions to be valid if signed by all entitled to participate, whether or not a formal meeting has
been held. And the Act provides for telephone meetings which may be especially suited to the circumstances of closely-held corporations. Security of tenure in management or employment is permitted by the ability to structure the voting arrangements attached to shares, to achieve the end sought. The constitution can provide for the dissolution of the company or repurchase to facilitate shareholder exit and, to the extent that more control is required than the control stipulated for fundamental change, that extra control can be imposed by the constitution, for instance by allocation of voting rights through classes of shares or by a requirement of unanimity.

236 The Australian Close Corporations Bill would not achieve anything that could not be achieved under the draft Act, with the exception of its dropping of the requirement for directors. It is, in fact, more restrictive than the arrangements that would be possible under the draft Act in that it

- prohibits corporate shareholders
- restricts membership to 10
- prohibits share classes
- assumes active participation by all members in management and imposes fiduciary duties upon them.

237 An advantage of moving to a closely-held corporations statute is that it provides a structure which can be applied directly without the need for the design of a constitution to suit the special circumstances of the company. On the other hand, if there is a demand for standard constitutions for closely-held corporations, they will be readily available. It is, moreover, a feature of closely-held corporations in other jurisdictions that they are extremely diverse. The flexibility required of statutes catering for them means that tailor-made constitutions may generally be necessary in any event.

238 We have considered also the benefits of harmonisation with Australian law, should the Australian reform proposal proceed. We have come to the conclusion that in the case of closely-held corporations there is little benefit to be obtained from harmonisation because the nature of closely-held corporations is such that they are less likely to have trans-Tasman trade or securities concerns.
239 In all, the Law Commission has concluded that if the draft Act is acceptable in its present form, there is no need to make separate provision for closely-held corporations in New Zealand. The submissions we received in response to Preliminary Paper No 5 did not support adoption of such a system.

240 We pointed out that the power to place additional requirements upon companies whose shares are publicly traded makes imposition of extra regulations in core company law unnecessary. The desirability of flexibility in company form applies beyond companies which are closely-held. If the draft Act were considered to provide more flexibility than is desirable for core company law, then it would be necessary to reconsider the arguments for a closely-held corporations Act.

241 The provisions of the draft Act apply to all companies. While the company constitution can greatly vary the rights attached to shares, that in itself is in conformity with a basic policy of the Act and does not undercut its principles. Those principles apply equally to companies which are widely-held as well as to those which are closely-held. A general statute removes the need to make arbitrary definitions of what is a closely-held company. Where standard form constitutions are thought to be desirable in the public interest, they can be imposed by the Securities Act or by the Stock Exchange Listing Requirements.

COMPANY CLASSIFICATION

242 At present, the Companies Act 1955 classifies companies into

- companies limited by shares
- companies limited by guarantee
- unlimited companies
- no liability companies.

243 According to the records of the Registrar of Companies, the number of companies in the categories not limited by shares are

- limited by guarantee—96
- no liability—8
unlimited liability—36.

244 We wrote to all those companies asking for their views as to the continuation of the particular categories and the advantages they saw in them. We received 25 responses from companies limited by guarantee, seven responses from no liability companies and 17 responses from companies with unlimited liability.

245 Companies limited by guarantee may be formed with or without share capital (Tables C and D of the 1955 Act).

246 It appears that all but one of the responding companies which were limited by guarantee were without share capital.

247 Although many respondents cited advantages of the form under the existing Act, they were not in general concerned as long as these advantages continue to be available without separate classification. So, for example, the ease of resignation from the company, which was cited to us as an advantage, can be achieved under the draft Act if the company is permitted to buy its own shares. Shareholders’ liability can be limited to a specified amount, achieving the same effect as the liability limited by guarantee.

248 The main concern seems to be that there should be available a corporate form which

- does not distribute profits to members, and
- does not distribute the assets to members on its termination.

249 Both results can be achieved under the draft Act by the company constitution which permits shares to be designed to remove these vital rights. (section 26).

250 Only mining companies are permitted to be registered as no liability companies under the 1955 Act. With the abolition of par value, they can be formed and operate under the draft Act.

251 Unlimited liability companies are mainly used by professional organisations which are not permitted to have limited liability. Only three were not formed by accountants and solicitors.
252 Of the three companies which were not formed by professional firms

  - one was formed as an unlimited liability company because there were tax advantages and because it could reduce its share capital without the need for Court approval
  - one used the form to permit greater flexibility regarding its capital.

Both of these results can be achieved under the draft Act and neither of these companies in those circumstances favoured its retention. One company, AA Mutual Insurance Company, opposed abolition of the form because it "...emphasises the mutual nature of the enterprise".

253 The effect of unlimited liability can be achieved by the constitution under the draft Act (section 73). The name of an unlimited liability company would not contain the word "limited" (section 17).

254 The imposition of share structure upon companies limited by guarantee (which number only 96) is not sufficiently onerous to justify the procedural complexity of maintaining a separate system for them.

255 We have concluded that the present classification is unnecessary. The effect of limitation by guarantee, unlimited liability and no liability can be achieved by the constitution without the need for separate classification in the Act.

FLAT AND OFFICE-OWNING COMPANIES

256 The proposals made in this Report have implications for flat and office-owning companies. At present, these are covered by the Companies Amendment Act 1964. The form is subject to a number of disadvantages. For example,

  - registration of an occupation licence does not confer a fully indefeasible title under the land transfer system
  - the power to alter company articles can, in the circumstances of these companies, interfere with vested property rights
enforcement of rights is hampered by the rule in *Foss v Harbottle*

flat-owning companies provide a less attractive form of security for loans

shares in a flat-owning or office-owning company are less saleable than other interests in real property because of the discretionary bars to transfer permitted to companies

flat and office-owning companies have experienced problems in relation to insurance (a problem, however, also shared by properties subject to the Unit Titles Act 1972)

the costs of formation and administration of the company may be disproportionate

t here are unresolved problems connected with the distinction in law between licences and leases.

257 We have approached a number of law firms to try to assess the demand for retention of flat and office-owning companies and suggestions for their treatment in the reform. We have been unable to ascertain from Commercial Affairs Division or the Land Transfer Office how many flat or office owning companies there are or how many have registered licences.

258 From the responses it appears that the advantages of the company form over unit titles are

- the ability to exercise control over the entry of new property owners

- the lack of attraction for lenders, which is seen as an advantage by some because it restricts the risk of lender participation in the company where there is default

- there is doubt whether a unit title body corporate can carry on the business of property ownership for profit If that is so, the Companies Act is the only appropriate vehicle to enable owners to hold both occupation rights and investment interests in the same property.

259 Most of those we consulted suggested that the present system of flat and office-owning companies should be repealed.
They did not believe, however, that transition problems could be overcome by compulsory conversion of existing companies to the unit title system. There were suggestions that the whole area of joint interests in property needs a wider reform which would retain some elements of the existing Act.

260 There would be considerable difficulty in adapting the existing system to the draft Act proposed in this reform. In particular

- occupation rights would probably have to be classified as rights attached to shares with the consequences provided for in the draft Act

- in order to permit return of capital, the distribution definition in the draft Act would have to be modified

- the liquidation provisions in the draft Act would require modification

- the self-dealing provisions in the draft Act would have to be modified in their application to flat-owning companies because directors of flat-owning companies are usually flat owners

- the financial assistance provisions of the draft Act would require adaptation for the purposes of flat-owning companies

- the registration of licence provisions are completely out of place in the draft Act and would have to be transferred to the Land Transfer Act 1952.

261 We are of the view that flat-owning companies should be principally regulated in the Land Transfer Act 1952. It is quite clear that the 1964 Act cannot simply be repealed. Compulsory conversion to a unit title system would be expensive and would not entirely meet the needs served by flat-owning companies. We recommend that, during the transition period for implementation of the draft Act, the future of flat-owning companies should be considered in a general review of the land statutes, including the Unit Titles Act.
CO-OPERATIVE COMPANIES

262 There are presently four statutes by which special status and privileges are extended to co-operative companies: Co-operative Dairy Companies Act 1949; Co-operative Companies Act 1956; Co-operative Freezing Companies Act 1960; and Co-operative Forestry Companies Act 1978.

263 Those statutes do not provide a vehicle for incorporation of co-operative companies, but rather provide for registration as a co-operative company of any company incorporated under the Companies Act 1955 (or any of its predecessors) where the company is otherwise entitled to that registration.

264 Until recently, co-operative companies had certain tax privileges. The other main advantage of registration under one of the co-operative company statutes is the ability to "surrender" some of the shares in the company. This gives the co-operative company the flexibility it requires to cope with the changes in shareholding arising from movements in and out of the relevant industry.

265 The draft Act would permit a company to purchase its own shares. We are of the view that the draft Act could be used, with a suitable constitution, to achieve the same effect as the surrender provisions of the various co-operative company statutes.

266 Co-operative companies often have large memberships and a desire to exclude outsiders to the relevant industry from holding shares in the company. Special articles are often used (and are required in the case of co-operative dairy companies and co-operative forestry companies) relating to the distribution of income received by the company in respect of the produce supplied by its members.

267 We are of the view that companies could be structured under the proposed Act to achieve these results.

268 A main feature of the special statute is the protection of the word "co-operative" in the name of a company. The introduction of the ability of a company to purchase its own shares will enable other forms of co-operative enterprise to employ the company form. These organisations should not be denied
use of the word “co-operative” in their names. The “good faith” and “undesirable” provisions regarding company names in the proposed Act will protect against unwarranted use of the word “co-operative”.

269 Overall, repeal of the special co-operative company statutes is desirable as the proposed Act would render them unnecessary. The possibility of repeal was not expressly stated in the discussion paper and submissions did not focus on that possibility. The Law Commission has not subsequently sought submissions on this, and thus recommends that these statutes not be repealed without further consultation with the interested parties.

MINING COMPANIES

270 The reason for special provision in the Companies Act relating to mining companies, and the history of their special treatment, is to be found in the judgment of Smith J in In Re the Hartley and Riley Consolidated Gold-Dredging Co Ltd (No. 2) [1933] NZLR 336.

271 The object of Part XIV of the 1955 Act which deals with mining companies appears to be to foster investment in speculative mining ventures. The key provision is the ability to attract funds without imposing any additional liability on the shareholder.

272 The Macarthur Committee recommended repeal of Part XIV but retention of the ability to incorporate with no liability. The ability to form companies with no liability was to be confined to mining companies.

273 We wrote to the mining companies we were able to identify from the records of the Registrar of Companies about retention of special provisions for them. Those who responded did not urge the retention of Part XIV, if no liability was still available.

274 The draft Act, by removing the requirement for par value, enables all companies to achieve no liability status. All the other provisions of Part XIV of the 1955 Act can be adopted by inclusion in the constitution of the company.
275 For these reasons the draft Act does not continue the special provisions for mining companies contained in Part XIV of the 1955 Act.

PARTS IX AND X OF THE COMPANIES ACT 1955

276 Parts IX and X of the Companies Act 1955 set up processes for the application of the 1955 Act to companies formed or registered under former Acts and companies capable of being registered under the Act.

277 The Parts are largely carry-over transitional provisions which would be cleaned out if reregistration under Part 10 of the new Act is required of all companies. That seems to us to be a desirable reform in itself.

278 Sections 367 and 369 (which deal with obsolete formal classifications) are not worth retaining.

279 We have been advised by the Registrar of Companies that the last time the registration procedures for companies not formed or registered under previous Acts was used was in 1929 (under the previous Companies Act).

280 While there may be some companies still in existence which are not registered, we are of the view that it is wholly reasonable to require them to reregister as part of the transitional arrangements for bringing in a new Companies Act.

A BUSINESS CORPORATIONS ACT

281 In the discussion paper, we raised the question whether the Act should be available only to companies set up to make profit. In that case, a separate statute would be devised for non-profit companies. The responses received to the discussion paper favoured the retention of a single statute applying to both types of company. That is the New Zealand system and appears well accepted.

282 The North American statutes are “business corporations” statutes. The benefit of such specialisation is that it permits assumption of shared purpose to a certain extent. A
profit purpose is at least a measure against which the best interests of the company can be weighed. Interestingly enough, however, none of the statutes we have seen impose a profit-maximising purpose on companies and, indeed, very often it would be misleading to assume such a purpose.

283 The Law Commission has concluded that for New Zealand circumstances a statute covering both business and other companies is appropriate. The standard constitution in the draft Act does, of course, envisage a business enterprise in which profits are distributed to shareholders. Companies formed for charitable purposes will have to opt out of the standard form by their constitution. For example, a charitable company (which, with the elimination of companies limited by guarantee, will be required to adopt a share structure) may provide for its directors to hold all the shares in the company and provide that the shares do not carry any rights to distribution.

SOCIAL PURPOSES

284 In the discussion paper, the Law Commission indicated that it was not attracted to the view that wider social purposes should be imposed upon companies through the Companies Act. We quoted the view that

... the problems of regulating business as to protection, distribution, competition, monopoly, labour relations and undue concentration of wealth are not properly to be dealt with by corporation laws, ... but by specific statutes. (H W Ballantine, Law of Corporations, Chicago (Rev ed 1946) p 42)

285 The responses we received agreed. In particular, the inclusion of a provision such as is found in section 4 of the State-Owned Enterprises Act 1986 (which requires state-owned enterprises to act in a socially responsible manner) was opposed by a number of respondents and none supported the inclusion in the Companies Act of the imposition of a system for worker participation in management.

286 The Law Commission has come to the conclusion that such social objectives should be imposed by particular statutes
(see paragraph 19 above). We have thought it proper, however, to acknowledge in the Act the ability of directors to take into account the interests of employees, to the extent that their interests are not inconsistent with the fundamental duty of the directors to further the best interests of the company. Such specific provision is made in the 1955 Act (in relation to the capacity of a company) and is thought necessary to overcome the doubts raised by cases such as Parke v Daily News Ltd [1962] Ch 927.

OFFICERS AND SECRETARY

287 The draft Act does not attempt to provide a structure for the operation of a company below the level of directors. That is a deliberate decision based upon our belief that the directors are the organ of the company responsible for its management and that to provide for management functions below the level of directors in the Act would be to undermine director responsibility and accountability. The directors are given power to delegate, but retain the obligation to set up safe management systems and to monitor those to whom they delegate their powers.

288 It is for these reasons that the draft Act does not deal with the office of company secretary or, indeed, with any other officer of the company. Although the 1955 Act explicitly recognises the company secretary, it does not allocate to the secretary any responsibility or duties. Most respondents to the discussion paper agreed that it was unnecessary for the statute to provide for the office of company secretary.

289 In the case of the one-person company, which is permitted by the draft Act, such an officer is a formality that we would not wish to impose. In the case of larger companies, it was suggested to us that the Act should create a role for the company secretary in providing information to the shareholders, independently of the directors. On this suggestion, the company secretary would perform a function as a sort of tribune of the shareholders.

290 The Law Commission considers that this suggestion is impractical, as running counter to the reality in which the
company secretary is often an employee in the management hierarchy of the company. It also, in our view, undermines the primary responsibility of the directors.

291 For the purpose of imposing liability in circumstances where company confidential information is abused, the draft Act refers to “employees” of the company. We have thought it undesirable to perpetuate reference in the current Act to “officers” both because the definition is extraordinarily imprecise and because the mischief addressed is the same where powers are delegated to and abused by an employee who would not fall within the definition.

292 The primary responsibility for ensuring that the powers conferred upon them are exercised properly should attach to the directors. Where they delegate, they remain responsible to ensure that safe systems, including in appropriate cases perhaps employment contracts which impose duties of loyalty and care upon employees, are set up.

UNUSUALLY LARGE COMPANIES

293 Section 471 of the 1955 Act permits the Governor General by Order in Council to waive a number of provisions of the Act “where he considers it necessary by reason of the unusually large number of shareholders”. The provisions which can be modified are

- convening of extraordinary general meeting on requisition (section 136 (1) (a))
- articles prescribing the time for receipt of proxies (section 140 (3))
- circulation of members’ resolutions, etc, on requisition (section 144 (2) (b))
- investigation of the company’s affairs on the application of members (section 168 (1) (a))
- statement as to remuneration of directors which is required to be furnished to shareholders on demand (section 196 (1) (a)).

294 We have come to the conclusion that this provision should not be repeated in the draft Act. The draft Act permits
great flexibility in company form. The company is given a great deal of freedom to regulate by its constitution its own procedure. The mandatory requirements of the Act are minimum standards which we think should be applied to all companies. We do not consider that there is any justification for their modification in relation to unusually large companies.

TAKEOVERS

295 The reference to the Law Commission acknowledges "the continuing work of the Securities Commission" in takeovers. The Securities Commission reported to the Minister of Justice on the subject of company takeovers in its Report of October 1988. The present Report is made against the background that the Minister of Justice has announced that the recommendations of the Securities Commission have been accepted and will be implemented in legislation.

296 However, the Securities Commission's proposals are for a code applicable only to companies offering securities to the public. The Law Commission has therefore been concerned to determine whether the Companies Act should contain provisions in relation to takeovers which are applicable to all companies. It has formed the view that some provision in the Companies Act is required.

297 Our concern has been to prevent abuses which arise out of use of the corporate form. The draft Act does not duplicate the takeover code proposed by the Securities Commission, which is concerned in part with regulation of conduct outside the company structure. Regulation of the conduct of the offeror in relation to offeree shareholders is a matter of securities law policy. But the conduct of offeror directors in takeovers may adversely affect their own shareholders. And shareholders of offeree companies are particularly vulnerable to abuses or omissions by directors of the offeree company. These aspects of takeover law, it seems to us, are the proper subject of company law regulation because they arise out of the separation of ownership and control and the fiduciary duties upon directors which result. The concern is the same whether or not the shares in the company are publicly traded.
Shareholders in offeror companies have traditionally not been well served in takeover regulation. The draft Act protects them by

- requiring class vote and dissentient rights wherever class rights are affected by the takeover proposal
- requiring special majority and dissentient rights wherever the proposal amounts to sale or acquisition of assets equivalent to a greater part of the assets of the acquiring company.

Under the draft Act there is no equivalent provision to section 208 of the 1955 Act. Section 208 may be invoked in takeovers to enable compulsory acquisition or compulsory purchase of a remaining 10 percent minority after the takeover. The policy of the section in protecting minority shareholders from being locked in is more effectively met in the draft Act by the buy-out provisions where class rights are affected or the takeover amounts to a reconstruction or involves a major transaction.

So far as the section permits ownership to be perfected compulsorily this is not a policy we consider the draft Act should adopt. The ownership of a company is not a topic that the basic law relating to company structure and internal organisation can address. Many companies will be set up on the basis of the existence of small minority shareholdings. The circumstance of a triggering transaction or contract (such as is provided by section 208) does not, it seems to us, alter expectations in the ownership of the company. If it is considered efficient and in the public interest to require a mechanism achieving compulsory acquisition to rationalise ownership of companies, then we consider such a provision should be included in takeover legislation where the policy in the provision can be clearly referable to the goals of takeover law.

Under the draft Act, offeror shareholders will be entitled under section 178 to look to their directors for

- information as to whether the directors are in possession of material information which would mean the price offered for the shares is clearly inadequate
- details of any benefits obtained by the directors from the offeror company, directly or indirectly
any interest of the directors of the offeree company in the offeror company.

302 A particular concern in takeovers is the ability of directors of offeree companies to use their powers of management to defeat bids. The defensive devices resorted to in recent years are described in the Securities Commission Report. They are the concern of core company law because they often amount to abuses of fiduciary duty. They have the effect of undermining one of the most important disciplines shareholders possess over directors, the power to sell. And they arise in circumstances where the directors inevitably have a conflict of interest.

303 The Law Commission has considered whether it is practicable to introduce a provision, similar to those to be found in Rules 21 and 22 of the United Kingdom Stock Exchange Listing Rules, which prohibit the use of certain powers by directors during the course of an offer or when one is imminent. The powers which cause particular concern are those relating to the creation of shares and options, sale or acquisition of significant assets and repurchase of shares.

304 We have come to the conclusion that it is not appropriate to prohibit director use of these powers during takeover because

- such a prohibition would prevent legitimate action in the best interests of the company
- there is substantial difficulty in defining "takeover" for the purposes of such a prohibition.

305 We consider that the provisions in the draft Act which

- establish the best interests of the company as the fundamental duty of directors in the exercise of any power (including powers to dispose of or acquire company assets and to issue shares)
- require the directors to treat existing shareholders fairly
- presume pre-emptive rights for existing shareholders to new distributions of shares
- require shareholder consent and dissentient rights where major transactions are entered into
require benefit to existing shareholders in share repurchases not pro rata and in financial assistance in the purchase of shares

permit ready access to remedy for breach

provide a framework within which directors seeking improperly to entrench themselves against takeovers can be held to account.

306 The Law Commission agrees with the assessment of the Securities Commission that the Companies Amendment Act 1963 should be repealed. It is an unsatisfactory piece of legislation which is more appropriately the subject of securities law regulation in any event.

LIQUIDATION

307 Legislation which establishes and governs the operations of companies must also provide for their demise, and the ascertainment and adjustment of entitlements associated with that demise. Companies can come to an end because their purpose is spent or because those in control are in a state of deadlock, as well as in the more common situation of insolvency. A very substantial portion of the Companies Act 1955 is devoted to the liquidation or winding up of companies. Part VI (sections 210 to 341) deals with winding up of companies registered under the Act, and Part XI (sections 387 to 394) deals with winding up of unregistered companies.

308 The Minister's terms of reference to the Law Commission mentioned that the Department of Justice was engaged in a review of company liquidations as part of a wider review of the law of insolvency. But the assumption that the Department's work on insolvency would be completed in advance of or at the same time as the Commission's overall work, and in close liaison with the Commission, has not come about. Recognising this, and because company law reform was seen to call for an essentially new statute, the Law Commission formed the view that it would be wholly unsatisfactory to replicate or tinker with the existing legislation on this subject alone in an otherwise rewritten draft Act. Moreover, the proposals for
change in other areas of company law could not properly be tied in with the existing winding up provisions in the 1955 Act.

309 The Australian Law Reform Commission completed a major review of insolvency law when it produced its final report on insolvency reform at the end of 1988. At almost the same time a discussion paper prepared by our Department of Justice addressed the earlier Australian Law Reform Commission discussion paper proposals but did not respond to the points made in the New Zealand Society of Accountants' critique of the same paper. The Australian report has been widely applauded as a comprehensive and coherent study of the law and practice of insolvency and the direction and detail of reform in Australia. Given the quality of the report and the present emphasis on the harmonisation of trans-Tasman commercial laws, the Law Commission has gratefully drawn upon the work of the ALRC for much of the insolvency-related part of the proposed new Companies Act. Nevertheless, as will be seen from Part 14 and the relevant commentary in Chapter 4, there are differences between Australian and New Zealand practice and inter-related law and the Law Commission's proposals do not simply replicate those of the ALRC.

RECEIVERSHIPS

310 Part VII of the 1955 Act contains provisions dealing with receivers appointed in relation to the assets of companies. This is important in the company law context as it may involve a change of management. But, the appointment of receivers is not limited to corporate assets and the Law Commission has taken the opportunity of this review of the 1955 Act to consider receiverships in a wider context, and transfer relevant rules to the Property Law Act 1952. At some later stage a new Receivers Act may be appropriate. The present recommendations are described in some detail in Chapter 6.

ROLE OF THE REGISTRAR OF COMPANIES

311 The Macarthur Committee, in its interim Report of August 1971, recommended that the role of the Registrar
extend beyond maintenance of the register. It recommended that the Registrar be given powers to police the Act and, in particular, to investigate, detect and prosecute offenders for breaches of the Act and for fraud.

312 In accordance with the recommendations of the Macarthur Committee, the powers of the Registrar under Part I of the 1955 Act have been greatly extended. Recent legislation, most notably the Corporations (Investigation and Management) Act 1989 and the Companies Amendment Act 1988, has continued to give the Registrar wide powers of enforcement.

313 We have recommended that the investigative and enforcement powers under Part I of the 1955 Act should not be continued. We have retained and expanded the powers of shareholders to obtain information and inspection, at present found in sections 168 and 169 of the 1955 Act.

314 It should be acknowledged that in recent years in New Zealand, most investigation has been undertaken not under the provisions of sections 168 and 169, but by the Registrar under the powers conferred upon that position in section 9A in Part I of the Act. Until the events which followed the 1987 stock market collapse, the powers of the Registrar appear to have been used almost exclusively in cases of insolvency, as an aid to his or her role as Official Assignee. (This information has been informally given by officials of the Department of Justice. We have been unable to obtain any statistics from the Department as to the use of the Registrar’s powers under Part I of the Act.)

315 We have formed the view that in a core company Act where shareholder enforcement is the norm, the powers proposed in the draft Act under sections 134 and 135 are sufficient. In extraordinary circumstances, the Corporations (Investigation and Management) Act 1989 confers extremely wide powers of investigation and inspection.

316 The Law Commission accepts that a public agency should be empowered to investigate and have standing to remedy breaches of the Act in cases where the public interest is involved. For this reason, the draft Act proposes that the Attorney-General should have standing to obtain inspection and
enforce obligations in the same manner as a shareholder. The Attorney-General has been designated as a convenient recipient of these powers (which can then be delegated) pending reorganisation of the agencies charged with company and securities law enforcement.

317 It is important to remember that the enhanced powers given to the Registrar at the recommendation of the Macarthur Committee predate the Securities Act and the setting up of the Securities Commission.

318 While state agency enforcement is a legitimate backstop to the remedies provided to shareholders under the draft Companies Act, that backstop is designed to be exercised in the public interest. In the normal course the enforcement of their private interests will be a matter for the shareholders affected. Where the company offers securities to the public, the state has a more direct interest in ensuring compliance with the laws set up partly to maintain investor confidence in organised capital markets. For that reason, state enforcement of securities law is more important in the scheme of the Securities Act than it is in the scheme of the Companies Act.

319 The Law Commission has been anxious not to pre-empt reassessment of the form of enforcement which may be devised in a review of the Securities Act. It sees the residual role for state enforcement in the core Companies Act being most appropriately entrusted to the agency charged with enforcement of securities laws, following review of the Securities Act.

320 We suggest also that it is preferable for agencies wherever possible to have distinct functions. It permits better focus. It will allow the Registrar to concentrate on the task of providing an efficient public service in the registration of companies and the disclosure of information. We would prefer for that reason to see the registration function and the enforcement function separated in any event. Such a separation of functions was generally supported by the submissions received in response to Preliminary Paper No 5. We have been impressed by the registration system we have seen in operation in Ontario which maintains such a distinction. Similar distinctions are maintained in Alberta and British Columbia.
321 The draft Act therefore proposes that the enforcement powers of the Registrar should be limited to maintenance of the register.
IV

Commentary on Draft Companies Act

PART 1

Preliminary

322 The draft Act would replace the Companies Act 1955. We considered whether we should move to a different title for the new Act, to emphasise its reforming function. Because it is intended as the core Companies Act we have preferred to stay with the title that has historically applied to the statute governing New Zealand companies.

323 Following recent legislative practice, the draft Act includes a purpose section. It is designed to underscore the fact that company law recognises the economic and social value of the limited liability company in permitting the aggregation of capital and the taking of business risks. The Act aims to strike a balance in protection of shareholder and creditor interests which does not undermine the position of the company as a mechanism for harnessing capital and spreading economic risk.

324 The definitions contained in section 3 apply throughout the Act, unless excluded by specific provision or the context. In some cases where the definition is fundamental to a particular part only of the Act, we have preferred to include the definition in that Part, but with a cross-reference in the definitions section, for ease of use. Examples are to be found in the definition of director, contained in section 96, and the definitions
relating to group accounts, which are set out in Part 10 of the draft Act.

325 In some cases, the definitions may seem, taken out of context, extremely wide (an example is the definition of “distribution”). They need to be viewed in the sections which apply them. For this reason, where elaboration is required, we have discussed the definitions as they arise in the draft Act, rather than treating them in isolation as a commentary to section 3.

326 Some definitions, however, are more conveniently dealt with in this section of the Commentary because they apply generally.

327 The definition of “Court” reflects the division of work referred to in paragraph 130. The District Court is given exclusive jurisdiction in the enforcement of the penalty provisions of the Act, and has concurrent jurisdiction with the High Court in relation to shareholder and creditor enforcement and ancillary powers.

328 The definitions of “registration day” and “working day” are designed to make explicit the treatment of days of the week and holidays for the purposes of reckoning the time limits in the Act.

329 The definition of “related company” in section 3(2) is discussed in the commentary on director dealing in shares. For the purposes of company accounts, share repurchase and the incurring of indebtedness, other definitions of “subsidiaries” and “cross-holdings” are used.

330 The solvency test set out in section 3(3) is pivotal to the scheme of the Act. It applies to all transactions which transfer wealth from the company to the prejudice of creditors and, where some shareholders only receive benefit, to the prejudice of non-participating shareholders. The test is designed to be a substantial constraint in such circumstances because they are those in which limited liability and management power are most open to abuse.

331 The test is a two-pronged one to ensure both “balance sheet” solvency and “cash-flow” solvency. It recognises that measuring current assets against current liabilities may not be
sufficient to establish solvency. The test ensures that decisions are based on cash-flow analysis showing that known obligations of the company can reasonably be expected to be satisfied during the time they will fall due.

332 The solvency test is applied in the draft Act to all distributions, including share repurchase as well as dividends. At present, the law relating to dividends is entirely to be found in the cases.

333 The draft Act follows United States precedent in using the concept of “realisable value” in the assets over liabilities limb of the test. The Canadian reliance upon a concept of “stated value” (being the sum of all value received on issue of shares) seems to us simply to reinstate under a different name the concept of nominal capital for the purposes of distributions and is insufficient protection for creditors at risk. We realise that in making a determination whether to make a distribution in marginal cases the directors will not be able to rely upon the historic values of assets in their accounts. We think in those marginal cases it would be wrong to permit the accounts to be sheltered behind to the prejudice of creditors. In those circumstances prudent directors will require reassessment of the value of the company’s assets. The test is designed to be a purposive one for the protection of creditors.
PART 2
Incorporation

334 The essential characteristics of a company are set out at sections 5 to 9. These sections are designed as a useful overview of matters dealt with in separate parts of the Act. The draft Act does not continue the historic division of the company constitution into memorandum and articles of association, but simply requires a constitution.

335 Every company will have a name, a constitution, one or more shares, one or more shareholders and one or more directors.

336 The name is required to identify the company. It may be a registered name or an assigned name (a number name given to the company by the Registrar for the purposes of identification in circumstances where a registered name is not available or not sought).

337 The company constitution, as is made explicit in Part 4 of the draft Act, effectively comprises the standard constitution set out in the Act, unless and to the extent that it is specifically excluded.

338 While it is possible to devise a company structure without necessarily providing for shares, shareholders or directors, we have considered that there is little to be gained from such
sophistication in the Act because the imposition of such structures is well understood and can readily be adapted to achieve specific objectives for the company. For example, the company constitution can appoint the shareholders, or indeed name individuals as directors. Companies at present without share structure can readily be given one, through allocation of one share to the directors or each of them. Unlimited liability or no liability or liability up to a certain amount can all be provided for in allocating rights and obligations under the constitution to shares.

339 *Section 6* deals with the essential powers of the company. It is designed to ensure that there are no power vacuums in a company. Except where the constitution limits the power (for example, by providing that a director is not removable or that some provision in the constitution cannot be altered), it is essential that someone should have the power to do each of the things listed in section 6. Normally, all the powers listed will be exercised by the shareholders. The standard constitution provided by the Act provides for that and provides that all shares carry an equal right to vote on these matters (section 26). In some companies, however, the constitution may expressly confer some or all of these powers upon a named person or body, rather than through the mechanism of attaching the rights to a particular class of shares and issuing the shares to the person named.

340 Where at any time there is no person entitled to exercise one of the essential powers of the company, that is a ground for its liquidation pursuant to section 203.

341 Separate personality is one of the essential components of the company and has been critical to its success. *Section 7* makes explicit recognition of this feature.

342 *Section 8* extends and completes the reform introduced in 1983 by section 15A of the Companies Act 1955. It deals with the problems associated both with the ultra vires doctrine and the constructive notice doctrine as applied by the case law to company objects and the consequences for third parties of their infringement.
343 The ultra vires doctrine meant that acts taken by a company outside those expressly or impliedly authorised by its objects clause were void, because the company lacked legal capacity to enter into them.

344 This restriction upon company activity was designed for the protection of shareholder expectations, but has been for many years a protection available mainly in theory because from a very early stage companies commonly appropriated to themselves objects of such breadth that they were illusory standards against which to measure company action or director conduct. The reforms of 1983 simply bowed to reality in permitting companies to have the powers of natural persons and removed a source of much problem for third parties dealing with the company.

345 The reforms to the doctrine of ultra vires effected by the Amendment Act of 1983 were extended in relation to constructive notice in 1985. Even so, the result has not been, as was intended, to abolish the ultra vires doctrine and problems of constructive notice associated with it.

346 In the first place, the extension of the capacity of companies to include all powers of natural persons was applied only to companies formed after 1984 or those which changed their memorandum and articles to take advantage of the provision. We would perfect this reform by enabling companies to reregister any limitation on their powers within the transition period. Those that do not do that will have the powers of natural persons. The reforms of the 1980s have been substantially undermined by the failure to require all companies to face up to the change. In Australia and Canada similar reforms were either applied directly to all companies or required reregistration within a certain period.

347 Other difficulties associated with the ultra vires reforms are the continuing suggestions of restriction upon capacity contained in section 16A(2) of the 1955 Act and the continuation through section 18C of a form of constructive knowledge which continues to place at risk third parties dealing with a company which has restrictions on its objects. The draft Act deals with these concerns in section 8(2) by expressly providing that transactions in contravention of the constitution are not
invalid. A third party under the draft Act will not have constructive notice through registration of the constitution (draft Act, section 143), and the company cannot assert any invalidity against a third party, unless the third party “has or ought to have by virtue of his position with or relationship to the company knowledge to the contrary” (draft Act, section 142(1)). We have some doubts as to whether knowledge by relationship is a sufficiently precise concept for business law. In particular, there may be difficulties with forgotten knowledge and knowledge within a corporation. While actual knowledge does not seem to us to be sufficient because it would allow a third party to be wilfully “blind”, we have considered requiring the knowledge to be “in the transaction” in order to provide a more workable test. This is a particularly difficult area and in the end we have not felt justified from departing from such a recently enacted test. But we think its application should be kept under review.

348 It should be noted that section 8 does not reenact the list of powers expressed in section 15A(1) of the 1955 Act as among those possessed by a company. We have considered that list to be unnecessary. Section 15A(1)(g) of the 1955 Act is a legislative reversal of Parke v Daily News Ltd [1962] 1 Ch 927 which held that ex gratia payments to employees upon a company ceasing business were ultra vires the company. We do not think it necessary to make explicit reference to the powers of the company in such circumstances because we believe it is quite clear from section 8 of the draft Act that donations of all kinds are within the capacity of the company. (To the extent, of course, that they exceed “the best interests of the company” they will not be within the powers of management conferred upon directors.)

349 Authority to bind is dealt with in section 9 and in Part 9 of the draft Act. These provisions are a statement of the rule in Royal British Bank v Turquand (1856) E&B 327; 119 ER 886. By that decision, an outsider dealing with the company is entitled to assume that the company’s internal procedures have been properly complied with and that persons acting on its behalf do so with its authority. The section follows Canadian precedents (see section 19 of the Ontario Business Corporations Act 1982). It is largely a restatement of the common law,
including normal agency principles, but makes it explicit that the position is not affected by forgery unless the third party has actual knowledge of the fraud. Constructive notice of the company constitution by reason of its registration will not affect the ability of the third party to rely upon the authority of the agent contracting on behalf of the company, but the third party is not protected in cases of actual knowledge. In this, the draft Act follows the existing provision of section 18C and the Canadian models.

350 The method of incorporation of companies is set out at sections 10 to 12 of the draft Act.

351 The present law is altered by section 10 to enable one person to incorporate a company. This provision anticipates the change referred to in section 11 which would permit all companies to have one shareholder. At present, private companies can incorporate with the minimum of two shareholders, and public companies with the minimum of seven.

352 This change was suggested in our discussion paper and was generally supported. The recognition of the one-person company makes explicit what is already permitted by the law through use of sham holders of shares and some meaningless ritual. The legality of what is in effect a one-person company has been recognised at least since the decision of the House of Lords in Salomon v Salomon & Co Ltd [1897] AC 22. The insistence of the statute on additional shareholders provides no protection to creditors from abuse of limited liability and the draft Act will result in a more direct and less wasteful legislative scheme.

353 The information required to be registered under the draft Act on incorporation is simply the information required for identification of the company and those responsible under the Act, directors and incorporators. This streamlines the process of registration. It also makes it clear that the Registrar is obliged to expedite registration on the basis of compliance with the formal requirements of the Act. This changes the implication of the present law that the function of the Registrar extends beyond checking for form and involves ensuring compliance with the substantial provisions of the Act.
Sections 13 to 15 provide the process for reregistration of existing companies under the new Act and for the effect of registration. The proposed system (which will involve an amendment to the 1955 Act for the period of transition) is described in paragraphs 52–65 above.
355 Selection and authorisation of names for companies has traditionally been a source of delay in registration. The proposals made in the draft Act are designed to overcome those delays. They provide for an “assigned” (number) name to be applied by the Registrar where no name is registered (section 16). The applicant for registration of a name must cause a search to be undertaken and make a statement that the name • is adopted in good faith for the purpose of identifying the company and
• is readily distinguishable from other names in registers and directories he or she is required to search (the Registrar can prescribe what registers and directories are to be searched).

356 This procedure is designed to come up with a speedy system for registration of name which will allow the Registrar to presume that the name sought is appropriate.

357 Once the application is properly completed, the power of the Registrar to decline to register the name is limited to circumstances where the name is identical with one in the registers required to be searched, or where the use of any word in the name infringes any enactment.
That limited discretion is consciously adopted as a means to ensure that registration of companies is not delayed by administrative consideration of name desirability, and that effort and resources are not unnecessarily devoted to the topic by the Registrar.

Once the name is registered, it may be removed pursuant to section 20 if the Registrar has reasonable grounds to believe that the name is undesirable. It is envisaged that the existing case law on the term "undesirable" in this context will continue to apply. In that case, the company will have a right of appeal.

We have considered whether the vexed question of company names should not be dealt with by simply proscribing identical names, on the basis that for company law purposes all that is required of a name is that it identifies the company. Restrictions on the use of business names would then be a matter for the common law or a specific statute. We raised this suggestion for consideration in the discussion paper.

We have concluded that there is a substantial demand for and a public interest in name protection and in avoiding names that are confusing or otherwise undesirable. This calls for more protection than would be given in a system which simply prohibited identical names.

Section 21, continues the present requirement that companies must use their full name in correspondence and documents but drops the requirement that the company's name must be conspicuously displayed in every place where it carries on business. The rationale for that rule, which has been in all our Companies Acts and is derived from early English models, is that it is important for those dealing with a limited liability company to know that they are doing so. This provision dates from a time when companies were relatively uncommon in business and were viewed with suspicion. The ubiquity of the company and its use by small business means that red flag provisions of this sort are no longer called for. The requirement is an anachronism, it serves little useful purpose and even the small costs of compliance are not justified. Our own impression is that the current provision is not widely observed in any event.
The draft Act sets up a system which is, like the 1955 Act, partly enabling and partly regulatory. Under the 1955 Act, by the device of Table A articles, the Act provided a model constitution for companies. In the draft Act, we have thought it preferable to state the major rules of company organisation in the Act itself. In some cases these rules are mandatory as, for example, the limits on the powers to make distributions and the directors’ duties. In other cases they are permissive, for example, in the use of telephone communication for meetings. But many of the provisions of the Act state a model or standard which can be varied by the constitutional document of the company. The standard provisions will be part of the company’s constitution to the extent that they are not excluded. (An outline of the scope of company constitutions is given above at paragraphs 164–183.)

If a company, operating under the standard constitution, seeks to modify it, it will have to comply with the procedure for alteration of the constitution (section 24).

The draft Act gives companies considerable flexibility to devise a structure suitable for their circumstances. A premise of the draft Act is that shareholders cannot claim prejudice if they knowingly join a company whose constitution restricts the
rights attached to their shares. Once a shareholder has joined a company on the basis of the constitution, however, he or she is protected from change except in accordance with the constitution and the Act (which is hostile to changes which affect shareholder expectations, particularly in relation to class rights).

366 For this reason, the constitutional document (where the company has one) occupies a significant place in the scheme of the draft Act. It is a statement of deviations from the normal consequences of shareholding which are set out in the standard constitution provided by the Act.

367 We expect that in the case of companies listed on the New Zealand Stock Exchange, the listing requirements may restrict departure from the standard constitution, particularly in relation to the rights attaching to shares which are publicly traded.

368 By section 24, alterations of the constitution are required to be made by special resolution. This provision is subject to the constitution which may prescribe its own system although, where the change affects shareholder rights, section 88 is mandatory and cannot be excluded. Special resolutions require a 75 percent majority of those entitled to vote, which carries on the existing provision. Where the alteration of the constitution affects the shareholder rights defined in section 88 (the rights to vote and to distributions, pre-emptive rights and observation of procedures for alteration of rights) then the change requires a special majority of the interest group affected. The dissentient minority in such cases will have rights under section 81 to require that their shares be bought out.

369 This scheme represents a policy that the rules of the company in so far as they affect fundamental rights attaching to shares are to be entrenched. It is always open to a company to structure the rights of shareholders so as to reduce the control that the shareholders can exercise. If shareholders enter the company on that basis, they will not have been misled. If the company seeks to change the rules of the game, the shareholder will be protected.

370 Where the statutory standard constitution is not displaced by section 26, a share will carry
• an equal right to vote and to distributions
• rights of pre-emption on issue of shares
• rights to be treated pro rata with other shareholders on share repurchase.
PART 5
Shares

371 Section 26 sets out the normal range of rights which may be attached to a share, depending upon the company constitution. These rights are the more common ones but it is provided that any other right, privilege, limitation or condition may be imposed under the constitution.

372 Subsection (2) sets out the rights which attach to a share in a company under the statutory standard constitution. If the constitution is silent about the rights attached to shares, they will carry all the rights set out in this subsection. These are the rights to vote on all matters required by the standard constitution to be reserved to shareholders: appointment of directors and auditors, alteration of constitution, approval of major transactions, approval of amalgamation and approval of voluntary liquidation of the company. Shares also carry the rights to share equally in dividends and distribution of assets upon dissolution.

373 These are the residual proprietary rights and in voting on the matters reserved to them by this section the shareholders may act in their own self-interest and are not subject to fiduciary duties to other shareholders or to the company (section 80).
Section 27 emphasises the wide range of interests covered by the description “share” in the draft Act. It draws no distinction between preference and ordinary shares and explicitly recognises that shares may have no voting rights.

One of the most significant changes to the present law which would be effected by the draft Act is the abolition of the concept of par value for shares and the consequential abandonment of the concept of nominal capital: section 28.

By section 14(4) of the Companies Act 1955, every company limited by shares must state, in its memorandum of association, its nominal or authorised share capital and its division into shares of a fixed amount. The fixed amount attached to each share is its “par value”. These concepts have been central to the system of company law we inherited from the nineteenth century English models. They are the foundation on which the law relating to dividends and other distributions is based. The concept of par value was an attempt to ensure that no return to shareholders is made from a company except out of net assets which exceed the capital raised from shareholders. The theory was that the capital raised on issue of shares was a cushion of solvency for the trading activities of the company.

Par value was also seen as a protection for shareholders against stock-watering: additional authorised shares had to be issued at the same par value as the shares already issued.

These expectations have never been realised. The capital raised by shares usually bears no relationship to the capital employed by the company and thus is not an effective solvency cushion. The par value of a company’s shares is often a fraction of the issue price and so does not in practice operate as a protection against stock-watering. Worse, instead of providing the protection originally envisaged, the concepts of nominal capital and par value have given rise to unproductive complexity in accounting, substantial formality in management of capital (through, for example, the prohibition against companies acquiring their own shares) and have masked the true capital of the undertaking and the relationship to it of such indications of corporate health as dividends. They misrepresent the share as a measure of value rather than a fractional interest in the net assets of the enterprise. They make it impossible to describe
the difference between book assets and liabilities of a company by the word "capital". They have led to confusion between legal concepts of capital and accounting concepts of capital.

379 Nominal capital and par value are not required in the United States or Canada. In the United Kingdom they are retained, although both the Gedge Committee (Cmd 9112) which reported in 1952 and the Jenkins Committee (Cmdnd 1749) which reported in 1962 recommended that the Companies Act be amended to permit the issue of shares with no par value.

380 In our discussion paper, we proposed that par value be abolished. The submissions we received in response to that proposal were decisively in favour of it.

381 We have concluded that no useful function is served by the par value concept. Moreover, it is arbitrary and misleading. Its abolition would mean that financial accounts can be greatly simplified (share premium accounts and "reserves" are concepts that will no longer be required), the rules relating to payments of dividends and other distributions can be made purposive and give a real protection for creditors through imposition of a solvency test applied to the real circumstances of the company, and the way is open for a more sensible approach to issues such as company share repurchase.

382 The Law Commission does not propose that the concept of nominal capital be replaced by a concept of "stated capital" (being the proceeds actually received by a company on share issue) for the purposes of distributions. Instead, it proposes a solvency test, described at paragraphs 330–333, which it considers to be a significant improvement for the protection of creditors.

383 The Gedge Committee in the United Kingdom suggested that no par value should apply only to ordinary shares and not to preference shares. The Jenkins Committee, reporting 10 years later, however, suggested that no par value should be applied to preference shares as well as ordinary shares. We raised the point for discussion in Preliminary Paper No 5 and suggested that if par value were abolished for ordinary shares, there seemed to be no good reason to retain it for redeemable
shares and preference shares. The respondents to the discussion paper did not dispute that conclusion and we have therefore implemented it in section 28. It is, of course, possible, without using the concept of "par value", to specify a redemption or liquidation value in a preference or redeemable share, or the manner in which the value will be determined. The distinctive features of preference or redeemable shares will therefore remain.

384 We have considered whether the concepts of par value should be made optional or done away with altogether. Par value is optional in five Canadian provinces (the other four having compulsory no par value shares) and in most states of the United States. Professor Gower in Principles of Modern Company Law (4th ed) 1979, at p 238, argues that no par shares should be made compulsory. So did the Alberta Law Reform Commission and the Dickerson Committee in Canada. We have concluded that to retain par value as an option would be unacceptably complicated and would serve no useful purpose.

385 Section 29 of the draft Act provides that, unless otherwise specified in the constitution of the company, a share is transferable. As is indicated in paragraph 148, the Law Commission considers that transferability of shareholder interest is one of the substantial benefits of company form and it is regarded as one of the significant disciplines shareholders exert over director management. The policy of the Act is to protect it unless clearly excluded by the company constitution. It is for this reason that the standard constitution makes shares transferable and section 63 requires the board to register transfers promptly unless the constitution permits refusal or delay and the board gives its reasons for not registering the transfer promptly. There will of course be some types of company, for example family companies and similar closely-held companies, where restrictions on the transfer of shares will be appropriate. And companies wishing to confine membership to particular groups, for example dairy farmers, will also need the power to transfer shares circumscribed. The company's constitution can provide for this.
Section 30 deals with share options. It is designed to ensure that directors do not circumvent the prohibitions on issue of shares, distributions, repurchase and financial assistance by entering into share option agreements.

The draft Act contains detailed provisions as to the issue of shares. It is in relation to issue of shares that shareholders are most at risk in the enjoyment of their class rights in the company. Creation of shares ranking ahead of or equally with the shareholders' shares can substantially erode class rights. The common law has provided insufficient protection against such dilution (see, for example, White v Bristol Aeroplane Co [1953] Ch 65) and the draft Act would change the law.

Shares can be issued

- under the company constitution pursuant to section 32 (there must be at least one share in this category), or
- by the company pursuant to section 33.

Shares can be issued at any time by the board of directors where the company constitution has made provision for them and they have not yet been issued. In all other cases, shares will be issued by the board under section 34. The share description of any such shares is registered as part of the constitution because it forms part of the structure of the company.

The protections of the draft Act apply to share issues authorised by the board. In those cases, unless the constitution provides otherwise, existing shareholders have pre-emptive rights which require shares to be offered to them in a way which preserves their relative distribution and voting rights. They must be given a fair and reasonable opportunity to accept any such offer. This is a major change but one that is foreshadowed by Stock Exchange practice. It was raised in PP5 and generally supported.

Where the constitution of the company excludes pre-emptive rights, the shareholder buys in that knowledge and in that case takes the risk of dilution of rights. Change to the constitution after a shareholder has bought shares to remove pre-emptive rights is subject to safeguards for alteration of class rights which include rights to buy-out (see paragraph 202 and section 37 (3)).
392 Where shares are issued wrongfully, in breach of the preemptive rights provisions, the draft Act provides that the issue is itself valid but the non-compliance is deemed to be unfairly prejudicial conduct which permits shareholders affected to seek relief from the Court under section 135. Under that provision, the Court can make any order that seems to it to be appropriate, including repurchase of the shares of the shareholder affected, issue of further shares or payment of compensation.

393 Section 38 confirms that shares can be issued for a consideration other than cash. Section 60 (3) of the 1955 Act, which permits exchange of property other than cash for shares by the device of an exchange of cheques, will no longer be necessary and has been dropped.

394 Section 38 extends the present law in permitting shares to be issued in consideration for contracts for future services. There are difficulties in putting a value on such contracts. But the overall duty of directors to ensure that their powers are exercised with care and good faith in the best interests of the company should provide sufficient protection in these cases. Future services often have value as real as other forms of property. And there may be considerable benefits to a company if it is able to recognise that fact.

395 Section 39 protects the company from a share issue for inadequate consideration. At present, the only protection is the requirement that shares cannot be issued at a discount on par value. As pointed out above at paragraph 378, par value often has little relation to the real value of the share. As a result, shares may be issued to effect a substantial distribution or transfer of wealth from existing shareholders. Section 39 gives considerably greater protection. It provides not only that the consideration must be fair and reasonable to the company and existing shareholders, but also that the terms of the issue may not erode the nominal consideration (as, for example, where deferred payment affects the real value received by the company). The section reforms the common law which has traditionally been reluctant to look at adequacy of value on issue, despite the stock-watering effect of inadequate consideration.
(see *In re Wragg Ltd* [1897] 1 Ch 779, *Re White Star Line* [1938] Ch 458.)

396 Section 40 makes it clear that shares cannot be issued to increase the liability of a shareholder unless the shareholder consents in writing. The provision is necessary if limited liability is not to be defeated.

397 Section 41 clarifies the point of time at which a share is issued. A share is issued, if under the constitution, on registration of the constitution and in other cases upon entry of the shareholder’s name on the share register. It is at this date that the shareholder becomes entitled to the rights conferred by the share. The position of purchasers is protected by the duty to register transfers and other safeguards contained in sections 68 and 69.

398 A distribution under section 42 can only be made if the solvency test is satisfied.

399 The definition of distribution, contained in section 3, is extremely wide and includes any transfer of property to a shareholder in respect of any share. Share issues are excluded because the requirement of fair value ensures that the company’s position is not prejudiced and raising capital when the company is in difficulty should not be discouraged. (Potential investors will be protected by other legislation and the general law if misled in such circumstances.)

400 The solvency test in relation to distributions reflects two goals: avoidance of prejudice to creditors; and avoidance of prejudice to higher ranking shareholders with fixed entitlements, for example in preference shares.

401 The company must have sufficient funds to be able to meet its debts to outside creditors as they fall due and its realisable assets must exceed its liabilities, including contingent liabilities. The test is designed to be a rigorous one, as is discussed above in paragraph 333.

402 Shareholders with fixed entitlements cannot be prejudiced by distributions to shares which rank after them. For this purpose, therefore, the fixed entitlement is treated as if it were a debt.
Discrimination in payment of dividends between shareholders of the same class is prohibited. This provision does not apply to distributions in the form of repurchase or financial assistance (section 43) because those types of distribution will often need to be discriminatory, and specific safeguards are imposed for shareholder protection in relation to them.

Section 44 makes provision for options which permit shareholders to choose between a dividend or shares. Because the value of shares may fluctuate, the provisions requiring equality of treatment of shareholders cannot strictly be met without a mechanism such as is provided by section 44.

The definition of distributions is wide enough to cover discounts to shareholders. These are a common form of transfer of benefit which we would not wish to inhibit, provided they are not abused. There is also some doubt as to whether discounts can ever operate with equal effect for all shareholders. In those circumstances, section 45 makes it clear that discounts can be authorised by the board if fair and reasonable to the company and all shareholders, and are available on the same terms to all shareholders. Creditors are protected by a requirement that the scheme cannot be approved or continued if there are doubts as to solvency.

Where distributions are made in breach of the solvency test, section 46 provides that they may be recovered from shareholders, except where they have acted in good faith and altered their position in reliance on the distribution. To the extent of shortfall in recovery from shareholders, they can be recovered from directors if the procedural requirements were breached or the directors had no reasonable grounds for being satisfied as to the solvency test.

Section 48 replaces the rule that a subsidiary may not hold shares in its holding company. The present rule is easily circumvented and fails to achieve the intended goal of preventing circular holdings through which assets can be stripped to the detriment of shareholders in either company. In this section, it is the company which is prohibited from taking steps to acquire cross-holdings where the solvency test would not be met, not the directors. Each director owes a duty to the company of which he or she is director to take reasonable steps to
ensure compliance with the cross-holding rule. The limiting of the directors' responsibility to taking reasonable steps is deliberate to ensure that inadvertent infringement through low levels of cross-holding will not impose liability. At such levels, no steps would reasonably be required to check solvency. But the larger the transaction in relation to the company concerned, the greater the steps that ought to be taken. This is therefore a duty which increases with the magnitude of the transaction. Where the directors have not taken reasonable steps, they will be personally liable.

408 Section 49 is an important policy departure from the existing law.

409 The principle that a company cannot hold its own shares was established in Trevor v Whitworth [1887] 12 App Cas 409. Statutory exemptions are provided under the current legislation in relation to redeemable shares.

410 There are two reasons for refusing to permit a company to buy its own shares. The first is that the repurchase is a distribution of wealth to shareholders which may prejudice creditors. The second is that the power to repurchase can be used to prejudice shareholder interests. Share repurchase has long been permitted in the United States and has been allowed in Canada since the implementation of the Dickerson Committee reforms. It is permitted in the United Kingdom, subject to elaborate safeguards, and there are proposals for reform in Australia which would permit repurchase including a Federal Bill introduced in 1988 following a report of the Company and Securities Law Review Committee to the Ministerial Council in September 1987.

411 We have taken the view that creditors are sufficiently protected from the dangers of share repurchase by treating repurchase as a distribution subject to the solvency test. That test, as is explained above at paragraph 333, is designed as a significant check upon distributions in cases where there is doubt as to solvency. The requirement that the realisable net worth of the company is used for the "balance sheet" limb of the test should ensure close review of the company's financial position before a repurchase decision is made if the directors are not to be personally at risk.
412 The more difficult problem in permitting share repurchase has been the provision of a system which protects shareholders.

413 Shareholders may be at risk if the power is used
   • to discriminate amongst shareholders by selective purchase
   • for insider trading, the company being the ultimate “insider”
   • to manipulate the market price of the shares
   • to manipulate company control
   • to pay “green-mail” or as a defence to a takeover.

414 On the other hand, permitting companies to purchase their shares gives them more flexibility to organise their capital, enables easier exit for dissentient shareholders or, in cases where there is no ready or appropriate buyer for shares (particularly in closely-held companies), may represent in many cases a prudent investment and in others may be a sensible way to return surplus resources to shareholders. And, as has been noted by the Australian Committee in respect of that country, New Zealand companies competing with companies from other jurisdictions which permit repurchase may be at a disadvantage if that tool is not available to them.

415 Both the United Kingdom legislation and the Australian law reform proposals rely upon procedural safeguards, involving shareholder approval, sunset provisions and limits upon the extent of the repurchase permitted.

416 We have considered both the Australian bill and the Report which preceded it. The bill departs from the Report in a number of respects. It has been much criticised in Australia.

417 In the discussion paper, we indicated a preference for the North American approach to repurchase which, instead of imposing procedural impediments and requiring shareholder participation, relies substantially upon the general fiduciary duties of directors.

418 The reaction we had to the discussion paper proposal was generally in favour of the Canadian approach.
419 Our own policy conclusions (as to which see, for example, paragraphs 196–213) do not favour the use of the general meeting as a safeguard against the abuse of shareholder interest and we do not like the complexity of the United Kingdom Act or the proposed Australian Bill. Our solution therefore is closer to the North American model, although we have proposed what we consider to be some important safeguards. Where the solvency test is met, shares can be purchased if the repurchase offer is pro rata to all shareholders.

420 Shares can be repurchased selectively where all the shareholders consent.

421 Shares can be repurchased selectively in other circumstances only where

* the constitution permits selective repurchase and
* the procedure set out in section 51 is followed.

422 Section 51 requires the directors to resolve that the selective acquisition is in the interests not only of the company (in application of the fundamental duty of directors) but is of benefit to the remaining shareholders and in terms which are fair and reasonable to them. Before the offer is made, disclosure must be given to shareholders who will have 10 working days to apply to the Court for an order restraining the acquisition. The terms of the disclosure are covered by section 52.

423 Shareholders selling to the company are protected from the company making use of inside information to achieve an unfair price, by the provisions of section 50 (2) (c). Section 53 requires cancellation of shares repurchased. This avoids the complication of "treasury" shares; but where the constitution is not affected, the share can be re-issued without the need to comply with sections 33 and 34. Pre-emptive rights and restrictions on issue will still apply.

424 These safeguards should ensure that the interests of non-participating shareholders are sufficiently protected without imposing too much procedural complexity.

425 Redemption of shares at the option of the company is treated by section 55 as a repurchase. Redemption at the option of the shareholder, or on a fixed date, converts the shareholder into an ordinary unsecured creditor on the date of redemption,
but the sum payable may be recovered if the solvency test was breached at the time payment was made.

426 Associated with the relaxation of the restriction on share repurchase, is the *section 58* relaxation of section 62 of the Companies Act 1955, which makes it unlawful for the company to give financial assistance for the purpose of the purchase of its own shares.

427 Again, we have considered that creditor protection is sufficiently met by the imposition of a solvency test. Shareholder protection is provided by the requirement that financial assistance can only be given if considered by the board to be in the best interests of the company and of benefit to shareholders not receiving the assistance, and is fair and reasonable to them.

428 While the restriction on providing financial assistance is lifted under the draft Act, the concerns that prompted section 62 of the 1955 Act are still reflected in the provisions made in the draft at sections 58 and 59. The procedure to be followed is similar to that required on repurchase. The directors must put information before the shareholders who may apply to the Court to restrain the assistance. That information includes certification by the directors that the giving of financial assistance is in the best interests of the company and is of benefit to those shareholders not receiving the assistance and the terms and conditions of the assistance are fair and reasonable to those shareholders not receiving the assistance.

429 The draft Act extends the present exemption for financial assistance by lending institutions to all transactions which are in the normal course of business and subject to usual terms and conditions and in which the company receives fair value. The scope of the section is extremely wide. In the United Kingdom the words "in connection with" have been dropped. We prefer to retain them so that avoidance of the section is more difficult, but think it realistic to exempt unexceptional business transactions where fair value for the company is obtained so that uncertainty is restricted. But the present exemption in section 62 of the 1955 Act for employee share purchase schemes has been dropped. We consider the employee share purchase exemption has proved to be open to serious abuse and is not
warranted. Financial assistance can still be given to such schemes, subject to the essential safeguards in the draft Act.

430 Shareholders and creditors will have an opportunity to restrain the giving of assistance and directors will be liable where they act without reasonable grounds for believing that the transaction is in the best interests of the company and benefits existing shareholders. Shareholders affected can apply to the court for relief under section 135.

431 Section 61 makes it clear that a contract in contravention of the financial assistance provisions is not for that reason invalid although the court will have wide remedial powers under section 135. The contract may be enforced by the company or a lender for value in good faith without notice of the contravention, without affecting the liability of any person for loss suffered as a result. This strikes what we consider to be a practical result and removes much commercial uncertainty from the present operation of section 62. The liability of any person as a constructive trustee is not affected and the transaction itself will not be invalid.

432 Section 62 provides for a statement of shareholder rights. These statements are intended to replace the share certificates required by section 90 of the 1955 Act. At present, share certificates are prima facie evidence of the title of members to the shares. The draft Act provides instead for a document which is not a title document at all but simply provides information to the shareholder. No person other than the shareholder is entitled to rely on the statement (section 62 (3)). Specific provision is made under section 71 for share certificates for security purposes. The certificates issued under that section are not evidence of title, in the manner of the 1955 share certificates, but are analogous to a caveat on the register: while share certificates are outstanding, no transfers of shares covered by them can be registered.

433 In the discussion paper, we suggested that the share certificate was devised in a more leisurely age and observed that the existing legislation predates modern recording methods. They are not usually issued by private companies.
Transfer of shares is dealt with in section 63. The methods of share transfer for listed companies have recently been considered by the Committee of Inquiry into the Sharemarket. It viewed the statutory requirements of share certificates and the legal requirements for transfers of shares to be signed by transferor and transferee as barriers to improved operational efficiency of the share market, which should be removed. We have been concerned to ensure that our proposals do not cut across sensible options for further reform, while they meet the objective of providing a reliable system for accurately recording share ownership and the rights and liabilities attaching to shares. Such a system requires a permanent record which is accessible and continuous, and safe methods of updating the information.

The provisions of the draft Act

- impose on the company the responsibility to keep complete accurate and up to date records of shares issued, their ownership and the rights attaching to them

- require the company to provide realistic access to the information by providing, on request, statements of shareholder rights and by maintaining registers available for inspection.

Statements of shareholder rights are more informative to a shareholder than share certificates because they explain the shareholder’s entitlements and relative position in the share structure of the company.

Under section 71 share certificates can be obtained where required to be pledged as security for a loan. This section represents a halfway house until the whole question of securities transfers is reviewed. One of the options that will then need to be considered is whether New Zealand should introduce a comprehensive system similar to the United States Uniform Commercial Code, Article 8. That sort of inquiry goes far beyond the scope of the review of the Companies Act 1955.

It is common practice in New Zealand for lending institutions to require share certificates to be deposited as security for loans. If there is a need for share certificates to be used in this way, then we think it can be accommodated without
requiring the company to have a register of interests or issuing certificates which represent, or are evidence of title to, shares. Under the proposals, where a share certificate is issued, the company will not be able to register a transfer until it is produced.

439 Transfer of shares is effected by registration. No share certificate is required to effect transfer, simply a form of transfer signed by the owner and the transferee. The Committee of Inquiry into the Sharemarket questioned the need for transfers to be signed by transferor and transferee. Some formal requirement is, however, necessary in a system where legal ownership derives from registration and may entail the imposition of liability. Although the matter will obviously have to be considered further in the review of the Stock Exchange and the Securities Act, it seems to us that the special needs of the Stock Exchange can be dealt with by trust arrangements without affecting the underlying company registration system which confers legal title.

440 The transferee is required to sign a share transfer so that any liabilities attached to the shares are not imposed on unsuspecting transferees.

441 Under section 63, the board is required to register transfers forthwith, unless the board is permitted by the Act or the constitution to refuse or delay transfer. Where transfer is refused or delayed, the board must give the reasons in full. The Act permits refusal or delay where sums are due in respect of shares sought to be transferred; the constitution of a company may permit the board to refuse or delay transfer in a number of circumstances, and in the case of closely-held companies may prohibit transfer without unanimous shareholder agreement altogether.

442 Under the standard constitution contained in the draft Act, the owner of a share has the right to transfer it. This was the position at common law (*Re Smith Knight* (1868) 4 Ch App 20), but has been seriously eroded by a common provision in the articles of association giving the directors a discretion to refuse registration of share transfer.
The power to refuse registration of transfer has provoked a great deal of litigation. If the directors refuse to register a transfer, the vendor of the shares is regarded in law as the trustee for the purchaser. Upon a successful challenge to the directors' discretion, rectification of the share register will be ordered under section 124 of the Companies Act 1955.

The power to refuse registration of transfer must be exercised in good faith and for proper purpose in the best interests of the company. This, of course, is the general fiduciary duty of directors in exercising any of their powers. Such powers have been strictly construed against the directors in recognition of the importance of transferability to the purposes of company law and the principle of shareholder control of director management.

In Australia, section 186 of the Companies Code permits a Court to make any order it thinks fit where registration has been refused without just cause. Although the practical operation of this section is as yet unclear, it has been argued that section 186 requires the directors to disclose reasons as well as the grounds for refusal (Ford, Principles of Company Law, (4th ed) 1986, p 220).

In the United States, the common law requires all restrictions on transfer to be reasonable. What is reasonable will depend upon all the circumstances of the case, including the size of the corporation, the degree of the restraint and the time the restriction is to continue in effect. The Model Business Corporations Act requires any restriction on transferability to be noted conspicuously on the share certificate.

Under the Canada Business Corporations Act, any restriction on transfer must also be conspicuously noted on the share certificates. There is no requirement that the restriction be reasonable.

The Macarthur Committee noted that the power to refuse registration, though subject to abuse, was firmly entrenched in New Zealand and was in some cases justified. It recommended no change to the existing law, noting that as between transferor and transferee, the transferees could protect themselves by making the sale conditional upon registration.
Section 63 (5) permits the board of directors to refuse registration of transfer where sums are owing in respect of shares. This is required to protect the company.

Apart from that exception, the policy of the draft Act is against restrictions on share transfer because of the scope it gives for management abuse (particularly to frustrate changes in control of the company) and because it undermines a concept central to the utility of the company form and to shareholder control, through the power to sell. We have therefore adapted from the Australian and United States systems the requirement to give reasons. The power to refuse transfer can only be used where specifically conferred and for the purposes specified. It will, of course, be subject to the general fundamental duties of directors to act in the best interests of the company and in good faith. The statement of shareholder rights must contain a warning of restrictions on transfer imposed by the constitution.

The share register determines legal title. The company is entitled to rely upon it in treating the registered owner as the person entitled to vote, receive dividends and so on. The share register is not, of course, evidence of beneficial entitlement.

The draft Act makes no provision for bearer shares or share warrants. These are provided for by section 93 of the 1955 Act. The Macarthur Committee regarded section 93 as "an obsolete provision". It noted that share warrants have been abolished in Australia and have been criticised in other jurisdictions. We propose their abolition here. They are open to abuse and indeed are an obvious device to avoid recent amendments to the Securities Act designed to discourage nominee shareholding.

Section 68 of the draft Act is an important provision. It makes each director responsible for taking reasonable steps to ensure that the share register is properly kept and that share transfers are promptly entered on the register. This duty gives rise to personal liability to shareholders and the Court is given power pursuant to section 69 to rectify the share register and to provide for compensation. Compensation may be payable at Court order not only by the company but by the directors. This changes the existing provisions.
454 Section 70 carries on the provision currently to be found in the present Act that trusts are not to be entered on the register. The exceptions to it, which in the 1955 Act appear as sections 125A and 125B, now appear in the draft Act under “Liability of Shareholders” as sections 74 and 75.

455 Section 71 sets out a mechanism for the use of shares as security. Where a certificate is issued for these purposes, the shares may then not be transferred without the certificate, or evidence of its loss or destruction, being produced, accompanied by an indemnity to the company.
PART 6
Shareholders and their Rights and Obligations

456 This part of the draft Act draws together the provisions setting out the rights and obligations of shareholders. It covers
- definition of shareholders
- liability of shareholders
- powers reserved to shareholders
- minority buy-out rights
- interest groups
- meetings of shareholders.

457 The position of shareholders in the policy scheme of the Act is discussed above in paragraphs 196–213.

458 Shareholders are defined by section 72 as those who are either named in the constitution as shareholders or who are registered on the share register.

459 Section 73 is crucial to the scheme of the Act. It limits the shareholder’s liability to that expressly provided for in the constitution. The shareholder is not liable for any obligations of the company simply by being a shareholder.

460 The draft Act is flexible enough to allow companies to achieve no-liability or the position of companies now limited by guarantee.
An exception to the general limitation is made in the case of any distributions made in breach of the solvency test, which are recoverable under section 46.

Section 73 (4) makes it clear that a person who enters into a contract with a company for the issue of shares remains liable on that contract even if he or she parts with the shares. The person who acquires the shares does not become liable on the contract. Conversely, where a share carries a liability (for example, for calls), that liability attaches to the holder for the time being, and prior holders escape liability whether or not the liability arose while they were shareholders. It should be noted that the company can prevent a holder of a share in respect of which a liability has arisen from escaping liability by transferring the share, because section 63 permits the board to refuse or delay registration of a transfer where there is an outstanding liability.

The provisions of section 73 recognise the liability of shareholders under section 80 (where they exercise directors' powers).

Sections 74 and 75 simplify and extend the reform recommended by the Macarthur Committee and introduced in sections 125A and 125B of the 1955 Act in 1982. Instead of trustees and assignees being registered as such, the liability of trustees and assignees is in all cases limited to the assets held by them as trustee or assignee. This means that where a shareholder with limited assets dies, his or her personal representative does not become liable beyond the assets held as trustee for the deceased shareholder. Similarly, where a shareholder becomes bankrupt, the assignee is liable to the company only for the funds held by him or her on behalf of the bankrupt shareholder. In this way the company does not gain a windfall, and personal representatives and assignees are spared an unfair burden.

Sections 77 and 78 carry on the existing distinction between ordinary resolutions and special resolutions.

Special resolutions are required by the standard constitution contained in the Act (section 78).
to approve any alteration to the constitution (including a reconstruction of the company)

to approve a major transaction

to approve an amalgamation

to approve the liquidation of the company.

467 Decisions made by special resolution can be rescinded only by special resolution, otherwise the company remains bound by them.

468 Section 79 is new. Since the Act confers exclusive powers of management on the directors of the company (subject to explicit variation by the constitution), it is arguable that shareholders do not have any rights in general meeting to pass resolutions affecting the management of the company. We think they should and that they should be able to call management to account. Such resolutions will, of course, under the standard constitution not be binding on the directors but their persuasive and monitory effect may be considerable. Section 79 makes it explicit that any shareholder can discuss the management of a company at a general meeting and can vote on non-binding resolutions relating to the management of the company.

469 Section 80 is new and gives effect to the policy discussed in paragraph 211. Shareholders exercising the proprietary rights presumptively given to them by the draft Act may act in their own interests. But where the constitution of the company confers powers of management or other directors’ powers upon shareholders, they are subject to the directors’ duties contained in sections 101 to 107.

470 Section 81 confers the minority buy-out rights which are another important new feature in the draft Act. Their place is described in paragraphs 202–207 above.

471 Buy-out rights are available to shareholders who voted against alterations to the constitution affecting the shareholders’ rights, and fundamental changes to the company (through amalgamation, transactions involving major assets or removal of restrictions on company powers).
In Canada and the United States, buy-out provisions are the subject of lengthy procedures for appraisal. In the draft Act, the procedure provided is more straightforward.

A minority shareholder may require his or her shares to be purchased by the company. The board must either then purchase them, arrange for their purchase by another buyer, obtain exemption from buy-out from the Court, or have the special resolution rescinded.

Disputes about buy-out purchase price are resolved by arbitration. The company has to nominate a price it considers to be fair and reasonable. If that is not acceptable, the matter is referred, with strict time limits, to arbitration. The price nominated by the company must be paid on an interim basis to the shareholder at the time the matter is referred to arbitration.

Where a third party is introduced as purchaser by the company, the same provisions apply except that the company remains obliged to indemnify the shareholder if the intended purchaser fails to pay for the shares (section 84 (3)).

A company may seek exemption from buy-out on the grounds set out in section 85, and must seek an exemption if the board considers that the purchase would render the company insolvent, under section 86. Where either section is invoked, the Court can adjust the rights of the company, the majority shareholders and the minority shareholders to achieve a fair result.

Section 87 is an important departure from the 1955 Act. In the first place, the groups which vote on alteration of rights attached to shares are interest groups, rather than classes. That means that where two or more classes have identical rights in relation to a matter affected by a proposal, they vote together, rather than separately. Voting groups will often be larger than one class.

Sections 87 and 88 also make it clear that the interests which give rise to the voting groups are interests arising directly out of shares. Shareholder identity of interest which is not directly derived from shares is not relevant. This removes some doubt in New Zealand arising from recent case law.
479 We consider that requiring interest group vote on parti-
cular issues rather than class vote is logical. It does mean that
members of particular classes may have less control over a
company decision but this is compensated for by their right to
buy-out, which may be a more effective brake on alteration of
shareholder rights than any voting requirement.

480 It has seemed to us that the issue of whether or not a
particular action should be pursued by the company, where
shareholder vote is required, is more appropriately dealt with
by vote of all shareholders affected than on the basis of classes
which may have no real relevance to determination of the
particular issue.

481 A further change is that in the existing legislation under
the present Act class rights approval procedure can be modified
or excluded. Under the draft Act it cannot. The essential rights
attaching to shares cannot be altered without interest group
approval and by special resolution of that interest group.

482 A further significant change is to be found in section
88(3) which abrogates the distinction established by case law
between action which affects rights, and action which merely
affects the enjoyment of those rights. (See, for example, Green-
halgh v Arderne Cinemas Ltd [1946] 1 All ER 512; White v
Bristol Aeroplane Co [1953] Ch 65.) In the draft Act, dilution
of voting or distribution rights is deemed to affect the rights
attached to existing shares, unless such dilution is expressly
authorised by the constitution so that the shareholders bought
in that knowledge.

483 Section 88(4) confers buy-out rights on shareholders in
the context of interest group voting.

484 Section 89 deals with the consequences of the failure to
seek interest group approval. Invalidity is not automatic, but
the conduct is deemed to be unfairly prejudicial to the mem-
bers of the interest group and the Court has wide powers to
adjust the matter.

485 Section 90 deals with annual meetings of shareholders. It
alters the existing law. All shareholders, whatever class of
shares they hold, are entitled to attend the annual meeting, and
so to receive notice of it and to receive the annual report of the
company. That does not mean that they have any particular voting rights, however.

486 Section 91 sets out the manner in which meetings to exercise shareholder powers may be called. The present provisions are changed to require a request by 50 percent of the shareholders entitled to vote rather than 10 percent of a fixed number which is wholly arbitrary. Any shareholder can apply to the Court where there is cause to call a meeting (section 93; and see discussion in paragraph 201 above).

487 Section 92 permits a resolution in lieu of a meeting where the resolution is signed by all shareholders entitled to vote at the meeting. This is designed to enable closely-held companies or single shareholder companies to operate with a minimum of formality.

488 Section 93 provides a procedure for the Court to call meetings where it is impracticable for shareholders to do so. A new provision permits the Court on the application of a director, shareholder or creditor to make an order calling a meeting if it is in the interests of the company to do so. This provision in part is designed to make sure that shareholders unable to obtain the support of 5 percent of the shareholders for the calling of a meeting in circumstances where it is desirable to do so can seek the assistance of the Court.

489 Section 94 is mandatory. It applies a regime for shareholder meetings set out in the First Schedule.

490 Section 95 does away with the present system by which the share register is closed before a meeting of the company. It seems to us wholly unnecessary for the register to be closed and instead we have provided a system for the fixing of a date at which the shareholders entitled to vote will be determined.
PART 7

Directors and their Powers and Duties

491 The place of the directors in the scheme of the Act has already been discussed in paragraphs 184–195 above.

492 Directors are defined in section 96 as the persons occupying the position, by whatever name called. This adopts the existing provision of the 1955 Act. The section contains other definitions to be used in particular contexts. Section 96(1)(b) adopts the provision currently to be found in section 2 of the 1955 Act. Where the entire board is controlled, the person controlling the board is deemed to be a director. Subparagraphs (c) and (d) are new. Delegates are treated as directors for the purposes of the liability sections of the draft Act. In the case of use of company information or opportunity and insider trading, the person who controls a single director of the board and an employee receiving confidential information, is treated for the purposes of liability as if a director.

493 The treatment of a nominating shareholder as if he or she were a director for the purpose of use of company confidential information and insider trading is extremely important in the scheme of the Act. It is designed to face up to the real problem caused by nominee directors. The nominee director is permitted to pass on confidential information to his or her nominating shareholder if so authorised by the company constitution,
but the use of that information by the nominating shareholder is restricted in the same manner as if it were used by the director. That is to say, duties of loyalty and good faith will be imposed upon nominating shareholders because they derive information through the director they control.

494 In situations where we see shareholder interest as being particularly at risk, the draft Act requires directors to certify compliance with the Act. This has the advantage of providing a formal focus for director determination and in resolving problems of proof where director action is challenged. They are a significant feature of the draft Act.

495 Section 97 recognises the reality that, although duties are imposed upon individual directors, powers will normally be exercised by the board as a whole.

496 Section 98 is a pivotal section in the scheme of the Act. It confers the power of management directly upon the directors, rather than derivatively from the shareholders through the memorandum and articles (as is the present position), except to the extent that the constitution of the company provides otherwise.

497 Transactions entered into by the directors in exercise of their power of management are subject to the general duties set out in sections 101 to 107. The fundamental duty to act in the best interests of the company means that transactions entered into by the directors must be of adequate benefit to the company. That will apply to both transactions for value and ex gratia payments, such as charitable donations. It is clear that the company has the capacity to make donations (see paragraph 348 above) but the directors' powers are not unlimited. They are subject to the constraint of the best interests of the company and benefit to existing shareholders.

498 Under section 99, the directors' general powers of management are restricted in the case of major transactions, where shareholder approval and dissentient rights are provided for unless the constitution of the company expressly provides otherwise. A "major transaction" is defined to mean the sale or acquisition of assets equivalent to the greater part of the company's undertaking before the acquisition takes place.
499 The provision is based on the view that some dealings have such far-reaching effects that they should be referred to shareholders. Shareholders should not find that massive transactions have transformed the company they invested in without warning. Clearly, unless the constitution of a company restricts its activities, all shareholders will have to accept a large measure of change. Normally that may be achieved over some time, permitting the shareholder who does not like the direction the company is taking to leave or to exercise his rights to call management to account. What we are concerned about is abrupt and substantial change which transforms the nature of the enterprise. We think that recent experience in New Zealand has demonstrated that such transformation is a problem that should be faced up to and that it has often operated to the detriment of the company and the shareholders.

500 A further reason which has weighed with us in proposing this change is the use of management powers to buy and sell company assets as a defence in takeovers. A "poison pill" involving the sale of the greater part of the undertaking of the company or acquisition of assets which would transform the company will have to go to shareholders for their approval. The section applies to contingent and conditional agreements.

501 We have considered whether the definition of major transaction should be set at a lower level than a transaction affecting the greater part of the undertaking of the company. In particular, some of us and those we have consulted would prefer to see the level set at 20 percent of the assets comprising the undertaking of the company. Any level is to a certain extent arbitrary. In the end, we have concluded that there are substantial difficulties in arriving at a satisfactory definition if a percentage formula is used. Moreover, setting the level at a figure lower than 50 percent may impede company activity unacceptably, particularly given the impact not only of the delay in obtaining shareholder approval but also affect the buy-out rights which are triggered by the substantial transaction provisions.

502 We have considered whether the substantial transaction provision should be subject to an exemption for transactions "in the ordinary course of business". We have concluded that
they should not because of the imprecision of such a test and the possibilities of abuse. We are of the view that if a transaction is of such a magnitude that it would be caught by section 99, the section should apply and shareholders be given an opportunity to determine it, whether or not it can be said to be in the ordinary course of business. A property speculating company, for example, with all its assets in one property, should not be able to sell that property without reference to the shareholders.

503 Section 100 is new in that it reserves to the board powers which may not be delegated. All other powers may be delegated but the section makes it clear that the board is not absolved from responsibility by delegating its duties unless it supervises the delegate, and has reason to believe that delegates will exercise the powers delegated in conformity with the directors’ duties.

504 The hierarchy of responsibilities imposed upon directors under sections 101 to 107 has been discussed above at paragraphs 184–196. They are largely new (although the 1955 Act contains an equivalent to the responsibility set out in section 105 for trading while insolvent). The draft Act attempts to draw together all the duties at present found either in the common law or scattered in disparate parts of the 1955 Act (for example, the existing section 209 and section 320).

505 Collecting the duties together has the additional advantage of permitting them to be assessed for consistency. Directors must of necessity be entrusted with wide discretionary powers. Where they have competing responsibilities, accountability becomes extremely difficult: one interest can be played off against another. The draft Act sets up a hierarchy which subordinates duty to competing interests to the directors’ duty to act in the best interests of the company. This hierarchy, it should be emphasised, is in the context of company law only. It does not preclude the imposition of direct and overriding obligations to other interests through other Acts.

506 Section 101 recognises as the fundamental duty of every director the fiduciary duties imposed by the common law.
In addition to duties of good faith and reasonable belief in the best interests of the company, the case law frequently has recourse to the concept of “proper purpose”. The concept of proper purpose was originally derived from the case law on powers and today arguably there is a lack of underpinning objects against which the powers could be assessed. On the other hand, recent cases seem to use “proper purpose” to impose an objective standard where the good faith of directors is accepted.

We are not purporting to alter the common law and some of us have had some misgivings about dropping reference to “proper purpose” from the statute. In the end, however, we have concluded that specific reference is not necessary. “Proper purpose” has been used in modern cases where powers are exercised by directors to defeat shareholders’ proprietary interests—in particular, the powers to issue shares and to refuse transfer of shares. We have faced up to these areas of concern directly by imposing duties upon directors in the interests of existing shareholders. An objective element has been introduced into the fundamental duty by requiring that the belief that action is in the best interests of the company must be “on reasonable grounds”.

“Good faith” is an equitable concept which requires more than “honesty”. Dishonesty is a matter for the general criminal law, which is one of the reasons why the draft Act does not (as the Australian Act does) back up directors’ duties by criminal sanction. Another reason, of course, to avoid relying on the criminal law as the principal sanction is that it makes investigations more prolonged and difficult by raising the standard.

Section 102 is new and states positively the duty negatively expressed in section 209 of the 1955 Act, which provides a remedy where a shareholder is treated in a way “oppressive, unfairly discriminatory, or unfairly prejudicial”.

The duty is expressly made subject to the fundamental duty to act in the best interests of the company. Where the duties clash, and the fundamental duty prevails, an affected shareholder can still apply to the Court for relief under the
minority oppression provision. In those circumstances, however, the directors will not be in breach of their duties.

512 The wording of section 102 is also designed to underscore an important policy determination in the draft Act: "the company" is the enterprise itself and may be contrasted with "existing shareholders".

513 Section 103 permits the directors to take into account the interests of creditors and employees. It operates both to empower and to limit because the section is expressly subject to section 101. It is permissive only and therefore would not permit an extension of dicta in recent cases which suggest that the directors owe fiduciary duties directly to creditors (see paragraph 220).

514 Section 104 is made necessary by the removal of section 34 of the 1955 Act. It makes it clear that directors must comply with the constitution and the Act and they may be liable if they act or agree to the company acting in a manner that contravenes either.

515 Section 105 is a restatement of the duty currently to be found in the winding up provisions of the 1955 Act at section 320. We have thought it more helpful to include the duty in the part of the Act relating to directors because it applies to actions taken before insolvency, even though the director may not be held liable until after insolvency.

516 In the course of restating the liability of directors for reckless trading as part of their general duties during a company's life, we have concluded that section 320 goes too far towards inhibiting the use of the company form as the vehicle for the taking of business risk. A company may be legitimately formed to embark on a speculative or very risky venture, or may undertake such a venture later. The chance of failure—and the prize for success—may be high. Indeed success may greatly benefit the community. Section 2 of the draft Act recognises this as an important function of the limited liability company. Section 105 of the draft Act therefore imposes personal liability only—where the directors have "unreasonably" risked insolvency. That will depend on the circumstances.
517 The duties of directors under section 105 are owed to the company. Section 105 describes a minimum standard. After that standard has been met, the directors may take into account the interests of creditors in exercising their functions so long as it is consistent with their fundamental duty to the company and to shareholders' interests.

518 Creditors under the draft Act have standing to restrain proposed action by directors which is in breach of the Act or the company constitution. But they will not have standing to enforce liability for breach. The duties are still owed to the company and can, before insolvency, be enforced only by the company, or shareholders suing derivatively. After insolvency, they are enforceable by the liquidator. Permitting creditors to have standing to recover loss from directors would undermine the statutory system of liquidation and dilute director accountability by upsetting the hierarchy of responsibility imposed by the draft Act.

519 *Section 106* sets out the standard of care required of directors. It is an attempt to overcome deficiencies in the common law by imposing duties of diligence and skill. Those duties are to be measured against what can reasonably be expected of a director acting in like circumstances. We have concluded that some objective measure is necessary, which is why we have not based the duty on what may reasonably be expected of a "like person" but rather a "director". We think it is reasonable to expect a certain level of competence of directors although the level of competence will vary markedly according to the nature of the enterprise.

520 *Section 107* has been a subject of considerable debate within the Law Commission. Some of us are of the view, which was expressed in Preliminary Paper No. 5, that it is unnecessary to provide that directors can rely upon reports and financial data or expert advice, because whether it is reasonable for them to have done so will always be an element in assessing the duty of care, and because it may give a misleading impression to single this circumstance out for special mention. There is a danger that directors will gain too much comfort from a provision such as this and will fail to exercise independent judgment.
In the end, however, the Commission has come to the conclusion that the provision is justified, and (in the form in which it has been drafted) desirable. Many people in the commercial community regard the law of negligence in its application to directors as uncertain, and even unfair in its tendency to review business decisions with the benefit of hindsight. We can sympathise with that view. The knowledge and expertise of directors are not boundless. They must often seek knowledge and advice from others, and indeed they would be irresponsible if they did not. They should be able to place some reliance on the reports and advice of others where it is reasonable and proper to do so. On the other hand, directors should not be able to shelter behind information and advice provided and abdicate or attenuate their responsibility for making final judgments.

The provision establishes a degree of predictability in a difficult area which is productive of disputes. Equivalent provisions are standard in Canadian and U.S. company statutes. It is only on certain conditions that directors may accept reports as correct: it also emphasises that they must have reasons for reliance, including the results of reasonable inquiry; they must still determine the issue at which the reports are directed; the reports are not simply to be rubber-stamped. The section also emphasises that there is an objective element to the reliance: the director must have “reasonable grounds” to believe the reports and the competence of those preparing them. The objective standard is one which the Courts can supervise.

The law relating to self-interested transactions at present is unsatisfactory. The policy of the draft Act in this regard is set out at paragraph 193 above.

The major purpose of the reform is to replace the application to company directors of the rule of equity which makes voidable any transaction in which a fiduciary is directly or indirectly interested, irrespective of the merits of the transaction. The replacement contained in the draft Act makes such a transaction voidable only where the transaction is not fair to the company.
The test of fairness is coupled with disclosure provisions. It may be said ultimately to derive from the rule in *Coles v Trecothick* (1804) 9 Ves Jun 234.

The fairness test is found in the United States Model Business Corporations Act, section 8.31, and in section 132(7) of the Ontario Business Corporations Act (in the latter Act it is combined with the concept of reasonableness).

The strictness of the rule at equity has meant that companies have commonly adopted articles drafted to remove altogether any civil consequences for transactions affected by conflict of interest. The legality of such articles, and in particular whether they conflict with section 204 of the 1955 Act, is a matter of some difficulty much commented on in legal journals (see, for example, J Bird, “The Permissible Scope of Articles Excluding the Duties of Company Directors” (1976) 39 MLR 394; R Gregory, “The Scope of the Companies Act, Section 205” (1982) 98 LQR 413; J E Parkinson, “The Modification of Directors’ Duties” [1981] JBL 325). We regard such provisions as undesirable and have replaced them with the statutory system set out in sections 104 to 109.

The present Act requires disclosure of interest in a transaction to a meeting of directors of a company (section 199). It has led to considerable difficulty in practice (often requiring directors to disclose to themselves or make disclosure in cases where their conflict arises out of inter-related company transactions) and operates only in relation to transactions which come to the board of directors (Gower, *Principles of Modern Company Law* (4th ed) at p 587; cf *Hely-Hutchinson v Brayhead Limited* [1968] 1 QB 549, where the English Court of Appeal assumed that the equivalent to section 199 is not so limited).

The draft Act imposes both a substantive test of fairness to the company and also disclosure to shareholders. Disclosure to directors only is inadequate because of difficulties in establishing disinterestedness. Disclosure to shareholders under the draft Act is secured in section 105 through the interests register which each company has to maintain. This requirement of an interests register is new, and the Law Commission attaches considerable importance to it. Any transaction included in the
interests register must also be included in the annual report to shareholders pursuant to section 177.

530 Transactions between the director and the company can be avoided by the company within three months of notification of the transaction to shareholders unless the company receives fair value (section 110). The onus of proof is upon the director to show that the transaction is fair, unless the transaction was entered into by the company in the ordinary course of business and on usual terms and conditions, in which case it is presumed to be fair.

531 We considered whether to exempt from the conflict of interest provisions transactions “in the ordinary course of business and on usual terms and conditions” altogether. We have come to the conclusion that such an exemption would be undesirably wide and open to abuse. We think it would be dangerous as a blanket exemption but, as a pointer to how a transaction may be shown to be fair, we think it is acceptable.

532 Where the transaction involves third parties, the onus of proving the transaction to be unfair is on the company unless the other party to the transaction knew of the conflict of interest at the time the transaction was entered into. It should be noted that we have not attempted to define “knowledge” for the purpose of this provision. We are of the view that actual knowledge would set the standard too low, and we prefer to leave the matter to be dealt with by the Courts on principles generally applicable (as to which see the analysis of Dillon L. J. in Baden, Delvaux & Lecuit v Société-General pour Favoriser le Développement du Commerce et de l'Industrie en France S.A. [1985] BCLC 258, applied in Westpac Banking Corporation v Savin [1985] 2 NZLR 41 per Richardson J at 52).

533 The reverse onus of proof strikes what the Law Commission considers to be the right balance between the strict equitable rule and the absence of civil consequences if disclosure is made (which is the effect of the present system where the articles modify the equity rule). The ability to seek to set aside the transaction is limited to three months from notification both as an incentive to make prompt disclosure and in order to limit uncertainty. Of course, where the transaction is clearly fair to the company, there is no real uncertainty.
It should be noted that the extension of the definition of directors so as to impose conflict of interest duties upon nominating shareholders, and the New Zealand practice of interlocking directorships, will mean that the rule imposed by the draft Act has quite wide effect. We think that is entirely proper because of the risk to company interest. It is a preferable alternative in a small business community such a New Zealand’s to prohibiting directors from getting into positions where there is a potential conflict of interest. And the risk to directors and to other contracting parties is answered if the substantive test of fairness is met.

Because the emphasis in the draft Act is upon disclosure to shareholders and substantive fairness, it has been made clear that interested directors can vote. We think it undesirable to encourage the use of disinterested quorums because that process will obscure the proper inquiry, which is whether the transaction is fair to the company.

Section 112 articulates a major premise upon which much law relating to fiduciary duties is based: the obligation to maintain confidential information in confidence. Section 112 also recognises the reality of the nominee director, in permitting him or her to pass on company confidential information to the appointing shareholder but only where that is disclosed in the interests register. This is an attempt to make the position of the nominee a more open one. It does not mean, of course, that the nominating shareholder is entitled to use the information for his or her own benefit: the nominating shareholder in such circumstances will be treated as a director for the purposes of use of the information and dealing with shares on the basis of confidential information (section 113). It should also be noted that employees are also covered by the section if they had confidential information.

Section 113 is new. It overrides the decision in Percival v Wright [1902] 2 Ch 421 by recognising that directors do owe duties directly to shareholders in circumstances in which they deal in shares on the basis of confidential price-sensitive information. Again, directors are not prohibited from dealing, but will have to disclose it and may be at risk if the value given is not fair in the light of the confidential information possessed.
This provision is grounded on misuse of company confidential information. It differs from the self-interested transaction in that normally the company itself will not suffer loss, only those from whom the director buys or to whom he or she sells shares will do so. The Securities Amendment Act 1988 covers similar ground, but only in relation to companies whose securities are publicly offered.

The Law Commission is of the view that use by a director of company confidential information is a direct concern of core company law, because it amounts to abuse of the position of director. The different focus of securities regulation and company regulation may suggest different solutions.

Section 113 requires director dealings in shares to be entered on the interests’ register. That means that they will also be notified in the annual report to shareholders. The Companies Amendment Act 1988 requires notification to the company of dealings by officers of the company in its shares and requires the company to keep a register of share transactions by officers. The draft Act does not contain any definition of officer or seek to regulate the conduct of officers, for reasons set out above in paragraph 287. Under section 96, any person to whom the board delegates its powers, is treated as a director for the purposes of the self-interested transaction provisions and the director dealing in shares provisions. Such a person will have his or her dealings in shares notified on the interests register. The same result is achieved in relation to employees who have confidential information. We consider these categories to provide a more useful test than the vague concept of “officer”.

Insider trading is notoriously difficult to regulate. Section 113 differs in some important respects from Part I of the Securities Amendment Act 1988. In particular, the concept of “substantial security holder” means the ambit of the draft Act is narrower than the Securities Amendment Act 1988. It places less emphasis on relationships and more on the confidentiality of the information. We have not, for example, used the concept of “substantial security holder”. We consider that in a core Companies Act which applies to all companies such sophistication is unnecessary. We have preferred a system which is more
simple and certain, even though it may not cover every problem.

542 The director who is in possession of material price-sensitive information has two options: to abstain from trading or to ensure that the person with whom he or she is dealing receives fair value.

543 **Section 114** of the Act implements the policy that each company must have at least one director but need not have any more. As such, it changes the existing law.

544 **Section 115** makes it explicit that directors cannot be corporate bodies, but must be natural persons. The liability provisions of the Act would be subverted if limited liability companies could be directors. On the other hand, through the nominee director provisions, a nominating company shareholder may be treated for the purposes of liability as though a director.

545 **Section 115** indicates those people who are disqualified from acting as directors. **Section 115** largely re-enacts section 188A of the Companies Act 1955 and, through the application of section 282 which provides for disqualification orders by the Court, section 189 of the Companies Act 1955.

546 **Section 282** provides for Court disqualification in cases of persistent failure to comply with the Companies or Securities Acts or incompetence in the performance of duties as a director. In requiring a Court order, the provisions of the draft Act do not adopt the provisions of section 189A of the Companies Act 1955. That provision was inserted into the main Act by amendment in 1988. It permits the Registrar to prohibit certain persons from managing companies and therefore would prohibit them from being directors of companies. Although this is a recent amendment, we are of the view that it is acceptably severe and that the power for the Registrar to make application to the Court provides ample protection for the public interest.

547 **Section 117(3)** provides a backstop to ensure that there is no power vacuum in the company and that the minimum requirement of the Act, that there be at least one director, is
complied with. Any shareholder or creditor may apply to the Court to appoint a director.

548 *Section 118* substantially re-enacts the existing provisions of the 1955 Act. In the discussion paper, we raised the question whether the Act should permit cumulative voting for directors. Cumulative voting is permitted in most North American jurisdictions. It facilitates minority shareholder representation at board level by allowing shareholders to vote all their shares multiplied by the number of vacancies on the board for less than the full complement of directors.

549 Responses to the discussion paper indicated some support for the system, but little enthusiasm.

550 The draft Act does not prevent a company from adopting a system of cumulative voting for directors because the method of appointment of directors is subject to the arrangements adopted in the constitution. But the default provisions for removal of directors contained in section 119, which permit removal of directors by ordinary resolution, would have to be displaced in the company constitution if a cumulative voting arrangement were to be effective.

551 In general, the Law Commission has come to the view that while cumulative voting should not be prevented, there is little demonstrated need for it in New Zealand conditions and it creates procedural complexity in appointment and removal of directors. In particular, it cuts across the general policies of the default provisions in the draft Act by

*setting up directors to represent factions of shareholders*

*providing a measure of entrenchment of directors, contrary to removal by ordinary resolution which is the default provision.*

552 For these reasons, it has not been thought desirable in the draft Act to make more elaborate provision for cumulative voting.

553 Any director of the company, subject to the constitution, may be removed by ordinary resolution pursuant to *section 119*. This represents a change to the existing system because it extends the provisions of the Act, at present only applied to
public companies, to private companies also. We have considered that it is desirable in all companies where directors have lost the confidence of a majority of shareholders for them to be able to be removed. It will, of course, always be possible for companies to entrench the position of their directors by allocation of voting rights or providing for appointment of directors in the constitution.

554 Subject to the constitution, proceedings of the board are governed by the provisions set out in the Second Schedule to the Act, pursuant to section 123. That Schedule authorises meetings by telephone and resolutions in lieu of meeting where all directors consent.

555 Section 124 deals with remuneration and other benefits for directors. This represents a departure from the existing legislation. The board may set its own remuneration and make loans and provide guarantees to directors. At present, the company is prohibited, except in the case of private companies, from making loans to or giving guarantees on behalf of directors and the remuneration of directors is fixed by the shareholders in general meeting.

556 We have thought it more sensible to impose the substantive standard that the payment or giving of a guarantee is fair to the company. In accordance with the policy of the draft Act, the duty to ensure that the remuneration is fair is imposed upon the board rather than passing the responsibility to the general meeting.

557 Remuneration and benefits to directors must be disclosed to shareholders in the interests’ register and therefore annually in the annual report. Disclosure relating to each director separately is required (section 124). That represents a change from the law which permits disclosure of the aggregate payments to directors only. A further significant change from the existing provisions is the requirement that the disclosure be of all remuneration and benefits received by the director from the company, whatever the capacity in which he or she received them. That will mean that the salaries of executive directors will have to be disclosed.
In this, we depart from the recommendations of the Macarthur Committee. Our reasons for requiring greater disclosure are that all contracts for remuneration or other benefit are transactions where there is a conflict of interest. Identification of the remuneration or benefit as directors' fees or executive salaries does not, it seems to us, alter that fact.

The standard imposed by the draft Act is one of fairness which, for its enforcement, must depend upon disclosure. We are also of the view that the remuneration of executive directors (and therefore the range of the salary scale within the company) is a matter upon which the shareholders are entitled to be informed if they are to enforce the obligations of the directors in management of the company. Remuneration disclosed under section 124 is expressly excluded from the operation of the standard conflict of interest provisions under section 108.

Section 125 is both a restatement and modification of section 204 of the 1955 Act. Section 204 prohibits any company from exempting any officer of the company from liability or indemnifying him or her against any liability. The meaning of this section is not entirely clear. Nor is its relationship with the usual provisions in the articles which purport to cut down the scope of directors' fiduciary duties in conflict of interest transactions (see paragraph 527 above).

Some of the difficulties at present surrounding section 204 are overcome by the draft Act in restating the general duties of directors in the statute. In section 125, therefore, a general prohibition against indemnity for liability or costs in proceedings is continued.

The section does permit a company, where expressly authorised to do so by its constitution, to provide indemnification or insurance in respect of proceedings by the company in which judgment is given in the directors' favour, and in any proceedings brought by other persons which do not arise out of a breach of the directors' fiduciary duties to the company.

Details of all insurance or indemnities given must be disclosed in the interests' register.
Effective enforcement of directors’ duties is hampered under the present system by

- the legal doctrine that directors’ duties, in the absence of special circumstances, are owed to the company alone and not to the shareholders (despite the recognition of the memorandum and articles as a contract)
- the procedural rule by which, in the absence of fraud or wrong-doer control of the company, a shareholder does not have standing to enforce a duty owed to the company (Foss v Harbottle (1843) 2 Hare 461)
- judicial recognition of a power in the general meeting to ratify by ordinary resolution director wrong-doing which is not fraudulent (Hogg v Cramphorn [1967] Ch 254)

This comes very close to identifying “the company” with the majority of shareholders.

- the costs of litigation
- difficulties of proof.

The draft Act contains significant changes designed to improve the remedies available to shareholders.
566 Shareholders are given rights to enforce the constitution and the Act by injunction restraining action proposed which is in breach of either (section 126).

567 Shareholders are recognised as having personal rights of action against the directors and the company wherever duties are imposed for their benefit (in the case of protection against erosion of class rights, and in the other circumstances where their proprietary interests are particularly affected, as in selective repurchase) (sections 131 and 132). Shareholders can also apply to the Court for an order requiring the directors or the company to comply with the constitution (section 131 and section 132).

568 Any shareholder, with the leave of the Court, may bring a derivative action to remedy a wrong done to the company (section 127). This provision, which is modelled on the Canadian reforms, does away with the rule in Foss v Harbottle while preserving, through Court supervision, protection against abuse.

569 Shareholder ratification is effective only to condone usurpation of powers reserved to shareholders (and where the ratification is by the majority required to exercise the original power) and is not a bar to a derivative suit authorised by the Court or a personal action (section 136).

570 A personal action may be in representative form where the Court so orders (section 133). This provision enables combination and Court control of an action, its costs and the distribution of proceeds recovered.

571 Section 128 provides that in derivative suits the Court has power to advance costs from time to time from the company.

572 The Attorney-General has standing under section 134 to take any action open to a shareholder as though a shareholder, where it is in the public interest to do so.

573 The remedy for unfair prejudice contained in the current section 209 is retained in the draft Act in section 135. This section modifies section 209 in two ways.
• it removes the present ability of a shareholder to seek relief for prejudice suffered other than as shareholder. We consider this undesirable because it does not relate to abuses arising from separation of ownership and management.

• it emphasises the diversity of orders available to the Court where it finds that shareholders have been prejudiced.

Section 135 is an extremely important section in the scheme of the draft Act. Breaches of a number of its requirements result in the action taken being deemed to be prejudicial conduct, giving the Court immediate jurisdiction to provide a remedy. Thus failure by the board to comply with the procedure of repurchase, issue, financial assistance or alteration of shareholder rights and absence of reasonable grounds for believing any matter contained in a certificate required by the Act is unfair prejudice giving the shareholder a right to seek relief. It should be noted that since the provisions infringed are for the most part procedural the Court is likely to require a shareholder to show loss or damage before granting substantive relief.

574 The draft Act seeks to overcome difficulties of proof of director wrong-doing in a number of ways. Directors must sign a certificate of compliance wherever a solvency test is imposed and wherever the Act requires adequacy of consideration or the reasons why a proposed transaction is in the best interests of the company and benefits existing shareholders. A certificate is required in the cases of share issue, distributions, repurchase of shares and financial assistance. In the case of self-dealing, the onus is upon the director to show that fair value was given.

575 Section 137 continues the present power in the Court to grant relief from liability where the director has acted honestly and reasonably and ought fairly to be excused. Section 137 requires the circumstances connected with the appointment of the director to be taken into account. And the Court can exercise its powers in advance on application of a director who believes that action may be taken against him or her.
576 Sections 138 and 139 provide for inspection of records and investigation of records. They replace sections 168 to 173 of the 1955 Act.

577 Section 138 provides a procedure for a shareholder to make written request to a company for information held by it. The company, within 10 days, must either agree to provide the information (and may require the costs of providing the information to be met) or may refuse to provide the information in which case it must give full reasons for the refusal. An aggrieved shareholder can then apply to the Court which can make such order as it thinks fit relating to the provision of the information and the use to which it can be put.

578 Section 139 permits a shareholder or creditor to apply to the Court for the appointment of a suitable person to inspect records of the company. The person appointed by the Court acts under the direction of the Court and reports to it.

579 The powers given to shareholders under section 138 and section 139 of the draft Act can also be exercised by the Attorney-General under section 134.

580 The existing New Zealand provisions for inspection at the instigation of shareholders or creditors are rarely used. It is not clear to what extent this has been due to the threshold requirements (a minimum number of shareholders or else circumstances suggesting fraud), the costs of the application or the consequences (a Court officer, reporting to the Court with further action on the initiative of the Court).

581 In the company law discussion paper, we sought comment upon the adoption of an equivalent to the Australian section 265B or, alternatively, the United States Model Business Corporation Act provision which permits all shareholders a right to inspect and copy directors' minutes and accounting records of the company, provided that the demand is made in good faith and for proper purpose. In the first place, at any rate, the intervention of the Court is not required.

582 Most of the submissions which addressed this point thought that the Model Business Corporations Act solution goes too far. On the other hand it seems to the Law Commission that the Canadian provisions, which have the sort of
threshold required under the 1955 Act, are too restrictive. The Australian solution strikes a more appropriate balance and has been the model we have used for investigations. We have not thought it desirable to specify that only an accountant or lawyer can be appointed as inspector because the Court may often consider the shareholder applying to be a suitable person to conduct the inspection (that will be particularly so in the case of small companies).

583 Court supervision of inspection is necessary to ensure that the interests of the company in maintaining confidential information held in its records are respected. The supervisory role of the Court is appropriate in what is an intrusive process.

584 The Attorney-General is given standing under these provisions because we are of the view that a public enforcement agency should be able to apply for orders under them. In accordance with our view that, until the Securities Act review is complete, the conferral of public agency powers of enforcement should be kept open, we have thought it sensible to confer the power on the Attorney-General in the meantime.

585 We consider that powers of investigation by a public agency should be limited in a core companies act to cases where the public interest is involved (when the Attorney-General will have standing) or where there are special circumstances which justify the extremely wide powers conferred under the Corporations (Investigation and Management) Act 1989 (which replaces the Companies Special Investigation Act 1958). For this reason, the draft Act does not repeat the provisions of section 9A of the Companies Act 1955.
PART 9
Administration of Companies

586 This part of the Act contains machinery provisions for the operation of the company.

587 Section 140 does away with the need for companies to have seals. This will not, of course, preclude the company from having and using one if it wants to. But section 140 sets out a simple method by which companies may enter into contracts and other obligations.

588 Sections 142 and 143 have been commented upon in relation to the reform of the constructive notice rule and the ultra vires doctrine (paragraph 347).

589 Section 144 substantially re-enacts the comprehensive reforms to the law concerning pre-incorporation contracts made in 1983 by section 42A of the Companies Act 1955. The draft Act makes it clear that these provisions operate as a code, exclude the application of the Contracts (Privity) Act 1982 and do not require recourse to the Contractual Mistakes Act 1977 as in DFC v McSherry Export Kilns Ltd (In Liquidation) (1986) 2 BCR 151.

590 The provisions relating to the company’s registered office contained in sections 145 and 146 do not substantially change the existing provisions.
591 Section 147 sets out the records to be kept at the registered office or at some other place in New Zealand by the company for inspection.

592 Since annual accounts are no longer required to be maintained on the public register, the requirement that the company keep accounting records available for inspection is of particular importance.

593 Section 150 is new and provides that the company may specify an address for service of documents other than its registered office. It recognises that there may be places more convenient than the registered office for serving documents.

594 Sections 152 to 155 provide for the service of documents upon a company and are self-explanatory.
PART 10
Accounts and Audit

595 Significant differences from the existing law are

- the dropping of Schedule 8 to the Act
- the modification of the requirement for audit so that audit is only necessary where required by any shareholder of the company.

596 We have thought it preferable not to prescribe in the Act the accounting standards to be applied. In the first place, the matter is under review by the Securities Commission, as is explicitly acknowledged in the reference to us. The report of the Securities Commission is expected shortly. In the second place, we have taken the view that the Act should define the object to which accounts should be directed, and require directors to meet that object, rather than prescribe accounting forms which may not achieve the object and which may be circumvented by compliance with form but not substance.

597 Prescription of accounting form should not, in our view, exhaust the obligation of the directors to ensure that accounts give a proper picture of the financial position of the company.

598 We have concluded that the Act should impose the test presently required by the 1955 Act. The Acts we have studied
from other jurisdictions all have similar statements. "True and fair" is almost universal.

599 The accounting provisions in the draft Act are generally equivalent to those in the 1955 Act. The draft Act, however, differs from the present provisions in using the concepts of "accounting period" and "balance date" instead of the present "financial year".

600 The financial statements of the company pursuant to section 160 must give a true and fair view of the state of affairs of the company at the balance date. The onus of establishing that financial statements comply is that of the board of the company which must also, without limiting its primary obligation, comply with any regulations made under the Act. The regulations will enable application of any standards approved, as a result of the review of accounting standards being undertaken by the Securities Commission and by the Committee of Inquiry into the Share Market. But compliance with those standards will not absolve the directors of their overriding duty to ensure that the accounts give a true and fair view.

601 It has been urged upon us that it is impossible for directors to know the financial position of the company at any time and that therefore the requirement in section 156(b) is little more than a pious hope. That conclusion is invalid. The requirement is not that directors should know the financial position at any time but that they should keep accounts from which it can be ascertained with reasonable accuracy. In the Law Commission's view that is a fundamental and basic obligation of all directors.

602 It is also the standard required by the Australian legislation and we think it would be wrong for New Zealand to resile from it.

603 Under section 158 companies are required to prepare balance sheets and profit and loss accounts and cash flow statements. The requirement for cash flow statements is new, although a similar requirement is now contained in the Securities Regulations 1983. We have concluded that a statement of cash flows is useful to shareholders in enabling them to assess
the solvency of their company and could not be more complicated for companies to produce than the profit and loss account.

604 Group accounts are provided for in sections 161 to 166 of the draft Act. The provisions generally follow the 1955 Act except that the definitions of holding company and subsidiary are amended so that a company is a subsidiary only if the holding company both controls the board and is entitled to more than 50% of the assets and earnings of the subsidiary. This reflects the actual ownership pattern of most group companies and is in our view necessary to prevent group accounts giving a misleading picture to shareholders. In particular, the control element alone without beneficial ownership should not be determinative of consolidation. We have thought it unnecessary to provide for consolidation of “in-substance” subsidiaries as a matter of basic company law because they are a sophistication that appears irrelevant to many companies. Moreover, the inclusion of the accounts of “in-substance” subsidiaries in cases where the shareholders have no beneficial interest in the assets of the subsidiary could be misleading. Again, additional standards, if thought desirable, can be imposed under the securities regime upon companies which offer securities to the public.

605 The requirement for audit is set out in section 167. Audit is necessary only if required by a shareholder in any accounting period. A director can require audit at any time as can the Court on application by any shareholder. This last provision is considered a necessary protection for directors. The requirement for shareholder request turns around the current provision for private companies (which requires unanimous resolution to dispense with audit). We are of the view that this reversal is more sensible and allows greater speed and less procedural complexity.

606 It is envisaged that in the case of companies which offer securities to the public, the Securities Act and the Stock Exchange Listing Requirements will require accounts to be audited.
607 Auditors under the draft Act are appointed by the board. They can be removed by the shareholders by ordinary resolution. This change may seem more significant than it really is. The law would reflect present practice whereby the general meeting approves auditors selected by the board. It is also considered desirable to cut down the cumbersome present system which is tied to shareholder meetings, and it would enable more prompt implementation upon a request being received (often the circumstances in which greater speed is desirable). It does not cut across the responsibility of auditors to the shareholders (described recently in Caparo Industries PLC v Dickman and others [1989] 2 W.L.R. 316) because the draft Act continues to require the auditors to report to the shareholders. In addition, we have required auditors to report to each director because in the scheme of the draft Act with its emphasis on director responsibility it may be particularly desirable for directors to receive such reports.

608 The provisions relating to qualification of auditors are generally consistent with the 1955 Act. In particular, we have not sought in this review to reassess the prohibition on bodies corporate being appointed as auditors. This is of concern to the accounting profession but raises considerations which go beyond the scope of this Report. It is allied to the question of liability.

609 Auditors may be excused liability by the Court pursuant to section 137. That section corresponds to section 468 of the 1955 Act. The concern of auditors (and others) about substantial liability in cases of professional negligence is a matter the Law Commission will address in the context of its current project on contribution in civil cases. For the time being, therefore, we consider that it is necessary to retain in the draft Act a power to excuse the liability of auditors.
Disclosure by Companies

610 The disclosure provisions contained in the draft Act have two audiences: shareholders and the public generally. The principal vehicle for shareholder information is the annual report. The contents of the report are a matter of prescription in section 177. In addition, specific disclosure is required where directors propose to take certain actions (for example, selective share repurchase). And shareholders have a right to seek information from the company.

611 Section 177 of the draft Act sets out the contents of the annual report. This section substantially changes the current Act and is an attempt to make sure that shareholders receive all possible useful information, subject only to the need to protect the company from harm. The annual report must describe any changes to the business undertaken by the company and any change in accounting policies made since the date of the previous annual report. It must include the annual accounts and entries in the interests' register since the previous annual report.

612 In a provision which is new, but follows similar provisions in other jurisdictions, section 177(1)(g) requires the disclosure of any charitable or political donations made by the company since the date of the previous annual report. We
consider that this is information which shareholders are entitled to have if they are to assess whether gratuitous disposition of company assets by the directors is consistent with the fundamental obligation to act in the best interests of the company.

613 *Section 178* implements the policy described in paragraphs 295–306 above. It requires directors of offeree companies to advise shareholders whether offers made to them are, by reason of information known to the directors by virtue of their position, clearly inadequate. At the same time, directors must disclose whether they have any direct or indirect interest in the offeror company or in the offer.

614 *Section 179* is designed as a useful collection of all specific disclosures required under the Act.

615 *Section 180* provides for the means of disclosure.

616 Disclosure to the public is disclosure through the register. In its discussion paper, the Law Commission proposed that public disclosure be limited to the matters required for identification of the company and the information required by those having legal dealings with it. As a result of consultation, we have decided that the company constitution should continue to be registered. That is mainly for reasons of safe keeping and it is specifically provided that registration of the constitution is not notice of its contents.

617 We considered dispensing altogether with the annual return. Such a return is not required, for example, in Ontario and was dismissed as a “superfluous nuisance” by the Dickerson Committee. Many jurisdictions maintain it largely to enable an annual fee to be extracted from companies.

618 We have come to the conclusion, however, that the return is a useful check on the currency of information. We envisage a shuttle return system in which the Registrar will send out a form requiring confirmation that the information maintained on the register is current.

619 On the other hand, the draft Act does not require the inclusion of annual accounts in the annual return, which is simply an update of information held on the register which relates to identification of the company and its directors.
620 Most of the submissions we received in response to Preliminary Paper No. 5 favoured abolition of the requirement because the accounts were seen as providing information of historic interest only which was no guide to the current state of health of a company for those wishing to deal with it. Some respondents, however, pointed out that the historical record was itself in many cases a useful pointer to the performance of a company over time. That point was made, in particular, by a journalist who regularly uses such accounts.

621 The Law Commission, while sympathetic to the public record argument, has concluded that the cost of requiring all companies to file annual accounts is not warranted. At present, private companies are exempt from the provision. We are proposing the abolition of private companies as a separate class. To impose the requirement upon all companies seems unnecessarily onerous. Where companies seek money from the public we expect that publication of accounts will continue to be required under the Securities Act.

622 Section 183 provides for the records that every company must keep available for public inspection. The information is also held by the Registrar with the important exception of the share register which is maintained only by the company. That is available for public inspection in the manner provided in section 185.

623 Section 184 prescribes company records which must be available for inspection by shareholders. They include, most importantly, the interests’ register of the company and all written communications (which will include the annual report and the financial disclosure required under it). Again, the manner of inspection is provided for in section 185 and any person entitled to inspect the register may require copies, on payment of a fee.
PART 12

Reconstructions and Amalgamations

624 Sections 187 to 195 of the draft Act provide a system for company reconstruction. They replace the existing sections 205 to 209. They are necessary to provide convenient machinery for merging and reconstruction, without the expense and commercial embarassment of liquidation.

625 The 1955 Act provisions cover both reconstruction affecting creditors and reconstruction affecting shareholders. The draft Act makes a distinction between compromises where the company is or may be unable to pay its debts (which are covered in Part 13) and reconstructions before insolvency, which may still affect creditors. These are covered in Part 12.

626 The provisions of the 1955 Act have the disadvantage that they require intervention of the Court in all cases. This may be necessary in the case of creditors because of the need to identify those affected and determine in an authoritative way matters such as service upon them. In most reconstructions of insolvent companies, however, Court supervision will be unnecessary although the draft Act provides it as a backstop for cases where there is difficulty in identifying the class of shareholders or the creditors affected.
627 Reconstructions which also involve a compromise with creditors must also comply with the provisions of Part 13 of the draft Act.

628 The draft Act provisions are derived mainly from North American models—the Ontario Business Corporations Act and the Delaware Corporations Act.

629 The draft Act is more detailed than the present provisions. Amalgamation can be effected by informed vote of those affected without initial recourse to the Court. To make sure that the approval is informed, the draft Act provides for the information the directors must circulate before approval is sought.

630 Section 187 requires reconstructions to be effected by amendment of the constitution, which means that, unless the constitution otherwise provides, they must be approved by a special majority and, where they affect class rights, will trigger dissentient rights.

631 Sections 188 to 194 are new and enable amalgamation of two or more companies. The directors must certify as to solvency of the company after amalgamation and must explain to shareholders the implications of the proposed amalgamation and any material interests of the directors in it. The proposal is then approved by a special majority and, where class rights are affected, will trigger dissentient rights.

632 Section 191 provides a simple amalgamation procedure, adopted from Canadian provisions, which enables the formalities of amalgamation to be avoided where the two companies are in the relationship of holding company and wholly owned subsidiary, or are both wholly owned subsidiaries of the same company.

633 Section 195 retains an equivalent provision to section 205 for cases where it is not practicable to use the specific procedures of the Act. In such cases, the Court has a supervisory role.

634 The draft Act does not retain an equivalent to section 208 of the Companies Act 1955. Minority shareholders who
are locked into a company after its reconstruction are protected by the buy-out rights available to them if they dissented from the reconstruction. Where their minority position results from a takeover, there will be buy-out rights for dissentients if class rights are affected or the takeover involves a major transaction. The draft Act does not permit compulsory buy-out in other circumstances and does not provide for the compulsory sale of the shares of a remaining minority. If it is thought desirable to retain wider powers to compel sale or purchase of shares, they should be included in takeovers legislation.
Compromises with Creditors

In the course of consultation with insolvency practitioners about possible changes to the statutory law on corporate insolvency and liquidations it became clear that compromises with creditors under section 205 of the 1955 Act are rarely attempted. The present procedure is perceived as slow, complex and expensive with an unnecessary degree of involvement by the Court. As a compromise should be a constructive alternative to liquidation of a company, the present state of affairs is most unsatisfactory. Part 13 of the draft Act is designed to provide a more useful procedure which features a greater provision of information by those proposing a compromise but limits the role of the Court to one of review on specified grounds.

In section 196 it may be noted that “compromise” is defined to include creditors’ agreement to a constitutional alteration affecting the likelihood of debt repayment by the company. The ability of a receiver to initiate a compromise (section 197(b)) is new and is a reflection of some degree of analogy between the modern role of a receiver and that of an administrator under the system of voluntary administration operating in the United Kingdom, favoured by the Australian
Law Reform Commission, and recommended in principle by the Law Commission (see paragraph 650).

637 The ability of a 75 percent majority to bind the majority of relevant creditors is retained in section 198 but is subject to notice of the proposal being given to a creditor as well as the grounds for challenge set out in section 200 (2). The details of information required in section 199 support the central theme that the compromise must be able to be properly considered by creditors affected, and opportunity afforded for other views to be made known.

638 As mentioned in the immediately preceding paragraphs, the role of the Court is quite different from that under section 205 of the 1955 Act. The fate of the compromise should rest with the voting creditors unless the information supplied or procedures followed are irregular. The “unfairly prejudicial” limb (section 200 (2) (c)) provides a residual power which will be available to prevent abuse of the new procedure.
PART 14

Liquidation

639 Legislation which establishes and governs the operations of companies must also provide for their demise. Part 14 of the proposed Act is intended to replace Parts VI and XI of the 1955 Act.

640 At present, there are five ways in which a company may be ended. The methods have different modes of commence- ment, different procedures and different consequences. We do not see any purpose or justification for this complexity. We believe that the disbanding of companies should be possible with minimum formality. Where a company is defunct, or where the shareholders or directors wish that it be disbanded, then the procedure should be rapid and simple. Where the appointment of a liquidator is desirable, however, that option is available. Liquidation can be applied to companies whether solvent or insolvent, and whether commenced by voluntary actions of the company or imposed by others.

641 We have therefore abandoned the terms “winding up”, “voluntary winding up”, “dissolution”, “members voluntary”, “creditors’ voluntary” and “striking off,” because we propose only two options—liquidation and direct removal from the register. We have used the term “liquidation” because it accurately describes the process under which a company’s assets are
liquidated, a process carried out by a liquidator. At the end of the process, it is ready for removal from the register. We have used “removal from the register” because it accurately describes the process of terminating the company’s existence whereby a company ceases to have a legal existence. It also relates to its opposite process, incorporation, by which the company is entered on the register (section 12).

642 One of the primary aims of our reforms is the simplification of the law, and this is no less critical in relation to liquidation than elsewhere. A major criticism has been the requirement that a liquidator must refer matters to the Court frequently. The draft Act would relieve the liquidator from having to do so. The Court’s involvement was, of course, a protection, and the draft Act also provides protection, but in a different way. It imposes a requirement that the liquidator be an experienced insolvency practitioner (a term which is defined), who is independent (section 217).

643 The Australian Law Reform Commission’s proposals proceed on a premise of independent and experienced insolvency practitioners being appointed as liquidators. That reflects the existence of a system of registration of insolvency practitioners in that country. No such registration exists in New Zealand and, although it is favoured by the New Zealand Society of Accountants, the Law Commission does not feel able to recommend that such a system be established. Our consultations indicated that the idea of a regulatory system was not supported by a number of leading accountants engaged in insolvency practice nor was it supported by the current New Zealand Law Society Committee on insolvency law reform. Further, the topic of occupational regulation is currently under review by other government agencies.

644 The reduced role of the Court also means that committees of inspection, which can be a substitute for the Court (section 240 of the 1955 Act), have a different role. Insolvency practitioners advised us that committees can be helpful in assisting the liquidator, and we see this as their primary function. It is recognised too, however, that the committee represents the creditors or shareholders, and therefore it is empowered to call for reports from the liquidator or call for a
meeting. This enables the committee to exercise a measure of supervision in the most effective way.

645 The second major simplification arises from the liquidation process being only one process, applicable to all liquidations. This flows from our belief that we have provided for adequate safeguards and sufficient shareholder or creditor involvement. We have therefore retained the advantages of the present court-ordered and voluntary liquidations, while shedding the disadvantages.

646 As well as seeking simplification, the Law Commission proposes several innovations. Firstly, we have endorsed the Australian Law Reform Commission’s proposal to prohibit monopoly suppliers – of electricity or telephone connections for example – from using their position to achieve an improper preference in relation to past debts by making the future supply of such services to a liquidator or a receiver (see paragraph 785) of a company dependent on payment in full of past debts incurred by the company prior to entry into liquidation or receivership.

647 Secondly, the Australian Law Reform Commission’s recommendation for the establishment of an assetless companies fund has been incorporated. This was a matter of debate within the Law Commission, but there is a recognised problem in a few cases of directors leaving a company so completely assetless that there are no funds for a liquidator to investigate and, if appropriate, pursue claims against the directors. A modest fund available for such cases is contemplated. It is also envisaged that applications to the fund be determined by experienced professionals. The funds should come from a small flat-rate levy on company annual returns. The fund should commence on a trial basis, with its future settled when the role of the Official Assignee’s office is reassessed in a general review of insolvency law.

648 Thirdly, the method of enforcement of the liquidator’s duties has been altered. Part VI of the 1955 Act includes more than a dozen penalty provisions for acts or omissions by a liquidator. We have preferred a regime that relies on a court ordering compliance with a particular duty, with the possibility of prohibition orders for serious or persistent default depriving
the liquidator of the right to practise for up to five years. This has the advantage of remedying the default, while also providing a sanction which, we suggest, is more effective than a fine.

649 The final innovation is that voidable transactions are dealt with differently. The focus at present, when a creditor receives payment in preference to others, is on the intention of the debtor company. This means that in circumstances where a creditor is preferred through no voluntary action by the debtor, for example, where a creditor is able to coerce the debtor, the transaction cannot be attacked. This leads to the unsatisfactory situation where creditors may be treated differently according to the quirks of their circumstances. The purpose of a voidable transactions regime is to avoid this, yet the present law permits it. Our proposals, which are drawn from both the Australian Law Reform Commission's Report and the submission of the New Zealand Society of Accountants, set out a test which is more straightforward to apply.

650 There are two areas where we favour change, but have not undertaken it. Firstly, the system of voluntary administration of companies, which is perhaps the most prominent feature of the Australian Law Reform Commission's proposals, does not appear in our draft Act. The Law Commission is persuaded that such a system would be valuable and should be introduced at an early date. On the other hand, it is a new procedure, which will be of relevance in only a relatively small number of situations, and could await the outcome of the Department of Justice's review of insolvency law.

651 Secondly, the Law Commission has resisted the temptation to rewrite the existing rules on preferential debts. The Australian Law Reform Commission recommended major changes in the position of such preferential debtors as employees and the revenue authorities. These are difficult and controversial matters which would apply to personal as well as corporate insolvencies and thus fall squarely within the departmental review of the law of insolvency.

652 Other, less major, changes are found in relation to claims (called proofs of debt in the 1955 Act) and powers of the liquidator.
Several matters have not been carried forward into this Part from the 1955 Act. The present provisions imposing liabilities on directors (sections 319 to 321 of the 1955 Act) have been dealt with in the provisions relating to directors’ duties (sections 101 to 105). This removes the anomaly in the 1955 Act that duties which do not exist when a company is solvent arise when it is in liquidation. Secondly, there is no “relation back” period, whereby the order of a Court for a company to be placed in liquidation relates back to the date of commencement of the liquidation, which is the date of the presentation of the petition (and there are equivalent rules for voluntary liquidations). The artificiality of such a concept is undesirable in the law, and we believe the position is adequately covered by the new voidable transactions provisions. Thirdly, we have completely removed the concept of contributories. Sections 211 to 215 of the 1955 Act are an unnecessary complication.

Our proposals will require consequential amendments to the High Court (Winding Up) Rules and the Companies (Winding Up) Rules. Other statutes which rely on the Companies Act to provide for the ending of incorporated bodies (for example, the Incorporated Societies Act) will also need to be reviewed to assess whether the draft Act is an appropriate model.

Section 201(1) provides a definition of “liquidator” to clarify that interim liquidators (discussed at paragraph 663) and Official Assignees come within the term. The definition of “Official Assignee” is a restatement in substance of section 228 of the 1955 Act.

Liquidation is a process, and section 202 states that the purpose of Part 14 is to provide for that process, which then leads to a company being removed from the register under Part 15. The section emphasises that liquidation means that a company ceases to trade, and its assets are collected, realised and distributed according to the Part. Subsection (1) is a statement of the present law.

Section 203 and following sections deal with commencement of liquidation and are the first major departure from the present law. They make the following changes.
solvent and insolvent liquidations are commenced under the same section (and subsequently dealt with in the same way)

the commencement of liquidation does not, as is the case with a court-ordered liquidation at present, pre-date the order

voluntary and insolvent liquidations, once commenced, are not distinguished
  Because the liquidation process has been simplified (discussed at paragraph 640), there is no need for three separate types.

the liquidator is appointed, and the liquidation commences, simultaneously.

658 Section 203(1)(a) provides for shareholders to resolve that the company go into liquidation. It is drawn from the present section 268(1). It departs from the voluntary winding up provisions of the 1955 Act from that point on, however, as there is no requirement for a declaration of solvency. The present declaration of solvency is a safeguard to ensure that the only liquidations with minimal supervision are those that will not affect the company's creditors. The draft Act provides one simple method of liquidation, and relies for safeguards on the experience and independence required of the insolvency practitioner (discussed at paragraph 687) and the powers of the Court (see section 220).

659 Section 203(1)(b) permits the board of directors to resolve that the company go into liquidation if the company's constitution permits or requires this (perhaps in a limited-term joint venture).

660 Section 203(1)(c) empowers the court to put a company into liquidation and appoint a liquidator. Three of the grounds appear already in section 217 of the 1955 Act, but there is the addition in section 203(1)(c)(ii) of persistent or serious failure to comply with the Act by the board. Obviously, insolvency of a company is an appropriate ground for imposing liquidation. Persistent or serious default in compliance with the Act provides an ultimate sanction in enforcing the provisions of the Act. We envisage that it will be invoked only rarely.
As the requirement for a shareholder and directors is fundamental, section 203(1)(c)(iii) makes absence of these a new ground for ordering liquidation. There is also the broad and well established “just and equitable” ground. We envisage that the existing case law on this topic (notably In re Westbourne Galleries Ltd [1973] AC 360) will continue to be applied.

Section 203(2) provides that a liquidation commences when the resolutions, agreement or court order provided for in subsection (1) are made and a liquidator is appointed. In practice, this will involve most change in relation to court-ordered liquidations. This differs from the 1955 Act, where the Official Assignee is automatically the liquidator until the first creditors’ meeting. We expect that the applicant to the Court would propose a named liquidator. In addition, we expect the Court would hold a list of liquidators who are qualified and willing to consent to appointment, and if faced with an application without a suggested liquidator, or with a liquidator unacceptable to the Court, the Court would be able to select from the list. This is a matter for administration not legislation, but we note that rosters of counsel in the court system can work quite satisfactorily. We also point out that a similar system operates informally now in relation to appointments by the Court of provisional liquidators under section 234 of the 1955 Act, and sometimes in relation to liquidators (other than Official Assignees) who are appointed at the first creditors’ meeting.

Section 204 permits the appointment of interim liquidators by the court after an application for liquidation has been made. It is a restatement of the present law but makes explicit that the basis of the appointment must be that it is necessary to preserve the value of the assets of the company. The use of “value” clarifies that the liquidator is not required to preserve assets if their value is declining; he or she may, for example, sell perishable goods, thereby preserving their value.

Section 205 brings together in one section all the provisions about the status of a company once liquidation commences. It is essentially a restatement of the present law, with additions to reflect the changed status of shareholders under
the draft Act. The section deals with the liquidator taking control of the company (see section 238 of the 1955 Act), the cessation of the directors’ powers (see section 287), the freezing and prohibition of legal proceedings against the company or its property (see sections 221, 222, 223, 226, 273 of the 1955 Act) (but note that the liquidator as well as the Court may agree to proceedings continuing; the 1955 Act leaves this solely with the Court), the freezing of the position of shareholders and a cessation of their powers and, for clarification, an explicit statement that the constitution of the company may not be altered.

665 The section also clarifies the position of a secured creditor in relation to any property of the company over which that creditor has a charge. This states existing law (that is, the creditor can take possession of and realise or otherwise deal with the property and must account for any surplus) but is included because the law is difficult to find (it is dealt with in the Insolvency Act which is imported into the Companies Act by virtue of section 309).

666 Sections 201 to 206 are intended to outline the entire process of liquidation, with the details set out in the following divisions of Part 14. Hence section 206 states the last duty of the liquidator—a final report with accounts, and a statement that the assets have been dealt with and the proceeds distributed—and ties this in with Part 15 (Removal from the New Zealand register).

667 Sections 207 to 216 concern the liquidator. They start with a general statement of the liquidator’s duties and powers. This statement of the common law is included for clarity and completeness. (The 1955 Act deals with some of these matters in sections 240 and 293).

668 The following four sections add to the general statement. They contain provisions that either impose mandatory requirements on the liquidator, or specify powers where a legislative basis is necessary (for example, to administer oaths) or where it seems preferable to state the powers for reasons of certainty.

669 Section 208 deals first with the duty of the liquidator to inform. This duty has been expanded. The liquidator must, within 10 days, advertise the commencement of the liquidation
and his or her appointment, and include a telephone number for inquiries from creditors and shareholders. The Registrar must also be notified. (See High Court Rules, R 700ZE; and section 225 of the 1955 Act). A list of known creditors must be prepared and, in a departure from the present law, the liquidator (not the directors) must prepare the statement of affairs. This subsection does not prescribe the form of the statement of affairs and a simpler statement than that now prescribed is envisaged. This does not relieve others from the duty to assist in this process (see section 209(2)), but it recognises that, at present in many cases, directors do not supply a statement of affairs, or supply an inadequate one. It is preferable that the liquidator compile reliable, if sometimes incomplete, information, and give that to creditors and shareholders rather than expend resources on obtaining a statement of affairs from difficult directors. (The expense of preparation of the statement is, of course, a cost borne by the liquidation.)

670 There is a new duty on a liquidator, when reporting on a company, to state proposals for the conduct of the liquidation, and an estimated date for its completion. This reflects the change from the court supervision of liquidators to creditor and shareholder oversight, which is aided by giving those groups full information.

671 The creditor and shareholder oversight function is further assisted under section 208(2)(b)(ii), which places a duty on the liquidator to notify them of their right to require the liquidator to call a meeting of creditors or shareholders.

672 The liquidator is required to report further at six monthly intervals until the liquidation is complete (subsection (2)(c)), when a final report is made (subsection (2)(d)).

673 Section 208(2)(f) permits disclosure of the liquidator accounts and records unless the liquidator believes this to be prejudicial to the liquidation. In that case, the Court may order disclosure to any shareholder or creditor.

674 The length of time a liquidator must retain records is prescribed in subsection (2)(g).
Section 208(2)(h) continues the present rule that documents issued by the liquidator must state that the company is in liquidation (see section 326 of the 1955 Act).

Section 209 contains a general statement of the powers of the liquidator, that is, all those necessary to carry out the liquidator's functions and duties under the Act, followed by a list of specific powers. These deal with the liquidator's ability to obtain information, and subsections (6) to (10) cover the Court's role in this process. The liquidator is empowered to require the delivery of books, records or documents of the company. This section is drawn from section 252 of the 1955 Act, but omits the need for a court order. The sanction is found in subsection (6) where the Court may order a person to comply if in default. The liquidator may also require specified people to provide information.

The section retains the present rule (section 326A of the 1955 Act) that a person may not enforce a lien over any document of a company in respect of unpaid fees. It also clarifies the situation where a liquidator needs access to documents which create a charge and are held by a secured creditor.

Subsections 209(6) to (10) provide for examination before the court and are drawn from section 262A of the 1955 Act.

Section 210 removes any doubt about whether section 207 covers calls on the grounds that a liability on a call is not an asset (see 1955 Act, section 254).

Section 211 permits the liquidator to disclaim onerous property and is a restatement of the present law (see 1955 Act, section 312).

The 1980 amendments to the 1955 Act included provisions about related companies and their joint winding up. These appear in a more concise form in section 212.

Section 213 overhauls the previous provisions relating to arrest, search and seizure (in section 264 of the 1955 Act), having regard to the Australian Law Reform Commission's
proposals. The section also incorporates requirements for disclosure of information and delivery of property to the liquidator, backed up by criminal sanctions (as in section 461B of the 1955 Act).

683 Section 215 prohibits the refusal of essential services to a liquidator. At present some suppliers of essential services (gas, electricity, water and telecommunications) are able, because of their monopoly position, to be treated as preferential creditors by demanding payment of their debt in full before continuing to provide the service. This section prevents that, and is based on the Australian Law Reform Commission's proposals.

684 Section 216 states the present law regarding the expenses of the liquidation and the liquidator's remuneration. Should the remuneration of the liquidator be thought unreasonable, the remedy is found in section 220(1)(e) and (f) where the Court can review it, and if it is found to be unreasonable, order the liquidator to make a refund.

685 Section 216 is essentially self-explanatory. The liquidator does not apply to the Court for a release, as is the case at present in relation to court-ordered liquidations, because the level of court intervention has been reduced. The liability of the liquidator for acts carried out in the course of the liquidation is governed by the provisions of the Limitation Act 1950 and the Insolvency Act 1967 (the latter imported by section 229).

686 Sections 217 to 221 cover the qualifications and supervision of the liquidator.

687 The liquidator must be an experienced insolvency practitioner, a term defined in section 217. The experience may be that gained as (or in assisting or advising) a liquidator or a receiver. In the case of joint appointments, only one of the appointees need fulfil the criterion. The Official Assignee may accept sole appointments. There are a number of specific exclusions, some taken from the present law (for example, excluding bodies corporate, some to ensure the independence of the liquidator (subsection (3)(c) and (d)) and some to mirror the provisions relating to the qualifications of directors.
Section 218(1) makes the liquidator's consent a prerequisite to appointment.

Section 219 deals with vacancies in the office of liquidator. It is drawn from the United Kingdom Insolvency Act 1986. There are only three ways the office may become vacant: if the liquidator resigns, dies, or becomes disqualified. If the liquidator does not, or cannot, appoint a replacement, the Official Assignee fills the vacuum.

The draft Act removes the requirements for frequent reporting to the Court, but it retains a considerable measure of court supervision available on application. On the most general level, section 220 retains the present ability of the liquidator to apply to the Court for directions. In place of the present mandatory audit, subsection (1)(c) and (d) makes an audit optional and subject to a court order. Another departure concerns the liquidator's remuneration. Instead of being set by the Court, the Court may review or fix the remuneration if it is challenged.

Section 221 deals with the enforcement of a liquidator's duties. If a liquidator fails to comply with a duty imposed when appointed or under the Act, then an application can be made to the Court for an order either relieving the liquidator from the duty or ordering compliance. Not only can affected parties apply to the Court, but so may the Presidents of the New Zealand Law Society and New Zealand Society of Accountants. Persistent or serious defaults may lead to an order prohibiting a person from acting as a receiver or liquidator. The defaults may be those arising from a person's appointment as a liquidator or a receiver.

Sections 222 to 224 deal with what is known now as the "section 218" procedure, and sets out the steps to follow when an application is to be made to the Court for the liquidation of a company under section 203(1)(c)(i), that is, where it is unable to pay its debts.

The principal method in practice of proving that a company is unable to pay its debts is failure to comply with a statutory demand. The requirements for a statutory demand are set out in section 223.
694 The company may apply to the Court for the demand to be set aside. This application must be made within 15 working days. The Court can set aside the application if the debt is disputed or for other specified reasons. A creditor is not delayed by the company seeking an order that the demand be set aside, however, because section 224(5)(b) provides that where an application to set aside is dismissed, the Court may authorise the creditor to make an application for the liquidation immediately.

695 Much of the procedure relating to the present "section 218" process is contained in the High Court (Winding Up) Rules, which will require consequential amendment.

696 Sections 225 to 228 cover transactions that may be set aside by the liquidator. For a transfer of property of a company to be voidable, it must be a transfer

- in relation to an antecedent debt
- while the company was insolvent
- within a year prior to liquidation
- enabling the creditor to receive more than the creditor would have received in a liquidation.

There is an exception, however, where the debt was incurred in the ordinary course of business and the transfer was made no later than 45 days after the debt was incurred. Transfers made within six months of the commencement of a liquidation are presumed to have been made while the company was insolvent and not in the ordinary course of business. Voidable charges (and set-offs: see definition of "charge" in section 3(1)) are treated in a similar manner, that is, if created to secure an antecedent debt given while the company is insolvent, they are voidable. In addition, transactions at undervalue made within a year of a liquidation may be set aside in certain circumstances. Transactions with related companies entered into in the six months before liquidation are presumed to be at undervalue. As can be seen, the emphasis is on the effect of the transfer. Any system which creates a regime rendering some transactions void has to choose between competing interests. In this case, some measure of commercial certainty is sacrificed in favour of fairness to all creditors. The procedure for setting aside voidable transactions is the same as under the 1955 Act.
Sections 229 to 240 use different terminology but in many respects follow the present law in relation to claims by creditors (called "proofs of debt" in the 1955 Act and the Insolvency Act 1967). Some additional provisions are included for clarity.

Section 229 applies bankruptcy rules in this area to claims by creditors, and is merely a redrafting of section 307 of the 1955 Act.

Section 230 describes what may constitute a claim in a liquidation, and is also a redraft of the present law.

The manner in which claims are to be made is dealt with in section 231, which contains a departure from the present law in that claims may be made without formality. It is a provision adopted from the Australian Law Reform Commission's proposals. There appears to be no advantage in requiring claims to be sworn, although a statutory declaration is an option for the liquidator.

Section 232 is of major importance. It addresses the position of secured creditors by recognising their rights and options but imposing duties as to giving of notice, except where the existence of the security is recorded on an easily searched public register. At present, many unregistered charges become void on liquidation (see section 103 of the 1955 Act) but the proposed Personal Property Securities Act would not provide for the same result. This section attempts to reconcile the needs of efficient administration of liquidation with reasonable opportunity for recognition of secured creditors' claims. In those cases where the notice period passes and the charge is deemed to have been surrendered, the position may be restored by the liquidator or the Court under subsection (11) (which follows section 90 (3) of the Insolvency Act 1967).

Section 233 tidies up an area presently not covered by legislation. It provides a rule for converting the amounts of claims not denominated in New Zealand currency.

Section 234 deals with estimates by the liquidator of claims of an uncertain amount, and repeats the present law.
found in sections 98 and 99 of the Insolvency Act. The liquidator may make an estimate or refer the matter to the Court for decision.

704 **Section 235** reverses the present law and permits fines or other monetary penalties to be the subject of claims. This reflects the Law Commission's endorsement of the Australian Law Reform Commission's discussion of and conclusion on this point (ALRC Report No 45, paragraphs 789 to 791): a fine may be seen as the making of a claim by the community and should rank with the debts due to unsecured creditors.

705 **Section 237** largely transports the current rules on mutual credit and set-off from section 93 of the Insolvency Act 1967 to the Companies Act. The actual draft draws from the work of the Australian Law Reform Commission. It clarifies the law, and overcomes the problem in the present law of the artificiality of trying to establish the equivalent of an "act of bankruptcy" in the context of a liquidation.

706 At present, creditors are not entitled to interest on their claims after the commencement of winding up. **Section 238** changes this and permits interest at a prescribed rate. This places creditors in an equivalent position to judgment creditors.

707 As discussed at paragraph 651, we have elected to leave the law on preferential claims unchanged. For convenience, however, we have listed all preferential claims in **section 239**. Other unsecured claims are governed by **section 240**.

708 **Sections 241 and 242** deal with those rights of creditors and shareholders that can be exercised through a committee of inspection. Because there is not a compulsory creditors’ meeting one month after a company goes into liquidation (as is the case under the present law), the creditors may require the liquidator to call a meeting of creditors to decide whether to appoint a committee of inspection. The same provisions apply to shareholders.

709 The committee may call for reports from the liquidator, call a meeting of shareholders or creditors, make any application to the Court which a creditor or shareholder is able to make, and assist the liquidator.
Sections 243 to 250 establish an assetless companies fund (discussed at paragraph 647). It is closely modelled on the Australian Law Reform Commission’s proposals. The provisions are self-explanatory, but there are two significant features to note. The first is that the main source of funding is a levy placed on annual return fees. Secondly, the fund is to be used to pursue matters that may result in benefit to creditors or shareholders.

In this latter respect the proposed fund would differ from the Australian proposals, in that the fund under those proposals is also to be used for paying the liquidator for carrying out the preliminary steps of a liquidation and reporting to the creditors. Because Part 15 (Removal from the New Zealand Register) permits insolvent companies to be removed directly without the necessity for a liquidation in some circumstances, the use of the fund in that way is unnecessary. It is limited therefore to matters where the liquidator needs funding for proceedings or inquiries that may result in assets being made available in the liquidation.

It is envisaged that the liquidator would be required to seek funding for each step of any process, and to report on how the money has been spent. The report should enable the supervisory board to determine whether its decision to fund a particular matter was appropriate, and hence aid decision-making on further funding applications.
PART 15

Removal of Companies from the New Zealand Register

713 Removal from the register terminates the existence of a company. Part 15 covers that termination, and sets out the procedure to be followed. It is important to note that removal under Part 15 can be the final step consequent on a liquidation or amalgamation, or it can constitute the entire process in its own right. In other words, solvent or insolvent companies may in certain circumstances without any prior steps be removed from the register directly.

714 Under the 1955 Act, a company can be removed from the register by way of an application to the Registrar (section 335A) and companies which appear to be defunct may be struck off by the Registrar (section 336). The simplicity of these procedures is desirable, but there appears to be two problems. First, it is not clear whether section 336 can, or should, be used as a process available by way of request. We are aware of different practices in this respect. Can a company, which cannot declare that it has discharged all its debts and liabilities, ask to be struck off? Secondly, if a company applies to be removed under section 335A, but the Registrar receives an objection from a director, member or creditor, the process stops. The objector may take no other steps beyond preventing the removal, and so the company remains on the register but
defunct. To overcome these problems we propose one procedure that is available to solvent and insolvent companies alike which contains protections for creditors and discourages frivolous objections.

715 Under the proposed procedure, there are several circumstances in which a company may be removed:

- as a result of an amalgamation
- the Registrar is satisfied that the company has ceased to carry on business
- the shareholders or board of directors have requested removal on the grounds that the company has ceased trading and discharged its liabilities (the ground for a solvent company) or that it has no surplus assets and no creditor has applied to put the company into liquidation (the ground for an insolvent company)
- a liquidation has been completed (section 252).

716 Except in the case of a removal after an amalgamation, the Registrar must advertise the intention to remove the company from the register (section 253). The advertisement advises the reader of the right to object to the removal. In addition, where the grounds are that the Registrar believes the company is defunct, or the directors or creditors of an insolvent company have applied for it to be removed, the Registrar must advise the company, any secured creditor and the Inland Revenue Department of their right to object. This provision recognises the status of the Department as a preferential creditor.

717 Section 254 sets out the grounds for an objection. One is that a creditor or shareholder has an undischarged claim against the company. Here it is important to note that subsection (2) excludes deficits on claims in liquidation from the category of undischarged claims. Other grounds for objection are that the company is still carrying on business, that it is party to legal proceedings, that it is in receivership or liquidation, or both, that the objector intends to take proceedings under Part 8 [Enforcement] or that it would not be just and equitable to remove the company from the register.
718 Section 255 provides that if the Registrar receives an objection on the grounds that the company is still carrying on business, is a party to legal proceedings, or is in liquidation or receivership, the Registrar is not to remove the company unless satisfied that the objection has been withdrawn, is not correct, is no longer correct or is frivolous. If there is an objection on the grounds that a person has an undischarged claim, intends to take proceedings, or that it would not be just and equitable for removal to occur, the Registrar advises the objector that he or she must apply to the Court for the company to be placed in liquidation or for a Court order that the company not be removed from the register.

719 Once a company has been removed from the register it is possible that property belonging to the company may be discovered. Its owner is no longer in existence and, as under the present law, the property is to vest in the Crown. Should a person believe that he or she would have had an interest in the property, as a shareholder or as a creditor, immediately before the company's removal from the register, he or she may apply to the Court. The Court may order that the property vest in the claimant, or that the claimant receive compensation. The Crown may disclaim any onerous property vesting in it under section 257.
PART 16

Overseas Companies

720 This part is self-explanatory and would substantially re-enact the existing provisions of the Act, although the provisions of the draft Act relating to company names and service of documents are adopted. The existing requirement to file annual accounts is omitted. There may be a case for further streamlining of these provisions and perhaps full integration with the rest of the Act. We received very few submissions on the existing part and have not felt in a position to make firm recommendations.
PART 17
Registrar of Companies

721 The policy of the draft Act in relation to the Registrar of Companies is set out at paragraphs 311–321.

722 The provisions of Part 17 are machinery provisions and are self-explanatory.

723 The references to District Registrars and registers are facilitative and not prescriptive. They will not preclude the reconstitution of the register in a central location, as will be sensible when it is computerised.

724 The function of the Registrar under the draft Act is to ensure that documents submitted for registration comply with form and not with the substantive provisions of the Act. We have thought, and have been confirmed in our view by the submissions received, that it is impracticable to require the Registrar to ensure compliance in substance.

725 Appeals from decisions of the Registrar are provided for in section 269, which follows the form of section 9B of the 1955 Act.

726 Section 264 permits fees to be set by Order in Council for the performance of the Registrar's functions. We received a number of submissions criticising the present system under
which the fees charged by the Companies Office bear no relation to the cost of the service provided and amount to a tax upon companies for the benefit of the Consolidated Account. At present, fees are tied to nominal capital so that the lack of proportion between fee charged and service rendered is exacerbated in the case of larger companies. We have some sympathy with the views expressed, and we have considered whether the draft Act should indicate that fees must be set to cover the costs of the service or that they should be set at a flat rate for all companies. In the end, however, we have concluded that such proposals should be considered as a matter of administration, not law. We have therefore followed the normal legislative formula of permitting fees to be set by Order in Council. We make the recommendation, however, that the policy of setting fees be reviewed in light of the criticisms of the present system.
PART 18

Offences and Penalties

727 This Part replaces the present extensive, and often overlapping and inconsistent offence provisions with a system which imposes standard and significant penalties for the few offences created under the Act.

728 We consider that the overhaul of the existing penalty provisions of the 1955 Act is a significant and worthwhile reform in itself. The Act creates over 100 offences with penalties ranging from fines of $2 pursuant to section 38(1) (for each incorrect copy of an altered memorandum or articles supplied) to 14 years' imprisonment pursuant to section 94 (for personation of a shareholder).

729 The principles that the Law Commission has followed in reviewing these provisions are as follows

- where an act or omission is an offence under the Crimes Act or some other general enactment, or is covered in the recently introduced Crimes Bill, that provision should not be replicated in the Companies Act
- breaches of minor or regulatory provisions should not be made criminal offences
- the principal and most effective remedies for breaches of duties created by or recognised in the Companies...
Act lie in civil rather than criminal proceedings, and in rules that are as far as practicable self-enforcing

- the creation of criminal offences by the Companies Act should therefore be restricted to those cases where the nature and seriousness of the wrongdoing demands the intervention of the criminal law (as with conduct that smacks of fraud), or where criminal prosecution is the most convenient and appropriate response (as with wilful failure to file information with the Registrar)

- maximum penalties, particularly fines, should be high enough to be a true deterrent, bearing in mind the financial resources of some companies and their officers.

730 In terms of penalty, the draft Act creates three categories of offence. Sections 277 and 278 apply where there is failure to comply with the provisions of the Act which are essential to the integrity of the registration system or to the general scheme of the Act and cannot adequately be left to shareholder enforcement alone—either because they serve a wider public interest or because they are fundamental to shareholder protection. Section 278 imposes liability on directors where the underlying duty is imposed upon the board or the company. Each group of offences is subdivided into two categories for penalty purposes. The first category relates to breaches for which there is no other effective sanction or where, in the case of the certificates to be given by directors, the policy of the provision (to facilitate shareholder substantive enforcement) would largely be frustrated if its enforcement had to be left to shareholders through the civil courts. These carry a maximum fine of $5,000. The second category of offence comprises failures which would substantially undermine the integrity of the registration system and the mandatory public interest provisions in the draft Act. In those cases, the maximum penalty is a $10,000 fine. Heavy penalties are imposed under sections 272, 273 and 274 for fraudulent conduct in relation to company property, records and statements. The provisions permit a fine of up to $200,000 and the imposition of a prison term not exceeding five years. They are to be compared with similar provisions in the Securities Act 1978 and the recently introduced Crimes Bill. It is important that the sanctions are sufficient to deter people and
companies of vastly different means from conduct which strikes at the heart of the protection the draft Act is designed to give.

Section 275 gives the Court power to disqualify directors. This does not follow the Companies Amendment Act 1988, discussed above in paragraph 312, in permitting the Registrar to ban directors. We are of the view that these powers are too sweeping for a core Companies Act.
PART 19

Miscellaneous

732 We have not attempted to draft prescribed forms or indicate the scope of regulations which might be made under the Act. Neither have we provided a substitute for Table A in the form of a draft constitution. The Act does, of course, provide a default constitution which should obviate the need to make detailed empowering provisions in the company’s constitution, as are presently to be found in Table A.

733 We do envisage, however, that standard form constitutions which deviate from the statutory presumptive form will be made available and might usefully be included in a schedule to the Act. Such standard forms might be useful in the case of closely-held companies which wish to displace the statutory presumption of director management, or which wish to avail themselves of some of the empowering provisions which depend on constitutional permission.

734 As mentioned in paragraph 600, we also envisage that accounting standards will be prescribed by regulations made under the Act.
Schedules

FIRST SCHEDULE

Proceedings at Meetings of Shareholders

735 The first schedule to the Act sets out the procedure to be followed at meetings of shareholders. Some of these matters may be varied by the constitution, but most apply to all the meetings of companies.

736 Clause 2 requires lists of shareholders entitled to notice of a meeting to be drawn up. The date on which entitlement to be on the list is determined is fixed under section 95. Persons on the list receive notice of the meeting and may attend and vote at that meeting unless they have transferred their shares, and the transferee requires his or her name to be entered on the list.

737 Clause 4 enables shareholder meetings to be held by telephone, unless the constitution prevents this.

738 Clause 7 makes it clear that a proxy is entitled to vote on show of hands. The proxy must be produced before the start of the meeting, to be effective. This represents a change from the present provision which requires 48 hours’ notice to the company.
Clause 8 is new and permits postal voting at shareholder meetings unless excluded by the constitution. This enables shareholders to vote without arranging for a proxy to attend, or appointing company directors with potentially conflicting interests as their proxies. Postal votes are counted both on a show of hands, and on a poll. The procedural requirements are not demanding, and ensure that postal votes are not ignored or withheld by directors with vested interests.

Clause 10 is new and enables shareholders by written notice to require notice to be given of any resolution. If shareholders can vote on the resolution by proxy or postal vote, the board must circulate any statement in support of the resolution, not exceeding 1,000 words, provided by the shareholder.

Clause 11 makes the current provisions relating to company representatives standard with the provisions for proxies, and clause 13 provides that shares are not entitled to be voted where there is any sum due to the company unpaid on them but permits such shares to be voted at interest group meetings.

SECOND SCHEDULE

Proceedings of the Board of a Company

The second schedule regulates the calling, and proceedings, of meetings of the board of directors. The main features to be noted are that

- directors are entitled to not less than two days’ notice of any meeting
  We consider that is the maximum time that should be prescribed without compromising the efficiency of management of the company.

- meetings by telephone are permitted by clause 3

- a presumption that all directors present at a meeting have voted in favour of a resolution of the board unless a director expressly dissents
  In this, we have followed the Canadian provisions. The rule is designed to assist enforcement of director responsibility. We have considered whether absent directors should have a similar rule applied
to them unless, within a certain period after hearing of the board decision, they take steps to have their dissent recorded. We have come to the conclusion that such a requirement would not be reasonable because the absent director would be dependent on the information given as to the discussion and the significance of the issue.

THIRD SCHEDULE
Proceedings at Meetings of Creditors
743 The third schedule adapts the provisions governing meetings of shareholders to situations where creditors need to hold a meeting, and provides that a vote on a duly circulated draft resolution may be taken by postal ballot without any need for creditors to meet in person. A liquidator who attends a meeting of creditors is to take the chair.

FOURTH SCHEDULE
Proceedings at Meetings of Committee of Inspection
744 This schedule outlines the procedure to be followed at any meeting of a committee of inspection which is representative of creditors or of shareholders or both.

FIFTH SCHEDULE
Liquidation of Assets of Overseas Companies
745 This schedule provides the modifications and exclusions necessary to enable the application of Part 14 [Liquidations] to the liquidation of the New Zealand assets of an overseas company.