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**THE COMPANIES ACT 1993:
TRANSACTIONS INVOLVING SELF-INTEREST**

LLM RESEARCH PAPER
LAW OF BODIES CORPORATE AND
UNINCORPORATE (LAWS 523)

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ABSTRACT

This paper examines the law as it relates to transactions involving self-interest. It examines the traditional common law position on the subject, the regime under the Companies Act 1955, the new regime under the Companies Act 1993 and the North American statutes that the provisions in the Companies Act 1993 were modelled on.

The writer concludes that the new regime in the Companies Act 1993 is unique, a New Zealand hybrid of provisions from the North American statutes and other provisions which have no obvious equivalent in other jurisdictions. While the new regime remedies many of the inadequacies in the law under the 1955 Act, it is considered that the reforms are not consistently worked through the new legislation. The new Act applies an unwieldy and inconsistent regime, especially in the context of closely held companies. Whether the problems identified during the course of this paper will, in practice, have a significant impact on the management of company business remains, of course, to be seen.

The text of this paper (excluding contents page, footnotes, bibliography and appendices) comprises approximately 15,000 words.

I. INTRODUCTION

A. Statutory Foundation

Directors and the companies they manage are creatures of statute. It is from this simple proposition that any examination of the role of directors must begin. Modern statutes confer on the board of directors the key role of management of the company's business and affairs. The Companies Act 1993 ("the Act") is no exception. In particular, s128(1) of the Act provides:

"The business and affairs of a company must be managed by, or under the direction or supervision of, the board of the company".

Accordingly, the Act both authorises and obligates directors to manage the company.

Many other responsibilities are imposed on directors, both by statute and by the common law. Traditionally the duties of directors have been imposed by the common law. Perhaps none of these duties are more significant than the imposition of fiduciary duties. In *Aberdeen Railway Co v Blaikie Bros*,¹ Lord Cranworth LC made his classic and often cited statement:²

"A corporate body can only act by agents, and it is, of course, the duty of those agents so to act as best to promote the interests of the corporation whose affairs they are conducting. Such an agent has duties to discharge of a fiduciary character towards his principal, ..."

Such fiduciary duties can be categorised under two broad heads:

- (1) the duty of loyalty; and
- (2) the duty to act with reasonable care and diligence.

¹ (1854) Macq HL 461, [1843-60] All ER 249. See Part II A of this paper for further analysis.

² Ibid at 252

The duty of loyalty may also be described as the duty to act in good faith and in the best interests of the company. It is the basic fiduciary duty governing the conduct of directors.³ In turn, this duty can be categorised under two further heads:

- (1) the duty to act for a proper purpose; and
- (2) the duty to avoid advancing a conflict of interest.

It is the duty to avoid advancing a conflict of interest which is the focus of this paper.

In the preface to the Law Commission's second report on Company Law Reform (No. 16 1990) the Commission stated that it had identified overwhelming support for the proposition that the law on directors' duties should be extracted from the common law and made accessible under companies statute. The Commission went on to state:

"Any definition of directors' duties in a companies statute raises the question of the relevance of the previous common law. The Commission has refrained from a recommendation that its proposals on directors' duties be described as a code but is confident that the courts would recognise a statutory set of directors' duties as the text of first resort in considering issues in that area."

It remains to be seen what approach the Courts will take. Given the deletion of clause 116 from the Companies Bill (which expressly preserved the common law) and the direction in the long title that the Act "defines" the relationship between companies and their directors, there is indicia that the Act does purport to be a code.

However, many of the Act's provisions relating to directors' duties really only restate the common law duties rather than reform them. Accordingly, the Courts will no doubt draw on the existing body of the common law to assist in the exercise of interpreting the Act's provisions. In addition, the directors' duties provided for in the Act are expressed in broad terms and therefore the Courts will necessarily play a role in shaping and defining the extent of these duties.

³ D O Jones *Company Law in New Zealand: A Guide to the Companies Act 1993*, Butterworths, 1993, Wellington at 105

The provisions in the Act relating to self-interested transactions may well be in a separate category. Sections 139-149, 161 and 162 of the Act set out a new regime of provisions to govern transactions involving self-interest which appear to be exhaustive and form a statutory code. It is clear that this new regime significantly reforms the law as it relates to self-interested transactions.

B. Self-Interested Transactions

It is not difficult for directors to become involved in both sides of a corporate transaction. There are many reasons why this may occur. It may be because of some relationship with or interest in the other contracting party. The director may also be a director of the other contracting company. Or the director may have a friend or family member with whom the company deals. It may be that the transaction involves the director's own property. Or it becomes necessary for the success of the transaction that the director, in a personal capacity, becomes a party.

In any such situation, the director's loyalties will be divided. Necessarily, it can be questioned whether the director has bargained on behalf of the company as well as he or she possibly could.

Prior to the intervention of company statutes, it fell to the Courts of Equity to deal with what was (and still is) a fact of corporate life. Applying classic principles of equity, the Courts provided a common law regime in respect to self-interested transactions.

II. THE COMMON LAW POSITION

A. Absolute Rule

As fiduciaries, at common law, directors owe an absolute duty not to be interested in a transaction to which their company is a party. This equitable principle can be traced back

to the leading trust case of *Keech v Sandford*⁴ and is classically stated by Lord Cranworth LC in *Aberdeen Railway Co v Blaikie Bros.*:⁵

"... it is a rule of universal application that no one having [fiduciary] duties to the discharge shall be allowed to enter into arrangements in which he has or can have a personal interest conflicting or which possibly may conflict with the interests of those whom he is bound to protect."

In this case, a Mr Blaikie was a partner of the plaintiff firm and a director of the defendant company. The firm contracted to supply goods to the company. However, for reasons not disclosed in the judgment, the company refused to accept delivery of the goods. The firm sued seeking specific performance or, in the alternative, damages. Despite the fact that the terms of the contract were fair, the Court held that the company was entitled to avoid the contract.

"So strictly is this principle adhered to that no question is allowed to be raised as to the fairness or unfairness of a contract so entered into."⁶

Because directors stand in a fiduciary relationship to their companies, at common law, any contract between them and the company can be avoided by the company. The rule is so absolute that it is simply irrelevant that the contract maybe fair and reasonable. It is also irrelevant that the director concerned may have made disclosure of his or her interest to the board. And, it matters not that the director may not have attended the board meeting or did not vote on the matter or an independent quorum authorised the transaction.

⁴ (1726) Sel Cas Ch 61; [1558-1774] All ER Rep 230. In this case, the lease of a market was devised to a trustee for the benefit of an infant. Shortly before the expiry of the lease, the trustee applied to the lessor for a renewal for the benefit of the infant. The lessor refused to renew the lease for various reasons, but granted a new lease to the trustee. The infant sued to have the lease assigned to him and for an account of the profits, on the principle that wherever a lease is renewed by a trustee or executor, it must be for the benefit of "cestui que use" (he to whose use land is held). Lord King LC found for the infant observing that if a trustee, on the refusal to renew, might have a lease to himself, few trust estates would be renewed to "cestui que use". He concluded that "it is very proper that rules should be strictly pursued, and not in the least relaxed; for it is very obvious what would be the consequences of letting trustees have the lease on refusal to renew to "cestui que use" (at 231).

⁵ [1843-60] All ER 249 at 252

⁶ Ibid

The rationale behind such a strict rule has been explained thus:⁷

"Good faith must not only be done but must manifestly be seen to be done, and the law will not allow a fiduciary to place himself in a position in which his judgment is likely to be biased and then to escape liability by denying that in fact it was biased."

Therefore, at common law, in the absence of any express provision in the company's articles, the only effective way of overcoming this problem was to make full disclosure to the members of the company and to have the transaction ratified by the company at general meeting.

B. Possibility of Conflict

The strictness of the common law position is illustrated by the requirement that it is not necessary to show that there was an actual conflict of duty and interest. In *Aberdeen Railway Co v Blaikie Bros.*⁸, Lord Cranworth LC said:⁹

"No one having [fiduciary] duties to discharge shall be allowed to enter into arrangements in which he has or can have a personal interest conflicting or which possibly may conflict with the interests of those whom he is bound to protect."

(The underlining is the writer's)

The test of "possibly may conflict" was reviewed by the House of Lords in *Boardman v Phipps*¹⁰ where Lord Upjohn said:¹¹

⁷ LCB Gower Gower's Principles of Modern Company Law (5th ed) Sweet & Maxwell, 1992, London at 559

⁸ nl

⁹ Ibid at 252

¹⁰ [1967] 2 AC 46

¹¹ Ibid at 124

"The phrase "possibly may conflict" requires consideration. In my view it means that the reasonable man looking at the relevant facts and circumstances of the particular case would think that there was a real sensible possibility of conflict; not that you could imagine some situation arising which might, in some conceivable possibility in events not contemplated as real sensible possibilities by any reasonable person result in a conflict."¹²

(Again, the underlining is the writer's)

In this case, the defendants were not company directors but a trustee and the trust's solicitor. The defendants had acted as agents of the trustees in respect of a company in which the trust had a substantial investment. Dissatisfied with the company's accounts, the defendants decided that the best course of action would be to try and obtain control of the company by making a takeover bid. Then, by a liquidation of the company's assets, they would make a repayment of capital to the shareholders. As there were difficulties in using the trust fund for bidding, the defendants obtained, or so they thought, the consent of all of the trustees and beneficiaries to bid on their behalf and at their expense. After protracted negotiations with the other shareholders the defendants acquired their shares, some at £3 a share, but most at £4.10s a share. The purchases proved to be profitable and the company was able to make distributions totalling £5.17s.6d, after which the shares were still worth more than £2 a share. Therefore, the trust with 8000 shares did very well, but the defendants who ended up with 22,000 shares did even better making a profit of over £75,000. Unfortunately for the defendants, the Court found that the defendants did not adequately explain their proposed course of action to the plaintiff, one of the beneficiaries of the trust. Therefore they had to account for the profit attributable to the plaintiff's share in the trust. Interestingly, the House of Lords held that the defendants were entitled to deduct payment, on a liberal scale, for their work and skill which for otherwise no profit would have been made.

¹² Lord Upjohn delivered a dissenting judgment but this was on the facts, not the law. The test of "real sensible possibility of conflict" has since been applied by the Privy Council in *Queensland Mines Ltd v Hudson* (1978) 18 ALR 1. See also *Chan v Zachoria* (1984) 53 ALR 417 and *Hospital Products Ltd v United States Surgical Corporation* (1984) 55 ALR 417.

C. Extent of Interest

The strict regime of the common law position was continued in respect of the extent of the interest required before the transaction was affected. The old authorities thought the extent of interest irrelevant. In *Transvaal Lands Co v New Belgium (Transvaal) Land and Development Co*¹³, Swinfen Eady L.J. said:¹⁴

"... the validity or invalidity of a transaction cannot depend upon the extent of the adverse interest of the fiduciary agent any more than upon how far in any particular case the terms of a contract have been the best obtainable ..."

Such a strict doctrine if applied literally has bizarre consequences. For example, say, a director of a computer software company owns 100 \$1 shares in a brewery company. If the computer company purchases some of the brewery company's products for a client function and the director does not disclose his or her interest in the brewery company, then technically the director is in breach of duty.

Not surprisingly, more modern authority has tempered the strictness of the rule. In *Boulting v Cinematography Assocn. etc.*,¹⁵ Upjohn LJ said in discussing the ambit of the rule:¹⁶

¹³ [1914] 2 Ch 488

¹⁴ *Ibid* at 503. In this case, the plaintiff company successfully sought to rescind contracts entered into with the defendant company on the grounds that a director of the plaintiff company held shares in the defendant company. The Court rejected an argument that the director held the shares only as a trustee made a difference.

¹⁵ [1963] 1 All ER 716

¹⁶ *Ibid* at 730. The plaintiffs were managing directors and employees of a film production company. The defendant union required the plaintiffs to join the union under its membership rules. The plaintiffs argued that the membership rules were ultra vires or unlawful in that they purported to make those whose principal functions were managerial, eligible to join what was essentially an employees' union. The English Court of Appeal held that the principle that no person who had a duty to perform should place himself in a position where he had interests that conflicted with the performance of the duty was a principle for the protection of the person to whom the duty was owed, who could relax it if he thought fit. Therefore the principle did not entitle the plaintiffs (who owed a duty to the company), as distinct from the company which was not a party to the action, to have set aside or declared void as illegal the membership rule of the union, even though it may lead to conflicts of interest.

"It must be applied realistically to a state of affairs which discloses a real conflict of duty and interest, and not to some theoretical or rhetorical conflict."

A more recent example of discussion on the extent of interest required before a transaction is affected at common law is provided by the Supreme Court of New South Wales in *Anarary Pty Ltd v Sydney Futures Exchange Ltd & Ors*.¹⁷ In this case a director had a minor interest in one of a number of contracts that were affected by the decision of the board of the Sydney Futures Exchange to extend the delivery period of trade steer contracts in the futures market. The director had disclosed his interest to the board but had voted on the resolution to extend the delivery period. The Court said that it was of the utmost importance:¹⁸

"... to have regard to the nature of the company's functions and the constitution of the board of directors and the powers of the board to determine whether the principle is in fact brought into play."

The Court noted that the company had a number of articles prohibiting directors from voting on specific types of resolutions where they had an interest which could be affected by the resolutions. But the Court found that, in respect to other resolutions:¹⁹

"... it is contemplated that a director is free to vote in a matter in which he has declared an interest, subject always to his own bona fide decision that he should not do so when the nature of the interest is of such a character or size as to affect his decision or give reasonable cause for apprehension that it might be so."

On the facts of the case the director's interest was not of such a nature and therefore the resolution was not affected.

¹⁷ (1988) 6 ACLC 271

¹⁸ *Ibid* at 276

¹⁹ *Ibid* at 277

D. Disclosure and Avoidance

At common law, where a director had placed him or herself in a position of conflict, the contract is voidable at the option of the company. The company must either affirm or avoid the contract. The only effective way of overcoming the problem was to make full disclosure to the members of the company and to have the transaction ratified by the company at general meeting. While, almost invariably, this requirement is waived by the company's articles, it is nevertheless still the law. As Fox LJ said in *Guinness plc v Saunders*:²⁰

"A person in a fiduciary position is not permitted to obtain a profit from his position except with the consent of his beneficiaries or other persons to whom he owes the duty. In the case of a director the consent required is that of the members in general meeting."

Disclosure to the board alone was thought to be inadequate because the board would be unable to give independent and unbiased judgment on the merits of the transaction. As Gower commented:²¹

"It hardly seems over-cynical to suggest that disclosure to one's cronies is a less effective restraint on self-seeking than disclosure to those for whom one is a fiduciary."

If the company elects to avoid the contract, two (or perhaps three²²) consequences follow. First, the contract is voidable against any party who has notice of the breach of duty,²³ though the company's right of avoidance will lapse if it affirmed the contract, or it

²⁰ [1988] 2 All ER 940 at 944. This was one of many cases that followed the take-over battle for Distillers plc. A Guinness director, a Mr Ward, was also a director of another company, MAC. Guinness paid MAC £5.2 million for services relating to the take-over bid. As Ward had failed to disclose his interest in MAC, Guinness was entitled to judgment for the £5.2 million. This was despite any claim Ward had by way of quantum meruit or equitable compensation for services rendered.

²¹ LCB Gower Gower's Principles of Modern Company Law (4th ed), Stevens & Sons, 1979, London at 587.

²² Under some articles, an interested director was disqualified and had to vacate office e.g. Table B to the Joint Stock Companies Act 1856 (UK).

²³ For example, see n13 at 499

delays unduly before electing to avoid, or third parties have acquired rights in the meantime.²⁴ As a condition of rescission of a voidable contract, the parties must be put in "status quo". For this purpose a Court of Equity will endeavour to do what is practically just, even though it may not be able to restore the parties precisely to the state they were in before the contract.²⁵ The second consequence is that any profit which the director gains from the contract is recoverable by the company, even if the contract was fair and reasonable²⁶ and/or that the profits made could not have been made by the company without the skills and diligence of the director.²⁷ If the shareholders at general meeting sanction the director's interest, then the contract ceases to be voidable and the directors may retain any profits.

In practice, the strictness of the common law rules proved to be unworkable. Contracts with directors, such as contracts of service, and contracts with other companies which had a common director, were not uncommon. Indeed there may be good commercial reasons for a company to contract with a director.²⁸ Faced with the prospect of having to submit all such contracts to a general meeting of the company with the resultant delays and possible embarrassment, not surprisingly, these fiduciary duties of directors became modified by express provision in the company's constitution. It became increasingly common for the articles of companies to include waiver clauses which abrogated the common law principles. However, it would seem that some of these waiver clauses went too far. As Gower explained:²⁹

"Alarmed by the increasing ambit of these clauses, the legislative intervened."

24 Ibid

25 Guinness plc v Saunders [1990] 2 AC 663 at 697

26 Aberdeen Railway Co v Blaikie Bros [1843-60] All ER 249 at 252

27 Costa Rica Railway Company Ltd v Forwood [1901] 1 Ch 746 at 761. In this case, Forwood was a director of both contracting parties. No disclosure was made but on the facts of the case the English Court of Appeal found for Forwood. Nevertheless, the principle above is of general application.

28 See V. Brudrey "The Independent Director-Heavenly City or Potemkin Village?" (1982) 95 Harv L. Rev 597 at 624

29 n7 at 561

III. SELF-INTERESTED TRANSACTIONS UNDER THE COMPANIES ACT 1955

A. Legislative Intervention

At one extreme a waiver clause in the articles of association of a company might adopt the inflexible rules of the common law. At the other end of the scale, a waiver clause might provide that a contract will be fully enforceable notwithstanding any interest by a director and the director will not be liable to account for any profit made. Further, the interested director may attend any meeting and even vote to authorise the transaction. It was such liberally drafted waiver clauses that caused the legislature to intervene and introduce minimum standards of disclosure.

Since 1933³⁰ the legislature has placed directors under a duty to declare their interests in a contract, or a proposed contract, with the company at a meeting of the directors. Section 199 of the Companies Act 1955 ("the 1955 Act") provided:

"SECTION 199 DISCLOSURE BY DIRECTORS OF INTERESTS IN CONTRACTS

(1) Subject to the provisions of this section, it shall be the duty of a director of a company who is in any way, whether directly or indirectly, interested in a contract or proposed contract with the company to declare the nature of his interest at a meeting of the directors of the company.

(2) In the case of a proposed contract the declaration required by this section to be made by a director shall be made at the meeting of the directors at which the question of entering into the contract is first taken into consideration, or if the director was not at the date of that meeting interested in the proposed contract, at the next meeting of the directors held after he became so interested, and in a case where the director becomes interested in a contract after it is made, the said declaration shall be made at the first meeting of the directors held after the director becomes so interested.

(3) For the purpose of this section, a general notice given to the directors of a company by a director to the effect that he is a member of a specified company or firm and is to be regarded as interested in any contract which may, after the date of the notice, be made with that company or firm shall be deemed to be a sufficient declaration of interest in relation to any contract so made:

Provided that no such notice shall be of effect unless either it is given at a meeting of the directors or the director takes reasonable steps to secure that it is brought up and read at the next meeting of the directors after it is given.

(4) Any director who fails to comply with the provisions of this section shall be liable to a fine not exceeding \$200.

³⁰ Originally s155 of the Companies Act 1933 which became s199 of the Companies Act 1955. The section is taken from the Companies Act 1929(UK), section 149.

(5) Nothing in this section shall be taken to prejudice the operation of any rule of law restricting directors of a company from having any interests in contracts with the company."

Coupled with s199³¹, further restrictions upon interested directors were prescribed by Article 84 of Table A in the Third Schedule to the 1955 Act. Article 84 provided:

"84. (1) A director who is in any way, whether directly or indirectly, interested in a contract or proposed contract with the company shall declare the nature of his interest at a meeting of the directors in accordance with section 199 of the Act.

(2) A director shall not vote in respect of any contract or arrangement in which he is interested, and if he does so his vote shall not be counted, nor shall he be counted in the quorum present at the meeting, but neither of these prohibitions shall apply to -

(a) Any arrangement for giving any director any security or indemnity in respect of money lent by him to or obligations undertaken by him for the benefit of the company; or

(b) Any arrangement for the giving by the company of any security to a third party in respect of a debt or obligation of the company for which the director himself had assumed responsibility in whole or in part under a guarantee or indemnity or by the deposit of a security; or

(c) Any contract by a director to subscribe for or underwrite shares or debentures of the company; or

(d) Any contract or arrangement with any other company in which he is interested only as an officer of the company or as a holder of shares or other securities, -

and these prohibitions may at any time be suspended or relaxed to any extent, and either generally or in respect of any particular contract, arrangement, or transaction, by the company in general meeting.

(3) A director may hold any other office or place of profit under the company (other than the office of auditor) in conjunction with his office or director for such period and on such terms (as to remuneration and otherwise) as the directors may determine, and no director or intending director shall be disqualified by his office from contracting with the company, either with regard to his tenure of any such other office or place of profit or as vendor, purchaser, or otherwise, nor shall any such contract, or any contract or arrangement entered into by or on behalf of the company in which any director is in any way interested, be liable to be avoided, nor shall any director so contracting or being so interested be liable to account to the company for any profit realised by any such contract or arrangement by reason of the director holding that office or of the fiduciary relation thereby established.

(4) A director, notwithstanding his interest, may be counted in the quorum present at any meeting whereat he or any other director is appointed to hold any such office or place of profit under the company or whereat the terms of any such appointment are arranged, and he may vote on any such appointment or arrangement other than his own appointment or the arrangement of the terms thereof.

31

Article 84(1) incorporated s199 as its first procedural step.

(5) Any director may act by himself or his firm in a professional capacity for the company, and he or his firm shall be entitled to remuneration for professional services as if he were not a director:

Provided that nothing therein contained shall authorise a director or his firm to act as auditor to the company."

Because adoption of the prescribed table of articles was not mandatory,³² the practice became either to exclude or modify the regulations in Table A.³³ Accordingly, the formulation of waiver clauses varied widely. Typical variations permitted interested directors to be included in the quorum and to vote in respect of a contract in which he or she was interested. Further variations existed as to the extent that Table A was integrated into the registered articles.

B. Case Law

Until the 1980s there was little judicial consideration of the 1955 Act's regime to govern self-interested transactions. However, two decisions of the High Court, *Saunders v Liquidator of Woodward Products Ltd*³⁴ ("Woodward Products") and *David Neil & Co Ltd (in rec) v Neil*³⁵ ("David Neil") highlighted a number of unsatisfactory aspects to the law in this area, particularly in the context of closely held companies.

1) The Woodward Products case

In the Woodward Products case, a Mr and Mrs Saunders were the sole shareholders of a private company. Mr Saunders was governing director for life.³⁶ Mrs Saunders was

³² Section 22(1) of the 1955 Act provided:
 "(1) Articles of association may adopt all or any of the regulations contained in Table A"

(The underlining is the writer's)

³³ Section 24 of the 1955 Act sanctioned alteration of articles by special resolution.

³⁴ (1982) 1 NZCLC 98, 341

³⁵ (1986) 3 NZCLC 99, 658

³⁶ In accordance with ss180(1) and 354(2)(c) of the 1955 Act.

secretary. The articles of the company allowed a director to vote in respect of a contract in which he or she was interested, provided disclosure was made in accordance with s199.

The company had an account with the Bank of New Zealand with an overdraft facility personally guaranteed by Mr Saunders. Later, and without releasing the guarantee, the bank required the company to give a debenture as further security for its overdraft. The debenture was executed by the company at a meeting attended by Mr and Mrs Saunders and the company's solicitor. At the same meeting the solicitor prepared a resolution, pursuant to s362 of the 1955 Act, which was signed by Mr and Mrs Saunders, noting the execution of the debenture.

Subsequently, the company went into voluntary liquidation, whereupon the overdraft debt became immediately due and payable. Accordingly, the bank made demand on Mr Saunders under his guarantee. Mr Saunders duly paid the amount due, thereby becoming entitled to take an assignment of the debenture. Mr Saunders then sought to prove in the liquidation as a secured creditor. The liquidator rejected Mr Saunders's proof of debt on the grounds that the debenture was invalid. The liquidator argued that Mr Saunders was personally interested in the debenture transaction because he had personally guaranteed the overdraft. Therefore he was not competent to vote or be counted in the quorum at the meeting which had authorised the execution of the debenture.

The first issue that the Court had to consider was whether there had been disclosure in accordance with s199 and the articles of the company. To that, Hardie Boys J said:³⁷

"The disclosure required is thus one made to a meeting of directors. Although it has been held that in an appropriate context there may be a "meeting" of one person (e.g. *East v Bennett Bros. Ltd* [1911] 1 Ch 163 per Warrington J. at p.168, 170)³⁸ there is no reason to interpret either the Act or the articles of this company in a way that requires a sole director to call a meeting of himself in order that he may disclose to himself what he already knows."

Not only did Hardie Boys J hold that a meeting was not required, but disclosure did not have to be in writing:³⁹

37 n34 at 98, 345

38 See Part IIID of this paper for further analysis

39 n34 at 98, 345

"The cautious would no doubt put compliance beyond question by recording the disclosure in a minute. But the section does not seem to require that the disclosure be in writing, unless it is a general notice given pursuant to subsec.(3). What is required is "a declaration", a word which comprehends an oral as well as a written statement. The section is in marked contrast to sec.198, which specifies that the disclosure it requires be in writing. So the absence of writing is not relevant. That being so, it would be impossible to prove breach of sec.199 where there is but one director; and that leads me to the conclusion that the section is not relevant to such a situation."

Hardie Boys J noted that the duty of disclosure required by the articles of the company, i.e. to a meeting of directors, meant, in the case of such a single director company, Mr Saunders disclosing his interest to himself. An exercise one might well think of somewhat dubious utility. But Hardie Boys J further noted that the situation would be no different to where all the directors might be interested in the transaction.

In such circumstances, Hardie Boys J suggested that disclosure by each of the directors to the others may not suffice, unless there was clear direction to that effect in the articles.⁴⁰ But, in this case, there was no such direction. Therefore, if a director's fiduciary duty could not be effectively discharged by disclosure to the directors, either because there is only one director, or because they are all interested in the transaction, it may be necessary for disclosure to be made to the shareholders.⁴¹ On the facts of the case, Hardie Boys J found there had been such disclosure, as the only other shareholder, Mrs Saunders, had implicitly consented to the ratification of the breach of duty.⁴²

"... Mrs Saunders concurred in the contract. Even if Mr Saunders was in breach of his obligation by not telling his wife in so many words what was well known to her, her assent to the contract, in full knowledge of the facts, was sufficient to bind the company."

Accordingly, the liquidators were directed to admit Mr Saunder's proof of debt.

40 Ibid

41 Ibid

42 n34 at 98, 345 - 98, 346

2) The David Neil case

In the David Neil case, a Mr Neil was governing director for life and owned all but one of the shares in the company. The company had only one asset, a house property, which was security for three mortgages totalling \$150,000 and a \$300,000 debenture to the ANZ bank. The property had been previously valued at between \$270,000 and \$350,000. In July 1984, Mr Neil entered into an agreement for sale and purchase with the company for the sale of the property to himself for \$275,000. Under the terms of the agreement no deposit was required. The purchase price was to be satisfied by the purchaser (Mr Neil) assuming the existing liabilities in respect of the property, as at settlement date, to the extent of \$275,000. Mr Neil then lodged a caveat claiming an interest in the property by virtue of the agreement. The next day the bank appointed receivers who purported to cancel the agreement and made an application to the Court for removal of the caveat.

The articles of the company specified that Table A applied, including Article 84, except where inconsistent or negated. The company's Article 9 provided that resolutions of any kind could be effected by entry in the minute book. But of central importance was Article 16 which provided:⁴³

"16. *The governing director shall not be disqualified by his office from holding any office or place of profit in the company or from contracting with the company whether as vendor or purchaser or otherwise, nor shall any contract or arrangement entered into by or on behalf of the company with any company or partnership of, or in which, the governing director shall be a member or otherwise interested, be avoided. Nor shall the governing director so contracting or being such a member or so interested be liable to account for any profit realised by any such contract and/or arrangement by reason of the governing director holding such office or of the fiduciary relations thereby established, provided that such governing director shall declare the nature of his interest in the manner provided by sec 199 of the Act*".

(The emphasis is Smellie J's)

The receivers argued that the sale and purchase agreement was voidable at the option of the company because of Mr Neil's non compliance with s199 and the company's articles in

⁴³ n35 at 99, 667

failing to declare his interest in the agreement.⁴⁴ In the alternative, the receivers argued that the agreement was voidable because of Mr Neil's breach of fiduciary duty in selling the house at undervalue.⁴⁵ On the other hand, Mr Neil argued that the fact that the agreement had been entered into was effective notice to the board, even if no specific written or oral declaration had been made.⁴⁶

In dealing with the receivers' first argument, not surprisingly, Smellie J referred to Hardie Boys J's judgment in *Woodware Products*. While indicating that, in the main, he agreed with Hardie Boys J,⁴⁷ Smellie J expressed:

"... some reservation as to whether it can be said that s199 has no application simply because there is one director."

He concluded that:⁴⁹

"Contrary to what is said in *Saunders*'s case I take the view following *East v Bennett Bros. Ltd* [1911] 1 Ch 163⁵⁰ that this is a case where the articles contemplate a meeting with only one attendee."

However, Smellie J did agree with Hardie Boys J that if there is a duty of disclosure required by the articles of the company then that duty must be discharged to prevent avoidance.⁵¹ On the facts of the case, Smellie J found that no such disclosure had occurred and therefore the agreement for sale and purchase was voidable at the option of

44 Ibid at 99, 665

45 Ibid

46 Ibid at 99, 668

47 Ibid at 99, 669

48 Ibid

49 Ibid

50 See Part IIID of this paper for further analysis

51 n35 at 99, 669

the company. In the alternative, Smellie J found that there was no evidence of Mr Neil disclosing his interest to the shareholders.⁵²

In respect of Mr Neil's argument that the fact that the agreement had been entered into constituted effective notice to the board, Smellie J examined Article 84(2) of Table A. Smellie J noted that, pursuant to Article 84(2), Mr Neil could not vote in favour of a resolution to sell to himself. Therefore, he found that the agreement was voidable and "quite probably void ab initio"⁵³ Accordingly, Smellie J ordered that the caveat be removed.

The *Woodware Products* case and the *David Neil* case illustrate a number of difficulties in the application of the law in this area. Some of these difficulties are discussed further below.

C. What was the relationship between s199, Article 84 and the common law?

It is implicit in *Hardie Boys J's* judgment, in the *Woodware Products* case, that he considered that the effect of s199 was to impose a statutory duty of disclosure upon directors, separate from the common law.⁵⁴ However, there has been academic comment to the contrary. In earlier editions of his text,⁵⁵ Gower suggested that a breach of s199⁵⁶ removes any protection afforded by the waiver clauses in the articles and brings the common law into play. Thereby the transaction is voidable at the option of the company and any profits made by the interested director are recoverable. This view has been

52 Ibid at 99, 670

53 Ibid

54 n34 at 98, 345

55 *The Principles of Modern Company Law* (3rd ed) Stevens & Sons, 1969, London at 529 and n21 at 586

56 Of the Companies Act 1948 (UK) which is identical

criticised by other commentators⁵⁷ and in the latest edition of his text, Gower reviews his earlier position.⁵⁸

Strong support for Hardie Boys J's view can be found in the judgments of the House of Lords in *Guinness plc v Saunders*⁵⁹ and the English Court of Appeal in *Hely-Hutchinson v Brayhead Ltd*⁶⁰ ("Hely-Hutchinson"). In *Hely-Hutchinson*, Lord Pearson said:⁶¹

"It is not contended that section 199 in itself affects the contract. The section merely creates a statutory duty of disclosure and imposes a fine for non-compliance. But it has to be read in conjunction with [the article]. If a director makes or is interested in a contract but fails to disclose his interest, what happens to the contract? Is it void or is it voidable at the option of the company, or is it still binding on both parties, or what? I think the answer must be supplied by the general law, and the answer is that the contract is voidable at the option of the company."

In *Guinness*, it was argued by the interested director that, even if there had been a breach of the statutory duty of disclosure, the articles of the company,⁶² still allowed the director

⁵⁷ E.g. C D Baker "Disclosure of Directors' Interests in Contracts" (1975) J.B.L. 181 and G L Williams "Interested Directors-Some Recent Cases" (1988) 14 NZ Recent Law 167

⁵⁸ n7 at 562

⁵⁹ [1990] 2 AC 663

⁶⁰ [1968] 1 QB 549. In this case, Hely-Hutchinson ("H-H") was the chairman and managing director of a company named Perdio Electronics Ltd. Perdio was in financial difficulties and H-H personally guaranteed a loan to Perdio from a merchant bank. This was after H-H had received an undertaking from Brayhead (in which H-H was also a director) to indemnify him for any loss under the guarantee. But Perdio's financial position remained hopeless and H-H was required to honour the guarantee. This he did and, in turn, claimed the indemnity. Brayhead refused, denying liability on the grounds that H-H had not disclosed his interest in the transaction as required by s199 and by Brayhead's articles. Accordingly, Brayhead argued that the indemnity was unenforceable. In short summary, the Court of Appeal found in H-H's favour. While there had been a breach of s199 and Brayhead's articles, this only rendered the transactions voidable not void and H-H was entitled to recover.

⁶¹ *Ibid* at 594

⁶² Which included the equivalent to Articles 84(1), (3) and (5)

to retain the profits under the contract. The House of Lords rejected this argument. The Court held that the English equivalent of s199⁶³ imposed a separate statutory duty to account for profits from contracts where an interested director had failed to make disclosure. The articles reaffirmed the statutory duty of disclosure and the equivalent to Article 84(3) only applied to contracts where there was no breach of the duty to disclose. In respect of the question as to the breach the equivalent of s199, Lord Goff referred to the above passage by Lord Pearson and said:⁶⁴

" ... I cannot see that a breach of section 317 [s199] ... had itself any effect upon the contract⁶⁵ between [the interested director] and Guinness. As a matter of general law, to the extent that there was a failure by [the interested director] to comply with his duty of disclosure under the relevant articles of Guinness ..., the contract was no doubt voidable under the ordinary principles of the general law to which Lord Pearson refers."

This rather untidy interaction of statutory provisions and the common law has been summarised as follows:⁶⁶

"(a) If the company's articles include reg 84 or its equivalent then the director must make disclosure to the board. This disclosure automatically constitutes compliance with s199.

(b) If the director fails to comply with the article, he or she is deprived of the protection afforded by it and therefore the common law principles [] will come into operation. The director will also be liable to a fine of up to \$200 for failing to comply with s199.

⁶³ s317 of the Companies Act 1985 (UK)

⁶⁴ [1990] 2 AC 663 at 697

⁶⁵ Subsequently, Lord Goff went on to find there was no such contract.

⁶⁶ K. Snook & P. Ratner "Interested Directors" Dimensions in Business Finance Law Butterworths, 1992, Wellington at 132, 133

(c) Where the articles of association contain no equivalent of reg 84, the general common law principles continue to apply, although the director must still disclose pursuant to s199. Section 199 is entirely negative in operation and has no validating effect on the contract even if complied with, and s199(5) expressly preserves the operation of the common law rules."

D. A Meeting of One Director?

Section 199 required that disclosure must be made at a meeting of the directors. The question arose, if a company has only one director, can there be a meeting of directors? There was conflicting authority on the point. In the case of *Sharp v Dawes*⁶⁷ notice was given that a general quarterly meeting of shareholders of a mining company would be held. However, only one shareholder turned up for the meeting. Unfazed by this, the shareholder took the chair of the meeting and purported to pass a number of resolutions including making a call. Subsequently, another of the shareholders refused to pay the call and an action was brought against him. The English Court of Appeal found for the absentee shareholder. Mellish L J said:⁶⁸

"In this case, no doubt, a meeting was duly summoned, but only one shareholder attended. It is clear that, according to the ordinary use of the English language, a meeting could no more be constituted by one person than a meeting could have been constituted if no shareholder at all had attended. No business could be done at such a meeting, and the call is invalid."

The *Sharp v Dawes* approach, "according to the ordinary use of the English language",⁶⁹ has been followed on a number of occasions.⁷⁰

However, another approach was to regard the word "meeting", in this context, as having a meaning different from the ordinary meaning of the word. In *East v Bennett Brothers*

⁶⁷ (1876) 2 QBD 26

⁶⁸ *Ibid* at 29

⁶⁹ *Ibid*

⁷⁰ See *Re Sanitary Carbon Co* [1877] WN 223, *Re London Flats* [1969] 1 WLR 711, *Re Primary Distributors Ltd* [1954] 2 DLR 438

Ltd,⁷¹ the company's memorandum and articles of association required that any fresh issue of preference shares had to be sanctioned by an extraordinary resolution of preference shareholders present at a separate meeting. Shortly after the incorporation of the company such a resolution was passed increasing the capital of the company by a fresh issue of preference shares. However, at that time, only one shareholder held any preference shares. Subsequently, this action was challenged. In distinguishing *Sharp v Dawes*, Warrington J particularly noted the drafting of the memorandum and articles of the company. He held that where only one person is the holder of all the shares of a particular class, the persons who drafted the memorandum and articles must have had such a position in their contemplation and therefore must be taken to have used the word "meeting" not in the strict sense.⁷² This approach was adopted by *Hardie Boys J* in *Woodware Products*⁷³ and by *Smellie J* in *David Neil*.⁷⁴

The problem could be overcome, simply enough, by a specific article providing that the attendance of one director constitutes a "meeting". However, somewhat unsatisfactorily, the issue turned on the wording of the company's constitutional documents.

E. Declaration of the Nature of the Interest

Section 199(1) required a director "to declare the nature of his interest at a meeting of the directors of the company". As discussed earlier,⁷⁵ in *Woodware Products*, *Hardie Boys J* held that disclosure did not have to be in writing, the word "declaration" comprehending an oral or a written statement. In that regard, *Hardie Boys J* compared s199 with s198 of the 1955 Act, which expressly required disclosure to be in writing.

71 [1911] 1 Ch 163

72 Ibid at 170

73 n34 at 98, 345

74 n35 at 99, 669

75 See n39

While this may have had obvious practical advantages for the interested director, it made effective enforcement of s199⁷⁶ a nonsense. As Hardie Boys J noted, a breach of s199 would be impossible to prove where there was only one director.⁷⁷

Under the 1955 Act regime, it was not sufficient for a director to merely declare that he or she had an interest. Section 199(1) required the "nature" of a direct or indirect interest to be disclosed. Immediately, it will be noted that the section contained no criteria of materiality. Accordingly, it seemed that the section required disclosure of any interest, however trivial or indirect.⁷⁸

As to the common law requirement, in *New Zealand Netherlands Society v Kuys*,⁷⁹ the Privy Council held:⁸⁰

" ... as to disclosure. Their Lordships entirely accept, as a matter of law, that if an arrangement is to stand, whereby a particular transaction, which would otherwise come within a person's fiduciary duty, is to be exempted from it, there must be full and frank disclosure of all material facts."

(The underlining is the writer's)

In *Woodware Products*, Hardie Boys J indicated, without offering anything further,⁸¹ that the fiduciary standard (full and frank disclosure of all material facts) may be more than is

⁷⁶ Under s199(4) any director who failed to comply with s199 was only liable to a rather modest fine of not exceeding \$200

⁷⁷ n34 at 98, 345

⁷⁸ J H Farrar & M Russell *Company Law & Securities Regulations in New Zealand*, Butterworths, 1985, Wellington at 242

⁷⁹ [1973] 2 NZLR 163. In this case, the appellants had obtained an injunction restraining the respondent from publishing a newspaper for the Dutch community called "The Windmill Post". The respondent, Kuys, had previously been the secretary and a member of the appellant society. The appellant argued that Kuys had acquired ownership of the paper by virtue of his position as secretary of the appellant and that Kuys had acquired such ownership without full disclosure of all relevant matters to the appellant. The Privy Council accepted the existence of a fiduciary relationship but dismissed the appeal, the appellants being unable to point to any relevant matter not disclosed by Kuys.

⁸⁰ Ibid at 168

required to achieve bare compliance with the statutory duty.⁸² That there was a separate statutory standard of disclosure was consistent with the proposition that there was a separate duty to account for profits.⁸³ But what actually was the statutory standard remained unclear. Commentators offered various formulations without agreement.⁸⁴ As Williams safely concluded, the standard would need to be more than merely stating "I am interested" but less than disclosing all material facts.⁸⁵

A further point that remained unclear was whether there was compliance with s199 where all the directors were interested, or where one director "disclosed" to him or herself. In *Woodware Products*, Hardie J thought s199 irrelevant in such situations,⁸⁶ so did not discuss the point further. But, in *David Neil*, Smellie J thought s199 did apply to single director companies.⁸⁷ However, on the facts of the case, he found that there was no evidence that disclosure had been made. This suggests that had disclosure been made, s199 would have applied and therefore the agreement for sale and purchase would not have been voidable at the option of the company.

F. Quorums

Before there was compliance with s199, disclosure by an interested director had to be made at a valid directors' meeting, i.e. a binding quorum must be present.⁸⁸ What was a binding quorum depended on the articles of the individual company.

⁸¹ Obviously, because on the facts of the case, he did not consider s199 to be applicable

⁸² (1982) 1 NZCLC 98, 341 at 98, 345

⁸³ E.g. *Guinness plc v Saunders* [1990] 2 AC 663

⁸⁴ For a summary, see G L Williams "Interested Directors - Some Recent Cases" (1988) 14 NZ Recent Law 167 at 174, 175

⁸⁵ *Ibid* at 175

⁸⁶ n34 at 98, 345

⁸⁷ n35 at 99, 669

⁸⁸ In addition, the meeting must have been properly convened, see Article 98 of Table A

Article 99 of Table A provided:

"The quorum necessary for the transaction of business of the directors may be fixed by the directors, and unless so fixed shall be 2."

Obviously then, in the case of single director companies, Article 99 needed to be immediately amended to permit a quorum of one.

A further impediment to a binding quorum was if the articles prohibited an interested director from being counted in the quorum. Article 84(2) contained such a prohibition. Again, obviously, particularly in the case of single director companies, Article 84(2) needed to be amended. The David Neil case well illustrates the consequences if this was overlooked. In the David Neil case, the company's articles included Article 84(2). Accordingly, as the only director, Mr Neil, was interested, no binding quorum would ever have been possible. However, in the *Woodware Products* case, Article 84(2) was expressly excluded from the company's articles. Therefore, the interested director, Mr Saunders, could be counted in any quorum.

A further variation was where the articles prohibited an interested director from voting, but were silent as to disqualification from the quorum. In the case of *Re Greymouth Point Elizabeth Railway and Coal Company Ltd*⁸⁹ two directors had made advances to the company which was in financial difficulties. At a subsequent board meeting it was resolved to issue debentures to the two directors to secure their advances. At the board meeting only three directors were present, two being the interested directors. Later, the company went into receivership and the validity of the debentures were challenged. Farwell J noted that the articles of the company required a quorum of two directors. His critical finding was that a quorum of directors meant a quorum capable of voting on the question. Therefore there had been no quorum and no valid contract for the issue of the debentures.⁹⁰

Similarly, in *Re Austplat Minerals N.L.*,⁹¹ the articles of a company required a quorum of two directors when the number of directors did not exceed three. At the relevant date

⁸⁹ [1904] 1 Ch 32

⁹⁰ *Ibid* at 35

⁹¹ (1990) 8 ACLC 720

there were only three directors who met to consider an agreement to purchase shares in another company. Two of the directors were interested in the transaction and abstained from voting. Accordingly, the resolution was "passed" by the remaining director. The Supreme Court of Western Australia found that the resolution was invalid:⁹²

" ..., a quorum at meetings of the board must be a quorum of persons competent to vote at the board meeting in question."

G. Miscellaneous

A number of minor points of uncertainty also existed under the 1955 Act. The wording of s199 seemed to suggest that disclosure could only be made at a meeting of directors. Arguably then, disclosure by a signed resolution in the minute book would not suffice, despite being made in accordance with Article 106.⁹³

The wording of s199(2) seemed to suggest that disclosure only needed to be made if the contract was brought before the board. If the contract need not be brought before the board, which may well have been the case with larger companies, then arguably no disclosure was required.

The relationship between Article 84(3) and s204 of the 1955 Act was never clear. In general terms, s204 prohibited articles or contracts making provision to exempt any officer of the company from liability for negligence, default, breach of duty or breach of trust. Articles or contracts which contravened s204 were void. Whether Article 84(3) was included remained a moot point. Commentators argued that Article 84(3) was permissible:

"as it is designed to prevent the duty arising, and does not relieve an individual from liability for breach of that duty."⁹⁴

⁹² Ibid at 722

⁹³ Which provided:
 "A resolution in writing, signed by all the directors for the time being entitled to receive notice of a meeting of the directors, shall be as valid and effectual as if it had been passed at a meeting of the directors duly convened and held. Any such resolution may consist of several documents in like form, each signed by one or more directors."

⁹⁴ n78

But there was no determinative authority on the point. As there as none on the position of third parties involved in a self-interested transaction. The issue being complicated by the provisions of ss18B and 18C of the 1955 Act.⁹⁵

For all these reasons, the law on self-interested transactions was ripe for reform under the new Companies Act 1993.

IV. SELF-INTERESTED TRANSACTIONS UNDER THE COMPANIES ACT 1993

Part VIII of the Act introduces a new regime to govern self-interested transactions. The theme of the new legislation reflects the move away from the strict prohibitions of the common law to more flexible rules invoking principles of fairness and disclosure. Rather than effectively imposing on directors a duty not to have a conflict of interest, reflecting the reality of business, the Act impliedly accepts the inevitability of self-interested transactions and imposes duties of disclosure and concepts of fairness to the company instead.

Like the rest of the Act, the new regime also reflects the move away from the United Kingdom company law model. Previously, New Zealand's company law statutes had largely been drawn from the English equivalent.⁹⁶ The new Act draws generally on North American corporation law statutes, particularly the Canada Business Corporations Act 1985, the Ontario Business Corporations Act 1982 and the US Model Business Corporation Act 1984. However, many provisions in the new Act, and in the new regime to govern self-interested transactions, have no obvious equivalent in other jurisdictions.

The new regime sets out provisions relating to four self-interest situations:

- (i) general transactions - section 140;
- (ii) use of company information - section 145;

⁹⁵ See n66 at 139-141 for further discussion

⁹⁶ E.g. The New Zealand Companies Act 1955 closely follows the Companies Act 1948(UK)

- (iii) share dealings - section 148;⁹⁷
- (iv) remuneration and other benefits - section 161

A. Meaning of Interested

Section 139(1) the Act defines exclusively the situations in which a director is deemed to be interested in a transaction. A director is interested, if and only if, the director:

- (i) is a party to the transaction; or
- (ii) will or may derive a material financial benefit from the transaction; or
- (iii) is a director, officer or trustee of another party or person who will or may derive a material financial benefit from the contract;⁹⁸ or
- (iv) is a parent, child or spouse of another party or person who will or may derive a material financial benefit from the contract; or
- (v) is otherwise directly or indirectly materially interested in the transaction.

Two differences from the regime under the 1955 Act are immediately obvious. First, the new Act refers to "transactions", while the 1955 Act referred to "contracts".⁹⁹ "Transaction" is not defined in the Act but would appear to have a wider meaning than "contract". Accordingly, the provisions of the Act may apply to situations less formal than contractual situations and/or prior to the relevant parties contracting or even proposing to contract with each other. Some guidance may be provided by s292(1) of the Act. That subsection provides a definition of "transaction" in the context of voidable transactions. However, it would appear that the definition is limited to only for the purposes of that

⁹⁷ The regime in respect to share dealings is not discussed further in this paper.

⁹⁸ This does not include a party or person that is the holding company where the company is a wholly-owned subsidiary, or a wholly-owned subsidiary of the company, or another wholly-owned subsidiary of the company's holding company (s139(1)(c)).

⁹⁹ I.e. in s199 and Article 84

section.¹⁰⁰ Secondly, apart from the rather obvious situation where a director is an actual party to the transaction,¹⁰¹ s139(1) introduces a criteria of materiality before a director is interested.¹⁰² It is not necessary that the benefit be "financial" because s139(1)(e) operates as a "catch-all" provision and provides that any direct or indirect material interest will be caught.

It is interesting that the section attempts on exhaustive definition. Accordingly, if it can be shown that a transaction is not caught by the definition, the regime will not apply. However, given the unrestricted ambit of "transaction" and the width of s139(1)(e), it is difficult to think of a situation that will fall outside the definition. Necessarily then the emphasis will be on the terms "material financial benefit", "material financial interest" and "materially interested".

Section 139(2) specifically provides that a director is deemed to be not interested if the transaction involves the director giving a guarantee, indemnity or security in respect of company business. Of course, in such a situation the director is clearly interested.¹⁰³ However, the reality is, particularly in the case of closely held companies, the giving of a security by a director will be critical to the company obtaining finance. The giving of such a security is clearly for the benefit of the company. Presumably then, the legislature considered this benefit to outweigh the danger from the director's conflict of interest. Arguably, a director may insist that the company provide additional security than is commercially necessary to reduce the risk of a call on the security that the director has provided.

¹⁰⁰ s292(1) provides: "In this section, "transaction", in relation to a company, means ..."
(The underlining is the writer's)

¹⁰¹ Section 139(1)(a)

¹⁰² See Part IVB of this paper

¹⁰³ As in the *Woodware Products* case, see Part IIIB(i) of this paper. Where a director guarantees a company loan, and the director has to pay the company's debt, the director will usually have a subrogated right to recover the same from the company.

In turn, s139(2) is subject to the qualification that the lender has no "connection" with the otherwise interested director. Again, the term "connection" is not defined in the Act. Accordingly, there is uncertainty as to its ambit. A quite common situation is where a director will have a personal account with the company's bankers. The question arises, is that a situation sufficient to constitute a "connection" and therefore s139(2) does not apply? Only after some interesting litigation will the answer be clearer.

B. Meaning of Material

The terms "material financial benefit", "material financial interest" and "materially interested" are not defined in the Act. Therefore it is not clear as to exactly when a financial benefit, a financial interest or an interest will become "material". It is easy to state that what is "material" will probably depend on the facts and circumstances of each individual case. But this provides little direction for affected directors. No doubt the experience of other jurisdictions with similarly worded statutes will be drawn on.

In Australia, s231(2) of the Corporations Law Act excludes any interest that "may properly be regarded as not being a material interest". However, that only applies where the director's interest consists of being a member or creditor of a corporation interested in a contract with the director's company. Similarly, to the New Zealand Act, the Corporations Act provides no assistance in deciding what is or what is not to be properly regarded as a non-material interest.¹⁰⁴

Ford offers that:¹⁰⁵

"The materiality of the interest of a member or creditor could depend on various factors in the particular circumstances including the relative size of the holding or debt and any special rights enjoyed."

¹⁰⁴ However, it is not unknown for a statute to define "material", at least in part. Section 97 of the Companies Act 1981 in Bermuda provides that an interest is not deemed material where ownership or direct or indirect control of the contracting party amounts to less than 10 per cent of its capital. See *Taking Responsibility, An International Guide To Directors Duties and Liabilities*, *International Financial Law Review*, April 1992 at 8.

¹⁰⁵ H A J Ford & R P Austin *Ford's Principles of Corporations Law* (6th ed) Butterworths, 1992, Sydney at 497

In *Alexander v Cambridge Credit Corporation Ltd*¹⁰⁶ the Supreme Court of New South Wales said that the word "materially" imports "an element of judgment and opinion which could be productive of uncertainty as to the obligations of the opponents in dispute, ..."107

Thus little of certainty can be taken from the Australian experience.

In Canada, s120(1) of the Canada Business Corporations Act refers to "material contracts" and "material interests".¹⁰⁸ Again, no assistance is provided as to what is meant by "material". Welling¹⁰⁹ opines that the meaning of what is material is conditioned by the purpose behind the section. And the purpose of the section is to identify those contracts or interests in which a director's ability to bargain effectively on behalf of the company may be inhibited. The test is, if disclosure of the interest had been made, would it be relevant to the board's decision whether to allow the director to continue with the other party? Welling suggests that, before this can occur, relying on the Privy Council decision in *Gray v New Augarita Porcupine Mines Ltd*,¹¹⁰ the director's declaration:

"... must make his colleagues "fully informed of the real state of things" [] If it is material to their judgment that they should know not merely that he has an interest, but what it is and how far it goes, then he must see to it that they are informed."

Of course this represents a return to what is very close to the fiduciary standard of full and frank disclosure of all material facts.¹¹¹ And the writer doubts whether the New Zealand courts would go that far.

106 (1986) 10 ACLR 327

107 Ibid at 331

108 See Part VIIA of this paper

109 B L Welling *Corporate Law in Canada* (2nd ed) Butterworths, 1991, Toronto at 452

110 [1952] 3 DLR 1 at 14

111 n79 at 168

In the United States, the American Law Institute's Principles of Corporate Governance: Analysis and Recommendations stipulates that disclosure must be of the known material facts relating to the conflict of interest and the transaction. A fact is material if there is "a substantial likelihood that a reasonable person would consider it important under the circumstances in determining the person's course of action."¹¹²

Until the New Zealand courts have grappled with this issue and laid down some guidelines, the prudent advice to interested directors may well be: if in doubt, disclose.

C. Disclosure

Section 140 provides a statutory duty of disclosure. Subsection (1) requires a director, who is interested in a transaction or a proposed transaction, to record his or her interest in the aptly named "interests register".¹¹³ If the company has more than one director, the interested director must also disclose the interest to the board. Unlike the entry in the interests register, there is no requirement that disclosure to the board must be in writing. So it would seem that an oral declaration will suffice with the obvious enforcement difficulties.¹¹⁴ However, the entry in the interests register (and disclosure) must be made "forthwith".

It is implicit in the drafting of the section that the director must be aware of the fact that he or she is interested in the transaction. Presumably then it will be a defence to any action, pursuant to s140, if the interested director can show that he or she was simply unaware of the conflict.

¹¹² Proposed Final Draft at 1.25

¹¹³ See Part IVD of this paper

¹¹⁴ s140(4)

The nature of the monetary value of the director's interest must be entered in the interests register¹¹⁵ or if the value of the interest cannot be qualified, the nature and the extent of the interest.¹¹⁶ For good practical reasons, a general notice may be entered in the interests register or disclosed to the board in situations where there may be an ongoing conflict.¹¹⁷ There is an interesting difference in the wording of s140(1) compared with s140(2) which the writer doubts was intended. Under s140(1) disclosure must be made by entry in the interests register, and, if the company has more than one director, disclosure to the board. However, s140(2) provides that a general notice entered in the interests register or disclosure to the board is a sufficient disclosure. If the option is taken to make disclosure to the board (and it can be done orally) then this would appear to circumvent disclosure to the shareholders?

Failure to comply with the disclosure requirements of s140(1) does not affect the validity of the transaction entered into.¹¹⁸ However, failure to comply by a director constitutes an offence under the Act, punishable by a fine of up to \$10,000.¹¹⁹

D. The Interests Register

The Law Commission in its Report No. 9 identified that, in the case of self-interested transactions:¹²⁰

"the case law has proved too strict and has been modified by articles and statute with results which are unsatisfactory; ... The draft Act:

requires self-interested transactions to be disclosed to shareholders and to be fair to the company;"

115 s140(1)(a)

116 s140(1)(b)

117 s140(2)

118 s140(3)

119 s140(4). Cf s199(4) of the 1955 Act.

120 Law Commission, Report No. 9 Company Law: Reform and Restatement (NZLC R9), GP Publications Ltd, 1989, Wellington at para. 193.

With that aim it appears that it is intended that the interests register will be the central mechanism in the administration of the affairs of the company to prevent directors from abusing their knowledge and powers for their own benefit. The concept of an interests register is new and, from the writer's researches, without parallel in other jurisdictions.¹²¹ Although it could be argued that s195A of the 1955 Act¹²² was some kind of precedent.

However, for all its apparent importance, the interests register is an elusive creature as provided for in the Act. Unlike s87 of the Act which requires a company to maintain a share register, there is no equivalent provision requiring the company to maintain an interests register. It may be that, the drafters of the new Act considered that while a company must have at least one share (s10(b)), there is no compulsion on directors to be interested. However, other provisions in the Act effectively require the compulsory maintenance of an interests register.

The company must keep an interests register at its registered office or, alternatively, at some other place in New Zealand upon notice to the Registrar.¹²³ As such the interests register forms part of the company's records. As part of the company's records the interest register must be kept in written form,¹²⁴ or in a form or manner that allows the information that comprises the record to be easily accessible and convertible into written form.¹²⁵ And, the board of the company must ensure that adequate measures exist to prevent the interests register being falsified.¹²⁶

The interests register must be kept available for inspection by directors and shareholders. Section 191 provides a procedure whereby directors may inspect the records of the company including the interests register. The company must make the interests register

121 In Australia, the maintenance of an interests register is part of a range of proposed reforms to the Corporations Law Act by the Companies and Securities Advisory Committee. Although the Committee's proposals for reform were published in July 1991, to date, they have not been made law.

122 Which provided that every company shall keep a register of officers' shareholdings.

123 s189(1)(c) and s189(3)

124 s190(1)(a)

125 s190(1)(b) - an obvious reference to computer records

126 s190

available for inspection by any shareholder of the company. Sections 216, 217 and 218 of the Act set out the procedure. Particulars of entries in the interests register must be included in the contents of the company's annual report.¹²⁷

The introduction of the concept of an interests register can be seen to have two particular improvements over the regime under the 1955 Act. First, disclosure must be in writing with the obvious publication and enforcement advantages. Secondly, it provides a mechanism whereby disclosure is made to the company as a whole, not just to the board, but without the need to call a general meeting.

E. Avoidance

As indicated earlier, failure by an interested director to make disclosure does not, in itself, affect the validity of a transaction already entered into.¹²⁸ However, unless the company's constitution specifically provides for the avoidance of transactions in which a director is interested, the transaction can only be avoided in accordance with s141.¹²⁹ Section 141(1) empowers the company with the right to avoid any self-interested transaction. However, this power expires three months after the transaction is disclosed to all the shareholders (whether by means of the company's annual report or otherwise). Presumably an expiry period has been provided for in the interests of certainty of the transaction. But a difficulty may well be that the three month period does not commence until after disclosure is made to all the shareholders. What if one shareholder is holidaying overseas at the time and does not read the annual report, and therefore disclosure is not effected, until some time later? Is the fact that the annual report was sent to the shareholder's latest known address in accordance with ss87(2)(a) and 209 of the Act sufficient?

Section 141(1) specifically provides that disclosure may be made otherwise than by the company's annual report. If made at a general meeting of shareholders, care would need to be taken that all shareholders were present. In the circumstances, if the transaction is of sufficient importance, it may be prudent to arrange for personal service of the disclosure document on each and all of the shareholders.

¹²⁷ s211(1)(e)

¹²⁸ s140(3)

¹²⁹ s141(6) But see Part IVE 2 of this paper

It will be noted that s141 does not convey any statutory right on the company to recover any profits made by an interested director. The only statutory right is avoidance of the transaction. Whether the company may provide for such a remedy in its constitution is a moot point. All that can be said with certainty is that the Act's silence on the point was deliberate. One of the model statutes, the Ontario Business Corporations Act, specifically covers the point. Section 132 of that Act provides that if the conflict of interest transaction is not rendered non-voidable, the director is accountable to the corporation for any profit unless the transaction was reasonable and fair to the corporation.

1. Fair Value

It will be recalled that at common law the fairness of the transaction was irrelevant.¹³⁰ However, under the new Act it is the central concept. Avoidance is only possible if the company did not receive "fair value" for the transaction and there is a presumption, which can be rebutted,¹³¹ that transactions entered into in the ordinary course of the company's business and on usual terms and conditions are fair.¹³² "Fair value" is to be determined on the basis of the information known to the company and the interested director at the time the transaction was entered into.¹³³ Accordingly, no element of hindsight is allowed.

For the purposes of s141, the person seeking to uphold the transaction and who knew or ought to have known of the director's interest at the time the transaction was entered into has the onus of establishing "fair value".¹³⁴ Otherwise, the onus of establishing that the company did not receive fair value is on the company.¹³⁵

It would appear that the drafters of the Act were under no illusion as to the difficulty of interpreting the meaning of "fair value".

¹³⁰ See Part II A of this paper

¹³¹ s141(5)

¹³² s141(4)

¹³³ s141(3)

¹³⁴ s141(5)(a)

¹³⁵ s141(5)(b)

"The concept of "fair value" will, if and when litigation is pursued provide mental exercise for expert witnesses and judges, but is not at all easy to define in advance. It was intended and may be expected to encourage corporate players and their advisers to err on the side of caution if any particular arrangement could be said to provide less than "fair value" to the party (often the company itself) with whom the director is dealing.¹³⁶

Section 141 follows similar North American provisions (e.g. Ontario Business Corporations Act 1982, s132(7), Canada Business Corporations Act 1985, s120(7), US Model Business Corporation Act 1984, s8.31). Accordingly, North American authorities should be of particular assistance in interpreting the section.¹³⁷

2. Section 141(6)

Section 141(6) is a difficult provision. On a broad interpretation, it provides the company with the power to effectively contract out of the Act's regime. For example, the company may choose to provide in its constitution that a self-interested transaction is not liable to be avoided.¹³⁸ But, on a narrow interpretation, coupled with s16(2) of the Act, it merely provides that the constitution may limit the company's powers of avoidance under the Act. For example, the 3 month period provided for in s141(1) may be limited to 2 months. The writer believes that the narrow interpretation will prove to be the correct one. It is implicit from the wording of s141(6) that the avoidance regime cannot, to coin a phrase, be avoided.

F. Third Parties

Avoidance of transactions necessarily raises issues of the effect on third parties. Section 142 provides that, if a transaction is avoided under s141, this will not affect the title or interest of a person in or to property which that person has acquired if the property was acquired:

¹³⁶ J Hodder, NZLS Seminar, Company Law 1 - Getting Started at 50.

¹³⁷ See Part VIIB of this paper.

¹³⁸ Similar to Article 84(3) of Table A.

- (i) from a person other than the company; and
- (ii) for valuable consideration; and
- (iii) without knowledge of the circumstances of the transaction under which the property was acquired from the company.

The wording of s142 seems to suggest that if the transaction was avoided in accordance with the company's constitution, as permitted by s141(6), then s142 does not apply. It is doubted that this was intended.

What also is not clear is what remedy the company has if it does not receive "fair value" under the transaction but it cannot avoid the transaction because of its effect on a third party. Does the company still have some general right of damages against the interested director?

G. Voting

Section 144 of the Act completely reverses the common law position as to voting. Subject to the constitution of the company, an interested director may vote, attend meetings, sign documents and generally do any other thing as if he or she was not interested in the transaction.

H. Enforcement

Failure to comply with the Act's provisions relating to self-interested transaction exposes a director to a raft of possible enforcement actions:

- (i) failure to make an entry in the interests register (and disclosure) is an offence under the Act (s140(4)). Upon conviction the director is liable to a fine up to \$10,000;
- (ii) section 169(3) provides that the duty to disclose interests (s140) and the duty to disclose share dealings (s148) are duties owed to the shareholders;
- (iii) section 169(3)(i) provides that the duty relating to the use of company information (s145) is a duty owed to the company;

- (iv) a breach of the general duty to act in accordance with the Act (s134);
- (v) the transaction may be avoided unless the company received fair value for it (s141(1));
- (vi) personal liability for an unauthorised payment (s161(5));
- (vii) liability to repay an unauthorised loan (s161(6));
- (viii) failure to keep the interests register at the registered office of the company or otherwise notified place is an offence under the Act (s189(5)). Upon conviction the director is liable to a fine up to \$10,000.

V. USE OF COMPANY INFORMATION

A. The Common Law Position

A corollary of the common law rule that directors, as fiduciaries, must not place themselves in a situation of conflict of interest, is that directors must not use a company's assets, opportunities or information for their own profit. If a director does so, then the company is entitled to an account of those profits.

In the case of small family owned companies and the use of company assets, abuse of this rule is probably epidemic.¹³⁹ With such companies enforcement of the rule is difficult and often uneconomic from a commercial point of view. But in the case of larger companies and the misuse of company information or a company opportunity a substantial body of common law authority has built up.

The leading case is the House of Lords decision in *Regal (Hastings) Ltd v Gulliver*.¹⁴⁰ The facts are somewhat complicated but can be summarised as follows. *Regal (Hastings) Ltd* ("Regal") owned a cinema. The directors of Regal, with a view to the future

¹³⁹ A conclusion based on anecdotal evidence only but few would doubt it.

¹⁴⁰ [1942] 1 All ER 378, [1967] 2 AC 134. The judgment was delivered in 1942 but for some reason was not reported in *The Law Reports* until 1967.

development or sale of the company, wished to acquire the lease of the two other cinemas. For this purpose, they formed a second company named Hastings Amalgamated Cinemas Ltd ("Amalgamated"). Amalgamated was registered with a capital of £5000 in £1 shares. The directors of Amalgamated were the same persons as the directors of Regal, except for one other person.

A difficulty arose because the lessor of the two cinemas insisted on a personal guarantee from the directors of Amalgamated unless the paid up capital of Amalgamated was at least £5000. The directors were not prepared to give guarantees so the venture appeared to flounder. A meeting of the directors of the two companies was held (without it being clear at any particular moment for which company a particular director was appearing) to discuss the matter further. As an alternative plan, it was resolved to subscribe the 5000 shares in Amalgamated. Regal took 2000 shares, being all that it could afford, and the directors took the remaining 3000. Accordingly, the lease was approved.

Subsequently all the shares in both companies were sold for a substantial profit. Later again, Regal, under its new owners, brought an action against the former directors to recover the profit made. There was no argument before the House of Lords that the former directors had not acted in good faith and with the interests of Regal in mind.¹⁴¹ However, the House of Lords found against them. Applying the classic trust case of *Keech v Sandford*,¹⁴² Lord Russell said:¹⁴³

"The rule of equity which insists on those, who by use of a fiduciary position make a profit, being liable to account for that profit, in no way depends on fraud, or absence of bona fides; or upon such questions or considerations as whether the profit would or should otherwise have gone to the plaintiff, or whether the profiteer was under a duty to obtain the source of the profit for the plaintiff, or whether he took a risk or acted as he did for the benefit of the plaintiff, or whether the plaintiff has in fact been damaged or benefited by his action. The liability arises from the mere fact of a profit having, in the stated circumstances, been made. The profiteer, however honest and well-intentioned, cannot escape the risk of being called upon to account"

141 Ibid at 143

142 n4

143 [1967] 2 AC 134 at 144

The issue was simply one of fact and the company need but show two things:

- (i) that what the directors did was so related to the affairs of the company that it can properly be said to have been done in the course of their management and in utilisation of their opportunities and special knowledge as directors; and
- (ii) that what they did resulted in a profit to themselves.¹⁴⁴

It will be observed that the result in the Regal (Hastings) Ltd case was quite undeserved. There was no evidence before the House of Lords that there had been any deceit in respect of the price paid by the new owners for the shares. Therefore, the result of the House of Lords' decision was to give the new owners "an unexpected windfall."¹⁴⁵ Furthermore, as the "interested" directors had owned a majority of the shares in Regal, they could, if they had wished, have protected themselves by having their action ratified by the company in general meeting. But, at the time, this had simply not occurred to them. Nor could it be said, in the true sense, that the directors had used the company's property or information, or had deprived it of an opportunity. On the facts of the case Regal could never have availed itself of the opportunity to acquire the further 3000 shares.

This is not to say that the Courts were not immune to the possible inequities of the common law rule that the Regal (Hastings) Ltd case illustrated. But the rule was thought to be too important for that. Lord Porter said:¹⁴⁶

"... the principle that a person occupying a fiduciary relationship shall not make a profit by reason thereof is of such vital importance that the possible consequence in the present case is in fact as it is in law an immaterial consideration."

A classic corporate opportunity case is *Cook v Deeks*.¹⁴⁷ In this case a construction company began negotiations to obtain a railway contract. However, three of the company's four directors obtained the contract in their own names excluding the fourth.

144 Ibid at 153

145 Ibid at 157

146 Ibid

147 [1916] 1 AC 554

Not surprisingly the fourth director sued. The Privy Council found that the benefit of the contract belonged in equity to the company and ought to have been dealt with as an asset of the company.¹⁴⁸ Similarly, in *Canadian Aero Service Ltd v O'Malley*,¹⁴⁹ the Canadian Supreme Court found that the president and executive vice president of the company (as such senior officers) owed fiduciary duties to the company similar to those owed by directors. Accordingly, they were held liable to account to the company, having participated in negotiations on behalf of the company, then resigned, formed a new company and acquired the contract for their new company.

B. The Companies Act 1993

Like the Act's general provisions in respect to self-interested transactions, s145 of the Act considerably reforms the common law as it applies to the use of company information. However, s145 maintains the basic obligation to maintain confidential information in confidence. In particular, a director must not disclose, make use of or act on information which he or she has in his or her capacity as a director or employee of the company.¹⁵⁰

Three immediate points about s145 should be noted. First, the section does not specifically refer to the position of company property. While clearly company information is company property, obviously not all company property is information. Accordingly, it would seem that misuse of company property, for example, use of company equipment for private use, would be a breach of s131¹⁵¹ of the Act rather than s145. Secondly, the definition of director in s126 of the Act is expanded for the purposes of s145¹⁵² to include a person in accordance with whose directions or instructions a director (as defined) may be required or is accustomed to act.¹⁵³ Thirdly, it would appear that use of company information may not be the subject of an unanimous agreement, see Part VIC of this paper.

148 Ibid at 564

149 [1973] 40 DLR (3rd) 371

150 s145(1)

151 Which provides for a duty of directors to act in good faith and in the best interests of the company.

152 And for the purposes of ss146-149 inclusive of the Act.

153 s126(1)(d)

Company information to be caught by s145 is information held by the director in his or her capacity as a director or employee of the company. The information must not otherwise be available to the director. Accordingly, s145 does not include information which comes to a director in a non-directorial or private capacity. The distinction was important in *Peso Silver Mines Ltd v Cropper*.¹⁵⁴ In this case, the company, *Peso*, was offered the opportunity to acquire various mining claims. However, at the time, *Peso's* financial resources were strained and the offer was rejected. The defendant, *Cropper*, was executive vice president and a director of *Peso* and a member of the board that made the decision to reject the offer. Later, *Cropper*, along with others, purchased the claims and formed two new companies, one to take over the claims and the other to develop them. *Cropper's* connection with the other mining companies caused "unfriendliness"¹⁵⁵ between him and the other directors of *Peso*. Eventually he was dismissed and required to resign as a director. *Peso* sued claiming *Cropper* was accountable to *Peso* for his shares in the new companies. On the facts of the case there was a crucial finding (not contested) that the original decision by *Cropper* and the other members of the board of *Peso* to reject the offer had been in good faith and in the best interests of the company. But importantly here, the Canadian Supreme Court found that *Cropper* was subsequently approached as a potential purchaser of the claims, not in his capacity as a director of *Peso* but, as an individual member of the public.¹⁵⁶ Accordingly, *Peso's* claim was dismissed.

Section 145(1) provides four exceptions to the prima facie rule. A director may disclose, make use of or act on company information:

- 1) for the purposes of the company;
- 2) as required by law;
- 3) in accordance with s145(2) and (3);
- 4) in compliance with s140.

154 [1966] 58 DLR (2d) 1

155 *Ibid* at 5

156 *Ibid* at 8

Of the above, 1) and 2) are self-explanatory and 4) is dealt with elsewhere in this paper.¹⁵⁷ But section 145(2) and (3) require further comment.

C. Section 145(2) - Necessary Information

Section 145(2) provides for the situation of nominee directors recognising the reality that such directors are expected to pass information on to the appointing shareholder. In its Report No. 9, the Law Commission explained the policy behind s145(2) as:¹⁵⁸

"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 ..."

Accordingly, unless prohibited by the board, s145(2) permits a nominee director to disclose information to his or her appointer provided that the name of the appointor is entered in the interests register.¹⁵⁹

D. Section 145(3) - Procedure for disclosure, use etc

Section 145(3) provides that a director may disclose, make use of or act on company information if:

- 1) particulars of the disclosure, use or act in question are entered in the interests register; and
- 2) the director is first authorised to do so by the board; and
- 3) the company will not be or is not likely to be prejudiced.

¹⁵⁷ See Part IVC of this paper

¹⁵⁸ Law Commission, Report No. 9 Company Law Reform and Restatement (NZLC R9) Publications Ltd, 1989, Wellington at para. 536.

¹⁵⁹ See Part IVD of this paper.

It would seem from 2) above that the board must give prior authority, otherwise, the director will technically be in breach of s145. But there is no requirement that the authority must be given in writing (unlike the entry in the interests register) and, in the context of single director companies, one could wonder at the relevance of such a procedure.

Jones¹⁶⁰ comments that s145(3) is an attempt to provide a "safe harbour" for transactions which, in the absence of s145(3), would be subject to the rigours of the common law requiring an account of profits. However, the "safe harbour" is undermined by the requirement that the disclosure or use of the company information not prejudice the company. Prior approval of the board should suffice because considerations of prejudice to the company should be considered by the board before its authority is given. Otherwise, the disclosure or use of company information may be subject to a subsequent argument that it prejudiced the company. In the circumstances, if the only safe course is to make disclosure to the company in general meeting, the usefulness of s145(3) is limited. Jones further questions that, if s145(3) is seen as a code, there may be some doubt whether the approval of the company in general meeting would provide sufficient authority for the director to take up the corporate opportunity as it would at common law.¹⁶¹ However, he subscribes to the view, as does the writer, that the approval of the company will continue to provide sufficient authority to a director to take up a corporate opportunity, s145(3) being seen as a procedural section only designed with administrative efficiency in mind.¹⁶²

As to the requirement that the disclosure or use of the company information not prejudice the company, at least it introduces an element of objectivity into the exercise. As the point has been made many times, in the context of small closely held companies, authority from the board is of dubious utility. At first blush, s145 appears to be somewhat of a toothless monster. There is no offence provision for non-compliance with s145.¹⁶³ Nor is there a provision requiring a director in breach of the section to account to the company for any profits made. However, under s169(3)(i) of the Act, s145 constitutes a duty owed to the company and therefore the company may sue the director for any breach. No doubt any such action would include a claim for any profits made. Further, any such breach could be

160 n3 at 119

161 Ibid

162 Ibid

163 c.f. s140(4)

the subject of a derivative action by the shareholders under ss164, 165, 170 or 172 of the Act.

VI. SECTIONS 161 AND 162 - A SEPARATE REGIME

Remuneration and other benefits paid to directors have always been of interest to the shareholders and creditors of the company. Reflecting a climate of concern, under the 1955 Act, loans to directors of public companies were prohibited.¹⁶⁴ And, at common law, any remuneration payable to directors was strictly limited to any express relaxation of the equitable rule contained in the articles of the company.¹⁶⁵ Typically, the articles required that the remuneration of directors be determined by the shareholders in general meeting.

In contrast, s161 of the Act adopts an enabling approach and applies a separate regime in respect to:

- payments of remuneration or the provision of other benefits for services as a director or in any other capacity;¹⁶⁶
- payments of compensation for loss of office;¹⁶⁷
- loans to directors;¹⁶⁸
- the giving of guarantees for debts incurred by directors;¹⁶⁹

¹⁶⁴ ss190(1), 354(4) and 9th Schedule. Although, one might have thought that, in the case of closely held companies, the risk was just as great, if not greater.

¹⁶⁵ E.g. *Guinness plc v Saunders* [1990] 2 AC 663 at 692

¹⁶⁶ s161(1)(a). Presumably the words "for services ... in any other capacity" are designed to catch payments made to directors designated to be payments to the director as a employee of the company.

¹⁶⁷ s161(1)(b)

¹⁶⁸ s161(1)(c)

¹⁶⁹ s161(1)(d)

- contracts to do any of the above.¹⁷⁰

The regime is separate because s143 of the Act provides that the general provisions relating to self-interested transactions (ss140 and 141) do not apply to:

- remuneration or any other benefit given to a director in accordance with s161; or
- an indemnity given or insurance provided in accordance with s162.

It should be noted that the phrase "in accordance with" is critical to the separate operation of the two sections. Otherwise, the arrangement will be subject to ss140 and 141 and therefore the requirements of disclosure,¹⁷¹ avoidance¹⁷² and penalty.¹⁷³

A. Authorisation Procedure

As a general rule, s161 empowers the board to authorise payments of remuneration and other benefits, provided the board is satisfied that the transaction is fair to the company.¹⁷⁴ However, this statutory authority is subject to any "restrictions" contained in the constitution of the company. By the use of the word "restrictions" it would seem that the constitution may include additional procedures or perhaps limits on the quantum of remuneration or benefits. But the Act does not appear to allow the constitution to contain a different authorisation process. In other words, the wording of the Act mandates that it is the board's responsibility to authorise such payments, not the company's.¹⁷⁵

¹⁷⁰ Cf the requirement of "fair value" in s143.

¹⁷⁰ s161(1)(e)

¹⁷¹ s140(1)

¹⁷² s141(1)

¹⁷³ s140(4)

¹⁷⁴ s161(1)

¹⁷⁵ s161(1) does not provide "Subject to the constitution of a company ..." Cf s160.

The only criteria that the board must consider is whether the transaction is "fair"¹⁷⁶ to the company. To that extent the rule in s161 can be seen as a more relaxed one. But what is fair to the company is a loose subjective concept. Reflecting this, traditionally, the Courts have been reluctant to interfere in the area of directors' remuneration." "[I]t is not for the Court to manage the company".¹⁷⁷

However, under s161, "fairness" is the only relevant criteria and necessarily it will eventually fall to the Courts to determine some guidelines.¹⁷⁸

After authorising the remuneration or other benefit, the board (not the director) must ensure that the particulars of the transaction are entered in the interests register.¹⁷⁹ Further, the directors who voted in favour of the transaction must certify that the transaction is fair to the company and give grounds for their opinion.¹⁸⁰

Section 161(3) provides that it is not necessary to obtain a separate authorisation for each transaction in accordance with a contract which has already been authorised under s161(1)(e). Obviously, in a situation of regular ongoing payments, for example, payments for services to the company, it should not be necessary to have to continually seek the board's approval.

B. Unauthorised Benefits

If the transaction has not been authorised in terms of s161(1), or the transaction has not been certified in terms of s161(4), or there are not reasonable grounds for the directors' opinion set out in the certificate, a director is personally liable for the amount of the payment or the value of the benefit.¹⁸¹ In the case of a loan, it becomes immediately

¹⁷⁶ Cf the requirement of "fair value" in s141.

¹⁷⁷ *Re Halt Garage Ltd* [1982] 3 All ER 1016 at 1039. A case where the liquidator of the company brought proceedings against husband and wife directors claiming that their remuneration exceeded the market value of their services.

¹⁷⁸ See Part VIIB of this paper

¹⁷⁹ See Part IVD of this paper

¹⁸⁰ s161(4)

¹⁸¹ s161(5)

repayable to the company, notwithstanding its terms.¹⁸²

The above is, however, subject to the proviso that, to the extent that the director can show that the transaction was in fact fair to the company, the director will not be liable. Accordingly, for example, if the director can only show that 80% of the payment was fair to the company, the director will only have to account for the remaining 20%. In this context of directors' remuneration, ss297 and 298 of the Act should also be noted.

C. Unanimous Agreements

The Companies Act 1993 imposes a multitude of formality requirements on companies. As well as the requirements associated with self-interested transactions, there are similarly complex regimes relating to the issue of shares, distributions to shareholders, share repurchases, amalgamations, financial assistance and so on.

In the case of closely held companies, where often the shareholders and the directors are the same persons (or person), such requirements, designed to ensure managerial accountability, are largely superfluous. Furthermore, such requirements involve the completion of relatively complex documentation which, in the context of such companies, is unwarranted and unduly expensive.

Section 107 of the Act is recognition of the inappropriateness of such complex formality requirements for closely held companies. The section provides that, if all entitled persons¹⁸³ agree, various transactions can be carried out by the company otherwise than in accordance with the provisions of the Act. Such an unanimous agreement must be recorded in writing.¹⁸⁴

Self-interested transactions are included among the transactions that may be the subject of an unanimous agreement. Prima facie, s107(3) of the Act provides that, if all entitled persons agree, nothing in ss140 and 141 of the Act shall apply to what would otherwise be a self-interested transaction. In the case of many closely held companies there will be only

182 s161(6)

183 As defined in section 2

184 Section 107(4)

one entitled person. Accordingly, that person (as shareholder) can authorise the company to enter into a transaction with him or herself (as director). As a result the provisions relating to disclosure, avoidance and penalties can be avoided. This is no further criteria.

But the operation of s107(3) very much depends on the nature of the transaction concerned. If the transaction falls within s161(1) (remuneration and other benefits) s107(3) does not apply. Instead the transaction is caught by s170(1)(f) of the Act. Such a transaction may be exercised under an unanimous agreement. However, under s108(1) of the Act, it is also subject to the solvency test.¹⁸⁵

Section 170(1)(f) is a somewhat curious provision. On the one hand, that the solvency test should apply to such transactions is logical. Payments of remuneration or other benefits to directors are equally able to undermine the position of creditors of the company as, for example, the payment of a dividend¹⁸⁶ or redemptions.¹⁸⁷ But, on the other hand, s170(1)(f) flies in the face of the policy behind allowing unanimous agreements. In the circumstances, the added obligation of certifying that the transaction satisfies the solvency test¹⁸⁸ may dissuade companies from using the unanimous agreement mechanism. Directors, in the case of a payment of remuneration under s161, may well prefer the lesser standard of fairness¹⁸⁹ and entry in the interests register¹⁹⁰ rather than involving the solvency test. Or, alternatively again, may choose to structure the transaction so that it falls outside the definition of s161. Accordingly, such a transaction would then only be subject to the general regime provided by ss140 and 141 and exercisable under unanimous agreement without the spectre of the solvency test.¹⁹¹

Short of unanimous agreement, there appears to be no reason in principle why the company could not "approve" a voidable transaction by ordinary resolution (s105(2)).

185 s4

186 s170(1)(a)

187 s170(1)(d)

188 s108(2)

189 s161(1)

190 s161(2)

191 s107(3)

However, if the transaction qualified as a major transaction (s129), approval by special resolution would be required (ss2 and 106). In the event of a disgruntled minority, s141(2) would remain the key provision, i.e. a transaction cannot be avoided if the company receives fair value under it.

VII. THE MODEL JURISDICTIONS

The Act's regime to regulate self-interested transactions was derived from similar Canadian and United States provisions. In particular, the Canada Business Corporations Act, R.S.C. 1985, c. C-44 ("CBCA"), the Ontario Business Corporations Act, S.O. 1982, C.4, as am ("OBCA") and the United States Revised Model Business Corporation Act 1984 ("MBCA"). Accordingly, further analysis of these model statutes should assist in our understanding of the Act's new regime.

A. Canada

Section 120 of the CBCA¹⁹² provides the Canadian regime for self-interested transactions. In the main, the CBCA has been adopted by the Canadian provinces although there are variations, for example, the OBCA.

1. What Conflicts Must Be Disclosed

Section 120(1) of the CBCA deals with three types of conflict of interest situations. The first type is when a director or officer of the corporation is involved as a party to a material contract or proposed material contract with the corporation.¹⁹³ Accordingly non material contracts are not caught. The New Zealand equivalent is s139(1)(a) of the Act. Although it will be noted that the CBCA refers to "contracts" as did the 1955 Act rather than "transactions".¹⁹⁴

The second type is when a director or officer of the corporation is a director or an officer of any person who is a party to a material contract or proposed material contract with the

¹⁹² See Appendix 1 of this paper

¹⁹³ s120(1)(a)

¹⁹⁴ However, s132 of the OBCA refers to "contracts" or "transactions"

corporation.¹⁹⁵ Again, non-material contracts are not caught. The New Zealand equivalent is s139(1)(c) of the Act.

The third type involves situations where a director or officer of the corporation has a material interest in any person who is a party to a transaction with the corporation.¹⁹⁶ This time non-material interests are not caught. The New Zealand equivalent is s139(1)(b) and (e) of the Act.

Obviously whether or not the contract or interest is "material" is critical. However, similarly to the New Zealand Act the CBCA provides no assistance as to what is meant by "material".¹⁹⁷

2. Disclosure

Section 120(1) of the CBCA requires that disclosure must be made in writing to the corporation or entered in the minutes of a meeting of directors. The nature and the extent of the interest must be disclosed.

There is no equivalent to the interests register. Accordingly, if the interested director chooses to make disclosure by an entry in the minutes of a meeting of directors, disclosure is effectively confined to the board.¹⁹⁸ But, unlike the New Zealand equivalent,¹⁹⁹ oral disclosure is not permitted.

Not all material facts need to be disclosed to ensure compliance with the CBCA. An interested director needs only to disclose "the nature and extent of his interest". The New

¹⁹⁵ I.e. s129(1):

A director or officer of a corporation who
(b) is a director or an officer of ... any person who is a party to a material contract or proposed material contract with the corporation

...

¹⁹⁶ s129(1)(b)

¹⁹⁷ See Part IVB of this paper

¹⁹⁸ There being no requirement in the CBCA (or the New Zealand Act for that matter) that the minutes of all meetings of directors be made available to the shareholders.

¹⁹⁹ There is no requirement that disclosure to the board under s140(1) of the Act must be in writing.

Zealand Act has adopted this requirement²⁰⁰ but only if the monetary value of the director's interest cannot be quantified.²⁰¹

Further details of disclosure are exclusively set out in s120(2), (3), (4) and (6) of the CBCA. The most important is s120(6) which allows for continuing disclosure of potential conflicts. There are obvious similarities in the wording of s140(2) of the New Zealand Act.

Section 120(4) provides for "routine"²⁰² contracts that would in the ordinary course of the corporation's business not go before the board. In such a case the nature and extent of the interest must be disclosed in writing to the corporation or entered in the minutes of the next meeting of directors, "forthwith" after the director or officer becomes aware of the contract or proposed contract. Any other type of contract must be disclosed under s120(2), in the case of directors, or under s120(3), in the case of officers. There are no equivalent provisions in the New Zealand Act.

3. Approval of Voidable Contracts

If the conflict of interest has been disclosed in accordance with s120(1), (2) (3) or (4), the next requirement is to get the otherwise voidable contract "approved". Section 120(7) provides that a contract will not be void or voidable if the board of directors or the shareholders "approve" the contract.

No criteria as to what is required for such approval is specified. Presumably a special resolution is not necessary. In the case of approval by the board, s120(5) provides that the interested director must not vote. But there is no restriction on the interested director voting as a shareholder,²⁰³ if the shareholders are to approve the contract. Nevertheless, s120(7) provides for a simple mechanism for approval of contracts. It is interesting that the drafters of the New Zealand Act chose not to adopt an equivalent procedure.

200 s140(1)(b)

201 s140(1)(a)

202 n109 at 445

203 Assuming, of course, the director is a shareholder.

Although, the provisions on unanimous agreements can be seen to have some similarities.²⁰⁴

4. Reasonable and Fair

In addition to disclosure and approval, the overriding criteria provided by s120(7) is that the contract must be "reasonable and fair to the corporation at the time it was approved". Accordingly, approval of an unreasonable or unfair contract to the corporation would be ineffective and the contract would remain voidable.

The equivalent provision in the OBCA is slightly different. Section 132 of the OBCA provides alternative procedures for rendering contracts non-voidable. Section 132(7) of the OBCA operates similarly to s120(7) of the CBCA. But, in addition, s132(8) provides that, where disclosure to the corporation has not occurred, a reasonable and fair contract may be rendered non-voidable by a special resolution of shareholders called for that purpose.

There does not appear to be any Canadian authority which discusses the "reasonable and fair" requirement in the Canadian statutes.²⁰⁵ Perhaps all that can be safely said is that the test is surely a objective one. But the New Zealand criteria of "fair value" under s141 of the Act is quite different. "Fair value" is to be determined on the basis of the information known to the company and to the interested director at the time the transaction is entered into.²⁰⁶ This suggests a subjective test. What information should have been reasonably known is irrelevant.

5. The Effect of Non-Disclosure

Failure to disclose a conflict of interest is an offence under s251 of the CBCA.²⁰⁷ More significantly, failure to disclose leaves a contract liable to be avoided by the corporation at

204 See Part VIC of this paper

205 But there is American authority, see Part VIIB of this paper.

206 s141(3)

207 Section 251 of the CBCA provides:

"Every person who, without reasonable cause, contravenes a provision of this Act or the regulations for which no punishment is provided is guilty of an offence punishable on summary conviction."

any time. Unlike in the New Zealand Act,²⁰⁸ no time limit is provided. Under s120(8) the corporation or a shareholder may apply to the court to set aside a material contract in the event that a director or officer has not made disclosure. The court can set aside the contract on such terms as it thinks fit.

Section 120(8) is a somewhat oddball provision. While s120(7) has three avoidance standards, disclosure, approval and fairness, there is no equivalent to s120(8) in respect of a failure to obtain "approval" or if the contract is not reasonable or fair.

It is interesting that the Canadian legislature should have regarded non-disclosure as worthy of a separate subsection. The drafters of the New Zealand Act thought the opposite. Section 140(3) of the Act specifically provides that failure to disclose does not affect the validity of a self-interested transaction.

B. United States of America

As in the Commonwealth jurisdictions, in the United States, traditionally, it has been the common law that has shaped the director's duty of loyalty to the corporation. However, now almost all jurisdictions in the United States have interested director statutes. The MBCA was designed to be a convenient guide for revision of state business corporation statutes, reflecting current views as to the appropriate accommodation of the various commercial and social interests involved in modern business corporations. It is designed for use by both publicly held and closely held corporations.²⁰⁹

Section 8.31²¹⁰ of the MBCA deals with conflict of interest transactions by a director with the corporation. The use of the term "transaction" will be immediately noted. In the

208 s141(1)

209 Official Text to Revised Model Business Corporation Act adopted by Committee on Corporate Law of the Section of Corporation, Banking and Business Law of the American Bar Association Spring 1984, Law & Business Inc/Harcourt Brace Jovanovich, New York at xvii.

210 See Appendix 2 of this paper

context of s144 of the Delaware General Corporation Law,²¹¹ Folk comments.²¹²

"The statute is all-inclusive within the area delineated by its language. Director interest may exist, inter alia, in sales and purchases of property of all sorts, contracts between the corporation and an officer or director, compensation of officers and directors, loans or an issue of stock or stock options to such persons, and corporate mergers where a director stands on both sides of the transaction. Director interest may also exist where determinations with respect to indemnification are made (unless displaced by the specific provisions of section 145), and where determinations are made with respect to maintaining suits by the corporation against persons allegedly injuring it."

Section 8.31 applies to transactions in which a director²¹³ has an interest, either directly or indirectly. An "indirect interest" has an extended definition²¹⁴ including the term "material financial interest".²¹⁵

Essentially section 8.31 is negative in effect. Transactions covered by the section are not voidable solely because of a director's interest in the transaction.²¹⁶ Instead three procedures are provided for to sustain what would otherwise be a self-interested transaction. They are:

- 1) approval by the directors (ss8.31(a)(1) and 8.31(c));
- 2) approval by the shareholders (ss8.31(a)(2) and 8.31(d));
- 3) fairness (s8.31(a)(3)).

²¹¹ The Delaware equivalent to section 8.31.

²¹² EL Folk Folk on the Delaware General Corporation Law (3rd ed) Little, Brown and Company, 1992 Cumulative Supplement No. 2, Boston at 144.3.

²¹³ Section 8.31 does not apply to officers, employees or any shareholder of the corporation. C.f. s126 of the New Zealand Act.

²¹⁴ s8.31(b)

²¹⁵ C.f. s139(1)(b) of the New Zealand Act.

²¹⁶ C.f. s140(3) of the New Zealand Act.

Little is to be gained by an analysis of the MBCA's approval procedures. The drafters of the New Zealand Act obviously shunned the adoption of express approval procedures for self-interested transactions. Under the New Zealand Act a self-interested transaction can only be avoided if the company does not receive fair value under it.²¹⁷ Accordingly, American authority on the concept of fairness to the corporation will be relevant and should be helpful.

1. Entire Fairness

The leading American case is *Weinberger v UOP, Inc.*²¹⁸ In this case, a corporation which was the majority shareholder of a subsidiary corporation sought, and acquired, the remaining shares of the subsidiary by a merger transaction, including the payment of cash to the minority shareholders of the subsidiary for their shares. A group of the minority shareholders of the subsidiary, who had not sold their shares for the merger attacked the validity of the merger transaction. In particular, the minority shareholders pointed to the fact that certain individuals had acted in a dual capacity as directors of both the parent and the subsidiary corporations. The Supreme Court of Delaware stated the fairness test as follows:²¹⁹

"There is no "safe harbor" for such divided loyalties in Delaware. When directors of Delaware corporation are on both sides of a transaction, they are required to demonstrate their utmost good faith and the most scrupulous inherent fairness of the bargain. The requirement of fairness is unflinching in its demand that where one stands on both sides of a transaction, he has the burden of establishing its entire fairness, sufficient to pass the test of careful scrutiny by the courts.

There is no dilution of this obligation where one holds dual or multiple directorships, as in a parent-subsidary context Thus, individuals who act in a dual capacity as directors of two corporations, one of whom is parent and the other subsidiary, owe the same duty of good management to both corporations, and in the absence of an independent negotiating structure ..., or the directors'

217 s141(2)

218 457 A.2d 701

219 Ibid at 710, 711

total abstention from any participation in the matter, this duty is to be exercised in light of what is best for both companies."

(The underlining is the writer's)

In respect to "an independent negotiating structure" the Court pointed to the desirability of an independent negotiating committee of outside directors and that if the directors were on an arm's length basis that is strong evidence that the transaction meets the test of fairness.²²⁰

Under the Weinberger test, directors who stand on both sides of a transaction are required to prove the entire fairness of the transaction. The court also described the two basic aspects of the fairness test: "fair dealing and fair price."

- Fair dealing "embraces questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and stockholders were obtained."²²¹
- Fair price "relates to the economic and financial considerations of the proposed merger, including all relevant factors: assets, market value, earnings, future prospects, and any other elements that affect the intrinsic or inherent value of company's stock."²²²

VIII. However, the Court did recognise circumstances which might mitigate the prima facie rule:

"[E]ven though the ultimate burden of proof is on the majority shareholder to show by a preponderance of the evidence that the transaction is fair, it is first the burden of the plaintiff attacking the merger to demonstrate some basis for invoking the fairness obligation However, where corporate action has been approved by an informed vote of a majority of the minority shareholders, we conclude that the burden entirely shifts to the plaintiff to show that the transaction was unfair to

²²⁰ Ibid at 709, 710

²²¹ Ibid at 711

²²² Ibid of course, it is

Perhaps the minority But in all this, the burden clearly remains on those relying on the vote to show that they completely disclose all material facts relevant to the transaction."²²³

(The underlining is the writer's)

Accordingly, the plaintiff retains the initial burden of proof in order for the entire fairness test to be applied. However, if the transaction was approved by an informed vote of a majority of the minority shareholders, the plaintiff will also have the ultimate burden of proof to show "unfairness".

On the facts of the Weinberger case, the Court found that the minority shareholder vote was not an informed one. Therefore the merger transaction did not meet the test of fairness and the burden of proof did not shift to the plaintiff.

It remains to be seen how far the New Zealand courts adopt the American regime of "entire fairness". Of course, unlike the American statutes, the New Zealand Act does not use the term "fair".²²⁴ Instead the term "fair value" has been preferred. It may be that the concept of "fair value" has by the addition of the word "value" an increased emphasis on the financial or monetary side of the transaction. Like with so many aspects of the new Act, only time will tell.

VIII. CONCLUSION

The new regime to govern self-interested transactions in the Companies Act 1993 is unique, a New Zealand hybrid of provisions from the North American statutes and other provisions which have no obvious equivalent in other jurisdictions. Compared with the regime under the Companies Act 1955, the new regime is complex and convoluted. But many of the new provisions are obviously designed to remedy the inadequacies in the common law and the law under the 1955 Act. The introduction of a criteria of materiality and the central concept of fairness to the company are but two examples.

223 Ibid at 703

224 Except, of course, s161

Perhaps the major criticism that can be made against the new regime is that the reforms have not been consistently worked through the new legislation. The new Act applies a complex but inconsistent regime, especially in the context of closely held companies. There are, for example, curious anomalies in the application of the solvency test and in the provisions on unanimous agreements.

Whether the new regime will, in practice, have a significant impact on the management of company business remains, of course, to be seen. From a practical point of view, in the day to day management of many companies, this is to be doubted. Few directors, particularly those of closely held companies, will have the inclination to familiarise themselves with the intricacies of the new regime. No doubt remuneration and other benefits will continue to be paid out to directors with scant regard to concepts of fairness, disclosure, materiality and the solvency test. Indeed, prudent practical advice might well be to ignore the regime. In the event, it is likely that the effectiveness of the regime will be tested in the context of company liquidations. Hopefully it will provide the appropriate balance between the interests of directors and the companies they manage.

(1) The disclosure required by subsection (1) shall be made, in the case of an officer who is not a director,

(2) forthwith after he becomes aware that the contract or proposed contract is to be considered or has been considered at a meeting of directors,

(3) if the officer becomes informed after a contract is made, forthwith after he becomes so informed; or

(4) if a person who is interested in a contract later becomes an officer, forthwith after he becomes an officer.

(5) If a material contract or proposed contract is one that, in the ordinary course of the corporation's business, would not require approval by the directors or shareholders, a director or officer shall disclose or notify the corporation or request to have entered in the minutes of meetings of directors the nature and extent of his interest forthwith after the director or officer becomes aware of the contract or proposed contract.

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

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

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

(c) one for indemnity or insurance under section 124; or

(d) one with an affiliate.

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

Appendix 1

Section 120 of the Canada Business Corporations Act provides:

"120 (1) A director or officer of a corporation who

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

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

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

- (a) at the meeting which a proposed contract is first considered;
- (b) if the director was not then interested in a proposed contract, at the first meeting after he becomes so interested;
- (c) if the director becomes interested after a contract is made, at the first meeting after he becomes so interested; or
- (d) if a person who is interested in a contract later becomes a director, at the first meeting after he becomes a director.

(3) The disclosure required by subsection (1) shall be made, in the case of an officer who is not a director,

- (a) forthwith after he becomes aware that the contract or proposed contract is to be considered or has been considered at a meeting of directors;
- (b) if the officer becomes interested after a contract is made, forthwith after he becomes so interested; or
- (c) if a person who is interested in a contract later becomes an officer, forthwith after he becomes an officer.

(4) If a material contract or proposed material contract is one that, in the ordinary course of the corporation's business, would not require approval by the directors or shareholders, a director or officer shall disclose in writing to the corporation or request to have entered in the minutes of meetings of directors the nature and extent of his interest forthwith after the director or officer becomes aware of the contract or proposed contract.

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

- (a) an arrangement by way of security for money lent to or obligations undertaken by him for the benefit of the corporation or an affiliate;
- (b) one relating primarily to his remuneration as a director, officer, employee or agent of the corporation or an affiliate;
- (c) one for indemnity or insurance under section 124; or
- (d) one with an affiliate.

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

(7) A material contract between a corporation and one or more of its directors or officers, or between a corporation and another person of which a director or officer of the corporation is a director or officer or in which he has a material interest, is neither void nor voidable by reason only of that relationship or by reason only that a director with an interest in the contract is present at or is counted to determine the presence of a quorum at a meeting of directors or committee or directors that authorized the contract, if the director or officer disclosed his interest in accordance with subsection (2), (3), (4) or (6), as the case may be, and the contract was approved by the directors or the shareholders and it was reasonable and fair to the corporation at the time it was approved.

(8) Where a director or officer of a corporation fails to disclose his interest in a material contract in accordance with this section, a court may, on the application of the corporation or a shareholder of the corporation, set aside the contract on such terms as it thinks fit."

- (1) the material facts of the transaction and the director's interest were disclosed as known to the board of directors or a subcommittee of the board of directors and the board of directors or committee authorized, approved, or ratified the transaction;
- (2) the material facts of the transaction and the director's interest were disclosed as known to the shareholders entitled to vote and they authorized, approved, or ratified the transaction; or
- (3) the transaction was fair to the corporation.
- (b) For purposes of this section, a director of the corporation has an indirect interest in a transaction if (1) another entity in which he has a material financial interest or in which he is a general partner or a party to the transaction or (2) another entity of which he is a director, officer, or trustee is a party to the transaction and the transaction is or should be considered by the board of directors of the corporation.
- (c) For purposes of subsection (a)(1), a conflict of interest transaction is authorized, approved, or ratified if it received the affirmative vote of a majority of the directors on the board of directors (or on the committee) who have no direct or indirect interest in the transaction, but a transaction may not be authorized, approved, or ratified under this section by a single director. If a majority of the directors who have no direct or indirect interest in the transaction vote to authorize, approve, or ratify the transaction, a quorum is present for the purpose of taking action under this section. The presence of, or a vote cast by, a director with a direct or indirect interest in the transaction does not affect the validity of any action taken under subsection (a)(1) if the transaction is otherwise authorized, approved, or ratified as provided in this subsection.
- (d) For purposes of subsection (a)(2), a conflict of interest transaction is authorized, approved, or ratified if it received the vote of a majority of the shares entitled to be considered under this subsection. Shares owned by or voted under the control of a director who has a direct or indirect interest in the transaction, and shares owned by or voted under the control of an entity described in subsection (a)(1), may not be counted in a vote of shareholders to determine whether to authorize, approve, or ratify a conflict of interest transaction under subsection (a)(2). The vote of those shares, however, is counted in determining whether the transaction is approved under other provisions of this Act. A majority of the shares, whether or not present, that are entitled to be counted in a vote on the transaction under this subsection constitutes a quorum for the purpose of taking action under this section.

Appendix 2

Section 8.31 of the United States Revised Model Business Corporation Act provides:

"8.31. DIRECTOR CONFLICT OF INTEREST

- (a) A conflict of interest transaction is a transaction with the corporation in which a director of the corporation has a direct or indirect interest. A conflict of interest transaction is not voidable by the corporation solely because of the director's interest in the transaction if any one of the following is true:
- (1) the material facts of the transaction and the director's interest were disclosed or known to the board of directors or a committee of the board of directors and the board of directors or committee authorized, approved, or ratified the transaction;
 - (2) the material facts of the transaction and the director's interest were disclosed or known to the shareholders entitled to vote and they authorized, approved, or ratified the transaction; or
 - (3) the transaction was fair to the corporation.
- (b) For purposes of this section, a director of the corporation has an indirect interest in a transaction if (1) another entity in which he has a material financial interest or in which he is a general partner is a party to the transaction or (2) another entity of which he is a director, officer, or trustee is a party to the transaction and the transaction is or should be considered by the board of directors of the corporation.
- (c) For purposes of subsection (a)(1), a conflict of interest transaction is authorized, approved, or ratified if it received the affirmative vote of a majority of the directors on the board of directors (or on the committee) who have no direct or indirect interest in the transaction, but a transaction may not be authorized, approved, or ratified under this section by a single director. If a majority of the directors who have no direct or indirect interest in the transaction vote to authorize, approve, or ratify the transaction, a quorum is present for the purpose of taking action under this section. The presence of, or a vote cast by, a director with a direct or indirect interest in the transaction does not affect the validity of any action taken under subsection (a)(1) if the transaction is otherwise authorized, approved, or ratified as provided in that subsection.
- (d) For purposes of subsection (a)(2), a conflict of interest transaction is authorized, approved, or ratified if it receives the vote of a majority of the shares entitled to be counted under this subsection. Shares owned by or voted under the control of a director who has a direct or indirect interest in the transaction, and shares owned by or voted under the control of an entity described in subsection (b)(1), may not be counted in a vote of shareholders to determine whether to authorize, approve, or ratify a conflict of interest transaction under subsection (a)(2). The vote of those shares, however, is counted in determining whether the transaction is approved under other sections of this Act. A majority of the shares, whether or not present, that are entitled to be counted in a vote on the transaction under this subsection constitutes a quorum for the purposes of taking action under this section.

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