NOTES ON THE COMPANIES (AMENDMENT) ACT 1974*

I. INTRODUCTION

On 14 March 1974 the Companies (Amendment) Bill was introduced into Parliament. On 27 March 1974 it was read a second and third time and passed as the Companies (Amendment) Act 1974.[1] On 25 April 1974 it was assented to by the President. On 15 November 1974 it was brought into force. According to the explanatory statement "most of the amendments... are inspired by the recommendations of the U.K. Jenkins Committee on Company Law Reform".[2]

References hereinafter to the Act are to the Companies Act as amended by this 1974 Amendment Act. The Companies Act immediately before the coming into force of the Amendment Act shall be referred to as the former Act.

II. THE COMPANY — financial assistance for acquisition of shares by employees

Amendment Act: section 8(a) and (b)

Under the former Act, a company could establish a scheme and under that scheme provide money to trustees to purchase or subscribe for fully paid shares in the company or its holding company to be held by or for the benefit of the company's own employees. The scheme could not, however, benefit employees of a subsidiary of the company. Section 67 of the Act has now been amended to permit this. Also under the former Act, a company could give financial assistance to employees, other than directors, either of the company itself or of its subsidiary to enable them to purchase fully paid shares in the company. Financial assistance could not be given to purchase fully paid shares in the holding company. The amendment now permits this. It has to be noted that provision of money and the giving of financial assistance are permissible only vertically in a group.[3] It is still not permissible horizontally between different branches of the group.

Amendment Act: section 8(c)

Section 67 has also been amended by adding at the end of sub-section (3): "and any transfer or allotment of shares pursuant to a purchase or dealing prohibited by sub-section (1) of this section shall

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1. No. 10 of 1974.

2. Report of the Company Law Committee (the "Jenkins Report"), Cmnd. 1749.

3. See the Jenkins Report, para. 187 (e).

be void". The explanatory statement says: "where company shares are acquired by or with the financial assistance of a company, any transfer or allotment of shares pursuant to a purchase or subscription prohibited by this section shall be void." With due respect to the author of that statement, the amendment does not go as far as the statement implies. Section 67(1) prohibits 2 things. It prohibits the giving of financial assistance in the purchase of or subscription for shares of the company or its holding company. It also prohibits the purchase, dealing in or lending of money on its own shares. The amendment affects a transfer or allotment pursuant to a prohibited purchase or dealing only, and not to a prohibited giving of financial assistance.

The transfer or allotment is void if made pursuant to the prohibited purchase or dealing. Such a transfer or allotment could include a transfer or allotment to the company, a transfer or allotment by the company to a third party and a transfer or allotment between third parties. It could affect shares in a company other than the offending company. Suppose a company were to purchase its own shares in the stock exchange, paying cash and receiving a share certificate and transfer form to blank transferee. Without registering the transfer, the company sells the shares for cash and delivers the share certificate and the same transfer form still to blank transferee. Notwithstanding that the transfer form was not completed to effect a transfer to the company and subsequently a transfer from the company, a right of property in the shares passed to the company on its purchase and from the company on its sale. It is submitted that there has been a transfer both to the company and from the company within the meaning of the Act and both transfers are now void. Alternatively the transfer as represented by the transfer form from the original seller to the ultimate purchaser would be a transfer pursuant to the prohibited purchase and dealing and would also be void. If, instead of cash, the purchase and subsequent sale were in consideration of, say, an allotment or transfer of shares in another company, the allotment and transfer would also be an allotment or transfer pursuant to the prohibited purchase and prohibited dealing. The transfer and allotment in each case is now made void.

"Void" *prima facie* means void *ab initio.* Upon the breach of the prohibition being known, there may well be chaos on the stock exchange where the shares the subject matter of the purchase or dealing and other shares as well which were allotted or transferred pursuant to the purchase or dealing have changed hands many times.

"Void" can also sometimes mean voidable if as a matter of construction this is the meaning to be assigned to it. In the present context there will be the additional problem of determining at whose instance the transfer or allotment should be voidable. The prospect of chaos on the stock exchange is still present. It is interesting to observe that by section 17 a corporation cannot be a member of its holding company and any allotment or transfer of shares in a company is void if it is an allotment or transfer to its subsidiary only.

What the Jenkins Report recommended was that it should be unlawful for a company to give financial assistance in the purchase of its own shares or those of its holding company unless approved by special resolution of the company as in a reduction of capital,[4] and any transaction in breach of this should be voidable at the instance of the company against any person who has notice of the facts.[5]

III. THE MEMBERS — substantial shareholders

Amendment Act: section 9

Formerly a person with an interest in 1/10 in nominal amount of all the voting shares or of all the voting shares of any one class in a company was a substantial shareholder. It is now *5%* in each case. A person in the intermediate position between *5%* and *10%* on the coming into force of the amendment on 15 November 1974 would become a substantial shareholder on that date, that is, he would become a substantial shareholder after Division 3A came into operation within the meaning of section 69D. However, by sub-sections (4) and (5) of section 69C which are new, his obligations appear to have been restated.

Amendment Act: sections 10 and 11

Substantial shareholders now have 7 days, instead of 14, to give notice to the company. Section 69L providing defences to prosecution is still related to the giving of notice within 14 days. This may have escaped the attention of the draftsman.

Amendment Act: section 12

By section 69N a company may by notice require any member to disclose the identity of beneficial owners of voting shares held by the member and particulars of voting agreements and arrangements affecting those shares. The power to require disclosure is given only to a company all of whose shares are listed on the stock exchange. If some of the shares are not listed the company appears to have no such power. It may be preferable that the power should be given to any company but to apply only to such shares as are listed on the stock exchange.

Sub-section (4) of section 69N provides that on receiving any information from a member who has been required to make disclosure the company is required to record the fact that the requirement was imposed, the date on which it was imposed and the information received. These particulars are required to be inscribed against the name of the member in a separate part of the register kept under section 69J. This is the register of substantial shareholders. The member who has been required to make disclosure under section 69N may not be a substantial shareholder and his name may not be a substantial shareholder and his name may not be in this register. Sub-section (5) goes on to provide that "The provisions of section 69J shall apply in relation to the part of the register referred to in sub-section (4) of this section as they apply in relation to the remainder of the register and as if references to sub-section (1) of that section included references to sub-section (4) of this section." Unfortunately, there are no references to section 69J(1) in either section 69J or section 69N(4). It is possible that the words

4. *Ibid.*, para. 187(d)(i).

5. *Ibid.*, para. 187(d) (viii).

"section 69D in" should be read after "as if references to" in section 69N(4). Reading section 69N as a whole and section 69N(4) and (5) in particular, it seems clear that the intention is to provide for a single register to contain particulars of substantial shareholders as well as particulars of beneficial ownership of voting shares and of voting agreements affecting those shares. Assuming this to be so, then it is suggested that section 69J(1), which provides for the register, be amended to include the information received under section 69N. Section 69N(4) and (5) will then be unnecessary.

IV. THE DIRECTORS

(a) Loans to directors

Amendment Act: section 16

Section 133A prohibits loans to a company or person connected with a director of the lending company or the provision of security for such loans. Where the borrower is a company, the prohibition applies if directors of the lending company or members of their family are together interested in shares of the nominal value equal to or more than 20% of the equity share capital of the borrowing company. If the borrower is a natural person the prohibition applies if the borrower is a member of the family of a director of the lending company or of its holding company.

The prohibition applies to every lending company, including an exempt private company. It is interesting to note that an exempt private company may continue to make loans to its directors themselves or directors of its subsidiary. The Jenkins Report recommended an extension of the scope of section 133, which prohibits loans to directors, to borrowing companies in which the directors hold a controlling interest.[6] Exempt private companies should not be affected and the interest in equity shares should be substantial enough to exercise control, perhaps not as low as 20%.

The prohibition extends to a borrower who is a member of the family of a director of the holding company of the lending company but not its subsidiary. Compare section 133 where the prohibition extends to directors of related companies. "Family" is not defined in the Act. The Oxford English Dictionary includes the following meanings:

a. members of a household, parents, children, servants, etc.

b. set of parents and children, or of relations, living together or not.

c. person's children.

Compare section 134(15) and (16) where specific members of the family are mentioned.

(b) Refusal to register transfer

Amendment Act: section 13

The articles of association of many companies, especially private

6. *Ibid.*, para. 99 (p).

companies, confer on the directors a discretion to refuse to register a transfer or transmission by operation of law of shares in the company.[7]

Where directors have a discretionary power, the discretionary power is of a fiduciary nature and must be exercised in good faith. It must not be exercised corruptly, or fraudulently, or arbitrarily, or capriciously or wantonly. In exercising it the directors must act in good faith in the interest of the company and with due regard to the transferor's right to transfer his shares.[8] Where, in the exercise of their discretion, directors refuse registration, then in the absence of specific provisions (a) the directors are not bound to give reasons, and if they do not give any reasons that is not a ground from which a Court ought to infer that they were acting arbitrarily;[9] and (b) they are presumed to have acted in good faith[10] and honestly for the furtherance of the interests they were bound to protect.[11] The presumption is rebuttable but the onus is on those challenging refusal.

Section 105 (1A) now provides that where an application is made to a company for a person to be registered as a member in respect of shares which have been transferred or transmitted to him by operation of law the company intending to exercise any discretion to refuse registration conferred by the articles must serve within one month of the application a written notice stating the facts which are considered to justify refusal. As in regulation 22 of Table A,[12] the discretion is invariably given to directors and it is usually given by the articles. It would appear though that a discretion given by the memorandum of association is not caught by section 105(1A).

Although facts which are considered to justify refusal have to be stated, the onus is still on those seeking to challenge the refusal to show that the directors have not acted in good faith and honestly in furtherance of legitimate interests.

If reasons are given by directors in circumstances where they are not bound to give any, then the reasons given are presumed to be the only reasons.[13] It is not clear whether under section 105 (1A) it is open to the directors to adduce other reasons to justify refusal. It is respectfully submitted that if the "facts which are considered to justify refusal" given within one month of the application to register the transfer or transmission are not in fact sufficient to justify refusal then the company would be precluded from adducing other reasons as these would not have been given within the stipulated time.

7. See e.g. the Companies Act, Fourth Schedule, Table A, reg. 22.

8. See *re Bell Bros. Ltd.* (1891) 65 L.T. 245; *Slee v. International Bank* (1863) 17 L.T. 425. See also *Smith* v. *Fawcett Ltd.* [1942] 1 Ch. 304.

9. In *re Gresham Life Assurance Society*, *Ex parte Penney* (1872) 8 Ch. App. 446 at p. 451.

10. *Ibid.*, at p. 450. See also *Berry* v. *Tottenham Hotspur Football & Athletic Co. Ltd.* [1936] 3 All E.R. 554 at p. 556.

11. *Weinberger* v. *Inglis* [1919] A.C. 606 at p. 626.

12. Rf. fn. 7, above.

13. *Re Bell Brothers Ltd.*, *supra.*

(c) Disposition of company's shares

Amendment Act: section 15

Section 132D prohibits directors from exercising any power to issue any shares in a company unless the prior approval of the company in general meeting has been obtained notwithstanding any provision in the memorandum or articles of association and any issue of shares made in contravention of the section is void.[14] The approval may be confined to a particular exercise of the power or generally and may be unconditional or conditional. The power to issue shares conferred on directors is a fiduciary power to be exercised *bona fide* in the interests of the company.[15] It seems clear that the fiduciary nature of this power is not affected by section 132D even if general and unconditional approval of the company in general meeting has been obtained.

The prohibition is clearly intended to apply to the granting of options.[16]

The resolution giving approval is subject to the provisions of section 154 which requires lodgment of a copy with the Registrar of Companies. The approval will remain in force until the conclusion of the next Annual General Meeting or the expiry of the period within which the next Annual General Meeting must be held, whichever is earlier. If while the approval is in force an option to take up shares authorised by the approval is granted the option may be exercised according to its conditions even after the expiry of the approval.

The prohibition is effective after the commencement of the next Annual General Meeting of the company or the last day for holding the Annual General Meeting whichever is earlier. It will accordingly not apply to any issue of shares within the first 18 months of incorporation of a company unless the first Annual General Meeting has commenced.

(d) Disposition of company's assets

Amendment Act: sections 6 and 15

No provision of the Act has had a history of as many changes as section 132C which concerns the directors' power of disposing of the company's undertaking or property. The function of directors is to manage the business of the company, not to dispose of it. To protect shareholders the Jenkins Report recommended provisions to prohibit directors from disposing of the whole or substantially the whole of a company's undertaking or assets without the specific approval of the company.[17] In the Companies Act 1967, section 35(3) (since repealed), which is quite unrelated to the rest of section 35, read as follows:

> 35(3). Where any contract is entered into by or on behalf of a company which involves the sale of all or substantially all of the undertaking or assets of the company and the contract is not expressed to be made subject to a

14. See the Jenkins Report, para. 122(h) (and see also paras. 119, 120 and 121).
15. *Howard Smith Ltd.* v. *Ampol Ltd.* [1974] 2 W.L.R. 689.
16. See s. 132D(4).
17. See the Jenkins Report, para. 122(e) and also para. 117.

> condition that it is subject to ratification by a resolution of the company passed at a general meeting of the company the company and every officer who is in default shall be guilty of an offence under this Act. . . .

The problems created by section 35(3) of the 1967 Act were quite serious. There were three such problems:

(a) "Officer" includes a receiver and manager appointed under a power contained in an instrument and a liquidator in a voluntary winding up. A debenture holder appointing a receiver and manager to realise his security may be frustrated by refusal of the shareholders to ratify any sale. A receiver who is not also manager is not an officer and would not be caught by the prohibition. But a receiver who is not also a manager cannot generally manage the business. While the function of directors may be to manage and not to dispose of a business the function of a receiver and manager appointed by debenture holders would certainly include disposal. In the last few years, such receivers and managers have done more disposal than management. Until November 15 last year they have had to wait hopefully for other creditors to put the unfortunate company into liquidation and in some cases actively encourage liquidation so that the liquidators may come to their rescue and ratify the sale effected by them.

(b) If the sale by the receiver and manager was not subject to ratification not only was the receiver and manager guilty of an offence but the company itself was guilty of an offence. This penalised the company and indirectly the shareholders who in the first place were to have been protected.

(c) A sale which offends against section 35(3) might not be enforceable. Since the company was penalised the company might not be able to enforce it. A purchaser acting in good faith for valuable consideration without notice of the facts constituting the offence might be able to enforce it. The result might well be that a sale favourable to the purchaser could be enforced by him but if favourable to the company and unfavourable to the purchaser could not be enforced by the company. This was clearly undesirable.

As a result of representations to the Attorney-General, the Companies (Amendment) Act 1973 was passed to amend section 35(3) with the following effects:

(a) A receiver and manager appointed under a power contained in an instrument and a liquidator appointed in a voluntary winding up were no longer caught by section 35(3).

(b) A contract offending against the provision no longer amounted to an offence by the company itself but only to an offence by the defaulting officers.

(c) A contract offending against section 35(3) was enforceable if it was entered into with a purchaser for value acting in good faith and without notice of the breach.

The 1973 amendment, while resolving the three serious problems, itself introduced minor problems. The enforceability of the contract which offended section 35(3) depended on the purchase being for value and on the purchaser acting (i) in good faith and (ii) without knowledge of the breach of section 35(3). "Good faith" may generally be presumed in a purchase for value but what is not good faith may not be easy to establish. Furthermore, since the contract must contain an express provision for ratification, knowledge of the breach must mean knowledge that the sale is of the whole or substantially the whole of the undertaking or assets. There may be circumstances from which knowledge may be inferred or which may put the purchaser on enquiry. Under these circumstances, is the purchaser without knowledge?

The 1974 amendment has repealed section 35(3) altogether and re-enacted new provisions in section 132C. Now, directors are prohibited from carrying into effect proposals for disposing of [18] the whole or substantially the whole of the undertaking or property unless these proposals have been approved by the company in general meeting.

Under the present section 132C, the prohibition applies only to directors and not officers. A receiver and manager would be able to effect a sale without the approval of the shareholders. But by subsection (4) the section is not to apply to proposals made by a receiver and manager appointed under a power contained in an instrument or a liquidator in a voluntary winding up. It would appear that directors would be able to carry into effect such proposals without the approval of the shareholders if the proposals were made by these two classes of officers but not by others.

Section 132C(3) now provides that a transaction entered into in breach of the prohibition is valid in favour of the purchaser provided that he has dealt with the company for valuable consideration and without actual notice of the contravention. Comparing with the former position, it is to be observed that "good faith" has been omitted and "actual notice" has replaced "knowledge". The Jenkins Report recommended good faith and valuable consideration only. Approval of the company in general meeting is a matter of indoor management with which a purchaser should not be concerned.

A transaction in breach of the prohibition would seem to be valid in favour of the company as well since the company can ratify it. It seems logical that a transaction entered into to carry into effect a proposal must *a priori* be a valid transaction. Otherwise the proposal could not be said to have been carried into effect.

(e) Directors' interests

Amendment Act: section 14

Under section 131 a director must declare the nature of his interest in a contract or proposed contract with the company. An interest of a

18. See *North, Rock Explorations Ltd.* v. *Zahavy Mills Ltd.* [1974] 3 O.R. (2n) 163 (Canada) ("Sell, lease, exchange or otherwise dispose of"); but see *Worcester Works Finance* v. *Gooden Engineering Co. Ltd.* [1971] 3 All E.R. 708 ("sale, pledge or other disposition"). "Disposing of" in section 132C may have a very wide meaning.

member of his family is now for this purpose treated as his interest. Again, as with section 133A, "family" is not defined.

Amendment Act: section 17

Under section 135 a director is obliged to notify the company of matters related to his interests in shares to enable the company to comply with section 134 relating to the register of directors' share holdings. If the matters relate to securities listed on the stock exchange then the director must, under section 135A, similarly notify the stock exchange. He must do so within the "like period". He has only 24 hours.

If on 15 November 1974 directors of a listed company had an interest in securities of the company or if their wives or husbands or infant sons or infant daughters who were not themselves directors had such an interest, they must notify the stock exchange of such interest and they must do so by 16 November 1974.

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