TRANS-TASMAN REGULATION OF FINANCIAL INVOLVEMENT OF DIRECTORS - The Aftermath of the Corporate Collapse

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One can discern from the papers by Mr Hartnell and Mr McKenzie two important ways in which there is a contrast between the position in Australia and that in New Zealand on the relationship between director and company.

The first relates to the fundamental duty of a director. In Australia, that duty has since 1962 been stated in statutory form and is now to be found in s232 of the Corporations Law. A breach of s232 attracts not only civil, but also criminal liability. In New Zealand, on the other hand, there is no statutory formulation of the fiduciary duty of a director to a company; instead, the duty is that formulated under the general law, and breach of it entails civil, but not criminal, liability.

Let me venture to say that there is more to be said in favour of the New Zealand approach than might at first appear. In the first place, s232 is the only instance under Australian law of which I am aware of a breach of fiduciary duty ***per se*** - that is, not involving theft, misappropriation or fraud - being made a criminal offence. Secondly, the need to discharge the criminal burden of proof beyond reasonable doubt means that a prosecution for an offence against a section in such broad terms as s232 is not something to be lightly undertaken.

Another problem with the criminalization of breach of directors' fiduciary duties is that where, as so often happens in Australia, the facts giving rise to a possible criminal prosecution emerge from a royal commission or other public inquiry, the adverse publicity given to the potential defendant in the course of the inquiry may delay or even prevent a trial. The ASC's co-ordinator of prosecutions, Mr Stephen Menzies, was quoted only a day or two ago (***Herald Sun***, 6 May 1991) as saying:

> "It's unfortunate that many criminal prosecutions will be stayed for some considerable period and it may be that if a defendant receives too much publicity through the process of hearing before a Royal Commission, he can apply to the court for his trial to be permanently stayed ... We are concerned about the fact that some of the criminal prosecutions which were ... already before the court may be indefinitely stayed."

There are therefore some grounds for re-considering the imposition of criminal liability for breach of s232. One must also remember that the Uniform Companies Act gave the Registrar of Companies few, if any, powers to bring civil proceedings for breach of the then equivalent of s232; but the vesting in the ASC of wide powers to mount civil proceedings under such provisions as s50 of the Australian Securities Commission Act and s1324 of the Corporations Law arguably removes much of the need to impose criminal liability for breach of s232. Indeed, by dispensing with it, we may promote, to borrow the attractive metaphor used by the present Chief Justice of the US Supreme Court in relation to SEC Rule 10b-5, the growth of a judicial oak from a legislative acorn.

Even more relevant to this morning's discussion is the contrast between the draft Corporations Amendment Bill 1991 in Australia and the NZ Companies Bill relating to transactions between directors and their companies. The Australian Bill runs to no less than 43 pages, and follows the prevalent Australian proclivity for prohibiting in great particularity transactions which are not inherently harmful, but are liable to be harmful when indulged in by the wrong people in the wrong circumstances, and then qualifying the prohibition by elaborate exemptions. it is not easy to read, even for a lawyer. If this is a specimen of "black letter law", one is tempted to define "black letter law" as legislation addressed by the Parliamentary Counsel to the legal profession over the heads of the parliamentarians who are supposed to enact it and over the head of the business community which is supposed to be regulated by it.

In contrast, the NZ Companies Bill will, as I understand it, allow loans to be made to, and guarantees to be given for the benefit of, a director by a company, provided first, that the transaction is disclosed in the interests register; secondly, that the directors voting in favour of it sign a certificate stating that in their opinion the relevant contract is fair to the company and the reasons for that opinion; and thirdly, that the director in question assumes the risk of having to reimburse the company if it turns out that the transaction is found not to have been fair to the company at the time it was made. That approach lends itself to legislation in much simpler terms than the Australian approach.

The efficacy of the New Zealand approach does not lie only in placing something like a sword of Damocles over the head of a director taking a loan from a company. Even more importantly, it would seem to make it necessary for the other directors to satisfy themselves as to the fairness of the loan to the company before authorising the making of the loan. Otherwise, were the loan to turn out not to have been fair to the company and to be irrecoverable from the director concerned, the other directors who authorised the loan may well themselves be accountable to the company.

In contrast, the Australian proposals, if implemented, will tend to direct the attention of directors (and their advisers) primarily to the detailed exceptions to the general prohibition and only secondarily to the more important question whether, even if a proposed transaction is outside, or exempted from, the general prohibition, it is still a proper exercise of the directors' powers. It will also add significantly to the proliferation of often complex and prolix legislation affecting company directors over the last decade which one fears has led to widespread unawareness of that legislation by those who are supposed to be regulated by it.

There is a third point relevant to our discussion this morning at which there is a clear divergence between Australia and New Zealand. Let me approach it in this way. By the early 1930s there had come to be noticed, most memorably by Adolf Berle and Gardiner Means in their study "The Modern Corporation and Private Property", a separation of the ownership of a company on the part of its shareholders from the control of the company by its management producing, in the words of the authors, "a condition where the interests of owner and of ultimate management may, and often do, diverge, and where many of the checks which formerly operated to limit the use of power disappear".

It is, I think, not far-fetched to suppose that the arrival of the takeover bid in the English-speaking world in the 1950s was a natural response to that phenomenon, a response that might have occurred earlier but for the second world war. A takeover, as we all know, is essentially the acquisition of control of a company by the voluntary sale and purchase of shares in the company at a price above the pre-existing market price: an inherently harmless transaction. The takeover mechanism, however, provides the means by which shareholders, who have themselves no real control over the management of the company, can collectively transfer control to others by, as it were, voting with their feet. On that view, the development of a market for corporate control was unquestionably for the benefit of shareholders and provided an inhibition against management treating the company as its own fiefdom.

Nevertheless, pressure to place restrictions on takeovers soon emerged. The source of the pressure tended, not surprisingly, to be the managerial sector rather than the shareholding sector. In Australia, legislation specifically regulating takeovers first appeared in the form of s184 of the Uniform Companies Acts of 1961/62, which was largely based on the UK Licensed Dealers (Conduct of Business) Rules. Not dissimilar legislation was introduced in New Zealand by the Companies Amendment Act 1963. Both pieces of legislation regulated, not the acquisition of shares as such, but the making of offers to acquire more than a given percentage (33% in Australia, 20% in New Zealand) of shares in a company. It was not long, however, before the paths taken by our two countries separated. So far as I am aware, the only subsequent significant legislative change in New Zealand affecting takeovers as such is to be found in the field competition law in the shape of the merger provisions of the Commerce Act 1986. In Australia, on the other hand, not only were takeovers made subject to competition law by s50 of the Trade Practices Act 1974, but the relevant Companies Act provisions were substantially re-cast in 1972 and then replaced in 1981 by the lengthy and complex provisions of the Companies (Acquisition of Shares) Act which, with effect from 1 January 1991 were substantially re-enacted in Chapter 6 of the Corporations Law.

In the result, the market for corporate control is far more heavily inhibited by regulation in Australia than in New Zealand. In Australia, it is in general possible to seize control of a listed company only if one is prepared to offer to acquire on the same terms all, or a fixed proportion, of the holding of each shareholder in the company. If equality as between shareholders is the only consideration, that regime has something to commend it; but, as with all efforts to impose equality, it carries a price. In this context, the price is a severe weakening of the takeover mechanism as a corrective to the divorce of management of a company from its ownership. Is that perhaps a cause of some of the corporate misbehaviour in Australia in the 1980s?