COMPANIES
AND
SECURITIES
LAW REVIEW COMMITTEE

DIRECTOR'S STATUTORY DUTY TO DISCLOSE INTEREST (Companies Act S.228) AND LOANS TO DIRECTORS (Companies Act S.230)

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CONTENTS

REPORT OF THE
COMPANIES AND SECURITIES LAW REVIEW COMMITTEE
ON
DIRECTOR'S STATUTORY DUTY TO DISCLOSE INTEREST (COMPANIES ACT S.228) AND LOANS TO DIRECTORS (COMPANIES ACT S.230)

TO: The Ministerial Council for Companies and Securities.

The CSLRC presents to the Ministerial Council its Report on a director's statutory duty to disclose interest (Companies Act section 228) and loans to directors (Companies Act section 230). This is the Ninth report of the Committee, the others being:

* Report on the Takeover Threshold (November 1984)

* Report on Partial Takeover Bids (August 1985)

* Report on Forms of Legal Organisation for Small Business Enterprises (September 1985)

* Report on the Civil Liability of Company Auditors (September 1986)

* Report on the Issue of Shares for Non-Cash Consideration and Treatment of Share Premiums (September 1986)

* Report on a Company's Purchase of its own Shares (September 1987)

* Report on Prescribed Interests (May 1988)

* Report on Nominee Directors and Alternate Directors (March 1989)

Terms of Reference

The Ministerial Council for Companies and Securities referred to the Committee "for inquiry and review the following questions relating to directors and officers of companies:

(a) standards relating to their conduct and performance"

Background : Discussion Paper No. 8

In August 1988 the Committee published Discussion Paper No. 8: Director's Statutory Duty to Disclose Interest (Companies Act s.228) and Loans to Directors (Companies Act s.230).

A list of respondents to the Discussion Paper is in Appendix A.

PART A - DIRECTOR'S STATUTORY DUTY TO DISCLOSE INTEREST (COMPANIES ACT s.228)

THE ISSUES AND RECOMMENDATIONS

[1] **Reasons for requiring disclosure of interest.** Because a director is a fiduciary acting not for himself, or herself, but. for the company whose business the director has been appointed to superintend, the company should know, through the board, of any interest or conflict of duties relevant to each director. Moreover, the other directors need to be informed in order to perform their duty to the company. If a director with an interest or conflict of duty participates in the discussion, the other directors should be in a position to weigh the arguments made by all participating directors.

[2] **A company transaction in which a director is interested is voidable under case law.** It is a well-established principle that a director should not have a personal interest in the company's transactions unless the company has given its informed consent. Under general law if a company learns that a director has been interested in its transaction without its consent, the transaction is, in general, voidable at the option of the company. The company's opportunity to free itself from the transaction can affect third persons involved in the transaction who were aware of the director's interest in the company's transaction.

[3] **The company's informed consent will prevent the transaction being voidable.** A principal's transaction in which a fiduciary for the principal is interested will not be voidable if the principal consents to the fiduciary being interested. Where the relationship is one between a company and a director, it is not enough under the general principle that the other directors consent on behalf of the company; the consent of the company can be given only by the members either in a general meeting or by unanimous informal assent. However, in many companies it is not practicable to convene a general meeting to approve each transaction in which a director may be interested. Accordingly, articles of association commonly contain provisions which lessen the disability of a director to be interested in a company transaction and which declare that the transaction in which the director is interested shall not be liable to be avoided. The following is an example:

"No Director shall be disqualified by his office from contracting or entering into any arrangement with the Company either as vendor, purchaser or otherwise, nor shall such contract or arrangement or any contract or arrangement entered into by or on behalf of the Company in which any Director shall be in any way interested, 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 such Director holding that office, or of the fiduciary relation thereby established, but every Director shall observe the provisions of the Act relating to the disclosure of the interests of the Directors in contracts or proposed contracts with the Company, or of any office or property held by the Directors which might create duties or interests in conflict with their duties or interests as Directors. The Company shall, by way of a note attached to the balance sheet, send to shareholders details of any material contract entered into by the Company or its subsidiaries in which a Director of the Company has a material interest either directly or indirectly, but this requirement shall not apply to any service agreement with a Director who is employed by the Company. The note shall include (inter alia) the names of the parties to the contract, the name of the Director (if not a party to the contract), particulars of the contract and the Director's interest in the contract. For the purposes of this Article a contract shall include any agreement or arrangement whether formal or informal and whether express or implied, and shall include an agreement that is not enforceable by legal proceedings whether or not it Was intended to be so enforceable. A contract with a subsidiary of the Company shall be taken into account as if it were a contract with the Company. A contract shall not be deemed to be material if it is entered into by the Company in the normal day to day conduct of its business. Particulars of any disclosable contracts or arrangements either still subsisting at the end of the financial year or, if not then subsisting, entered into since the end of the previous financial year shall be set out in the note attached to the balance sheet. No Director shall, as a Director, vote or be counted in the quorum in respect of ally contract or arrangement in which he is so interested as

aforesaid, and if he do so vote his vote shall not be counted, but this prohibition as to voting shall not apply to any allotment of shares or debentures of the Company or to any contract or arrangement where the Director is interested merely as a shareholder or director of another company, and such prohibition may at any time or times be suspended or relaxed to any extent by the Company in general meeting."

In unlisted companies the articles may go so far as to permit interested directors to vote on matters related to the company transaction in which the director is interested. But under the Australian Stock Exchange Limited's Listing Rules an interested director of a listed company is not to vote. Rule 3L(6) provides:

"A director (including an alternate director) shall not vote at a meeting of directors in regard to any contract or proposed contract or arrangement in which he has directly or indirectly a material interest."~

[4] **Superimposed legislation making non-disclosure criminal.** The general law requires a director who is interested in a company transaction to disclose the fact that he or The is interested if only to enable the other directors to be in possession of all relevant information necessary to their decision on the transaction. To meet the problem that a director may not perform that duty of disclosing a personal interest section 228 makes it a criminal offence to fail to disclose an interest in certain circumstances.

[5] Section 228 provides :

"228(1) Subject to this section, a director of a company who is in any way, whether directly or indirectly, interested in a contract or proposed contract with the company shall, as soon as practicable after the relevant facts have come to his knowledge, declare the nature of his interest at a meeting of the directors of the company.

Penalty : $1,000 or imprisonment for 3 months, or both.

The Listing Rules contain a definition of "contracts involving directors' interests" which seems to be for the purposes of Rule 3C(3)(d) which requires disclosure in the company's annual report of "particulars of material contracts involving directors' interests."

(2) The requirements of sub-section (1) do not apply in any case where the interest of a director of a company consists only of being a member or creditor of a corporation that is interested in a contract or proposed contract with the first-mentioned company if the interest of the director may properly be regarded as not being a material interest.

(3) A director of a company shall not be taken to be interested or to have been at any time interested in any contract or proposed contract by reason only:

(a) in a case where the contract or proposed contract relates to any loan to the company - that he has guaranteed or joined in guaranteeing the repayment of the loan or any part of the loan; or

(b) in a case where the contract or proposed contract has been or will be made with or for the benefit of or on behalf of a corporation that is related to the company - that he is a director of that corporation,

and this sub-section has effect not only for the purposes of this Code but also for the purposes of any rule of law, but does not affect the operation of any provision in the articles of the company.

(4) For the purposes of sub-section (1), a general notice given to the directors of a company by a director to the effect that he is an officer or member of a specified corporation or a member of a specified firm and is to be regarded as interested in any contract that may, after the date of the notice, be made with that corporation or firm shall be deemed to be a sufficient declaration of interest in relation to any contract so made or proposed to be made if:

(a) the notice states the nature and extent of the interest of the director in the corporation or firm;

(b) when the question of confirming or entering into the contract is first taken into consideration, the extent of his interest in the corporation or firm is not greater than is stated in the notice; and

(c) the notice is given at a meeting of the directors or the director takes reasonable steps to ensure that it is brought up and read at the next meeting of the directors after it is given.

(5) A director of a company who holds any office or possesses any property whereby, whether directly or indirectly, duties or interests might be created in conflict with his duties or interests as director shall, in accordance with sub-section (6), declare at a meeting of the directors of the company the fact and the nature, character and extent of the conflict.

Penalty: $1,000 or imprisonment for 3 months, or both.

(6) A declaration required by sub-section (5) in relation to the holding of an office or the possession of any property shall be made by a person

(a) where the person holds the office or possesses the property as mentioned in sub-section (5) when he becomes a director - at the first meeting of directors held after:

(i) he becomes a director; or

(ii) the relevant facts as to the holding of the office or the possession of the property come to his knowledge,

whichever is later, or

(b) where the person commences to hold the office or comes into possession of the property as mentioned in sub-section (5) after be becomes a director - at the first meeting of directors held after the relevant facts as to the holding of the office or the possession of the property come to his knowledge.

(7) A secretary of a company shall record every declaration under this section in the minutes of the meeting at which it was made.

(8) Except as provided in sub-section (3), this section is in addition to, and not in derogation of, the operation of any rule of law or any provision in the articles restricting a director from having any interest in contracts with the company or from holding

offices or possessing properties involving duties or interests in conflict with his duties or interests as a director."

[6] In Discussion Paper No. 8, the Committee raised questions as to the terms and operation of section 228. The nature of those issues, the views of respondents to the Discussion Paper and the Committee's recommendations now follow.

[7] **Transactions other than contracts and proposed contracts.** Section 228(1) requires a declaration only in respect of a contract or proposed contract. It does not cover dispositions of property unrelated to a contract, such as a trust.

In the United Kingdom in the equivalent of section 228 the Companies Act 1985 section 317(5) provides:

"A reference in this section to a contract includes any transaction or arrangement (whether or not constituting a contract) made or entered into on or after 22 December 1980".

In Discussion Paper No. 8 para 5.3 the Committee asked the question : should section 228(1) require a declaration in respect of a "transaction or proposed transaction"?

[8] Five submissions dealt with this issue and all agreed that the existing wording is too narrow.

[9] The Committee **recommends** that section 228 should require a declaration in respect of a transaction or arrangement (whether or not constituting a contract) or a proposed transaction or arrangement.

[10] **Should materiality be a test of matters required to be disclosed?** Section 228(1), for the most part, requires a declaration of interests whether or not they are material. But section 228(2) excludes an interest as a member or creditor of a corporation interested in a contract if the director's interest "may properly be regarded as not being a material interest" Section 228(2) has no counterpart in the United Kingdom.

In some other jurisdictions disclosure is required only in respect of a material interest. The South African Companies Act 1973 section 234(1)

requires a disclosure only where a director is "materially interested" and section 234(2) confines the required disclosure to "any contract or proposed contract which is of significance in relation to a company's business" The Ontario Business Corporations Act 1982 section 132(1) requires disclosure where a director "is a party to a material contract or transaction" or "is a director or an officer of, or has a material interest in, any person who is a party to a material contract or transaction"

The Committee notes that in The Draft Companies Act appended to Report No. 9 of the New Zealand Law Commission entitled "Company Law Reform and Restatement" (June 1989), section 108 limits the required disclosure to a material interest.

Respondents to Discussion Paper No. 8 were mostly opposed to any suggestion that disclosure under section 228(1) should be required only in respect of a material interest. There are difficulties in framing a test of "materiality" appropriate to the needs of section 228. There was a view, with which the Committee agrees, that the first decision as to whether an interest is material should not be left to the interested director. Moreover, the legislation should encourage disclosure between members of the board as fellow fiduciaries. The Committee **recommends** against amending section 228(1) so as to make it require disclosure of only a material interest.

[11] The director should be under a duty to make adequate disclosure so that the other directors are in a position to make a proper decision on behalf of the company. The Committee **recommends** that the terms of the requirement to declare should impose a duty to provide the board with enough information to enable the board to decide whether the interest may be disregarded as not being material. If that recommendation is adopted, section 228(2) could be repealed.

[12] **Disclosure of Conflicting duties.** Where a director has a duty to some third person which conflicts or may conflict with his or her duty to the company that conflict of duties can constitute a declarable interest within section 228(1). The express reference to conflict of duties found in section 228(5) may be contrasted with the language of section 228(1) which refers only to interest. In the background case-law a conflict of duties is as significant as a conflict between the director's personal interest and the duty to the company. In Discussion Paper No. 8 the Committee suggested

that it is desirable to make the position clear in order to provide clear guidance to the commercial community. The suggestion was supported by the Law Council of Australia. The Company Directors' Association of Australia suggested that there be a definition of "interest" which covered financial entitlement, directorships, employment contracts or family relationships in respect of the entity with which the company proposed to enter a transaction.

It seems to the Committee that section 228 should somewhere indicate expressly that it requires disclosure of a conflicting duty.

[13] The Committee **recommends** that "interest" in relation to a transaction or arrangement or proposed transaction or arrangement with the company be defined for the purposes of section 228 as including the possibility of deriving personal benefit from the transaction or arrangement, either directly or indirectly, whether by reason of business or family relationship or otherwise, or having, directly or indirectly, a duty in relation to the transaction or arrangement to another person who could possibly derive benefit from the transaction or arrangement.

[14] **Transactions that do not come before the board.** The mischief at which section 228 is aimed would seem to be the existence of a director's unauthorised interest in a company transaction whether the transaction comes before the board or not.

[15] Comparable legislation elsewhere expressly extends to transactions that do not come before the board.

The Ontario Business Corporations Act 1982 section 132(4) requires that a director 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 in a contract or transaction that, in the ordinary course of the corporation's business would not require approval by the directors or the shareholders, forthwith after he becomes aware of the contract or transaction.

The South African Companies Act section 234(2) requires disclosure of a contract or proposed contract entered into or to be entered into:

"(a) in pursuance of a resolution taken or to be taken at a meeting of

directors of a company; or

(b) by a director or officer of the company who either alone or together with others has been authorized by the directors of the company to enter into such contract or any contract of a similar nature"

In Victoria the State Bank Act 1988 section 16(1) provides:

"A director who has a direct or indirect pecuniary interest in a matter being considered or about to be considered by the Board or in any other matter in which the Bank is concerned must as soon as possible after the relevant facts have come to the director's knowledge, disclose the nature of the interest at a meeting of the Board."

[16] In Discussion Paper No. 8 para 6.3 a question was raised as to whether section 228 should be so worded as to make it clear that a declaration is required regardless of whether the particular transaction comes before the board.

[17] As pointed out by The Company Directors' Association of Australia, section 228 as it now stands is wide enough to cover contracts made by officers. However, the Committee believes that there is room for a view that section 228 is concerned only with contracts that come before the board; there could be a view that the aim of the section is to ensure that the board is informed about the influences that may affect a board member's vote. Whatever is the true position, it is desirable that the legislation should refer expressly to transactions entered into by company officers. A majority of respondents favoured that.

[18] The Law Council of Australia did not support alteration of section 228 in that way because in its view the transaction would be implemented on behalf of the company by independent minds considering what is best for the company. However, in the Committee's opinion there is a mischief that an officer's decision on a transaction in which a director is known to be interested could be influenced by a desire to curry favour with that director.

[19] The Committee **recommends** that if a director knows that a contract or other transaction is being entered or has been entered by the company and

the director is interested in that contract or transaction, the director should be under a duty to inform the board of his or her interest unless there has been a prior general notice. The wording of section 16(1) of the State Bank Act 1988 set out in para [15] provides a suitable model. The duty should be to inform the board by writing to the secretary as soon as reasonably practicable after the relevant facts have come to the director's knowledge.

[20] **Director's investments in the company and directorships in public companies.** If a director takes up shares, options or debentures in the company he or she is interested in a contract with the company and the director's interest is literally required to be disclosed by section 228(1). That is clearly unnecessary and should be excepted from section 228(1). Section 232(1)(a) and (b) require disclosure of such holdings by a director.

[21] Directors are also required by section 232(1)(c) to disclose their directorships in other corporations that are public companies or subsidiaries of public companies, other than related corporations. The company is required by section 238(2) to keep a register specifying particulars of those directorships.

[22] The Committee **recommends** an addition to section 228 of a provision declaring that compliance by a director with section 232(1) shall be regarded as sufficient compliance with section 228 to the extent of the matters disclosed by the notice given under section 232(1) when the attention of the board has been drawn to a copy of that notice. The fact of the board's attention having been drawn to the notice should be required to be minuted.

[23] The Committee notes in passing that following the introduction by many listed companies of dividend reinvestment plans some modification of section 232(1) may be needed. Those plans can involve relatively small adjustments at frequent intervals, usually six-monthly, and there is a risk of the Register of Directors' Shareholdings maintained by the company under section 231 becoming out of date unless the director is particularly assiduous. This is a matter outside the scope of Discussion Paper No. 8. Therefore, the Committee does no more than suggest that if a company allots shares under a dividend reinvestment plan or similar scheme which involves recurrent adjustment of holdings, the onus of keeping the register maintained under section 231 up to date in respect of such allotments should

be on the company. The same principle would be applied in relation to employee share plans.

Where a parent company issues shares to a director of its subsidiary the parent should be obliged to notify the secretary of the subsidiary of the changes in the holdings of the director.

The NCSC noted in Release 343 effective 4 January 1988 that in practice, the director may appoint the company secretary to act as his agent for the purpose of giving notice of change when shares are issued from time to time under a dividend reinvestment scheme. The Committee's suggestion would relieve the director of the responsibility.

[24] **Interest appearing on the face of a board document.** In Discussion Paper No. 8 para 7.3 the Committee posed the question whether section 228 should have a provision excluding the duty to declare where a transaction is evidenced by a document which comes before the board of directors and which shows on its face that a director is interested.

[25] There was a preponderant view on the part of respondents that such an exclusion should not be enacted. There was concern that it would allow uncertainty as to whether in particular cases the board was really aware of the interest. It was generally thought best to require a formal declaration. The Committee therefore decided not to recommend any such exclusion.

[26] **Director's guarantee of loan to the company.** Section 228(3)(a) excludes from the interests to be declared an interest of a director who has guaranteed a loan to the company. It does this by deeming the director not to have an ,interest in the contract of loan. In the absence of section 228(3)(a) the guarantor-director could have a personal interest in the company agreeing to give security because, if the guarantor has to pay the debt, he or she will be subrogated to the lender's rights against the company. It will often be the case that the availability of a guarantee from a director is the determining factor in favour of the company obtaining the loan.

[27] In Discussion Paper No. 8 para 8.2 the Committee posed an issue: given that the exclusion of guarantees is sound, is there any reason why the exclusion should not apply beyond a guarantee of repayment of a loan to a

guarantee of any obligation of the company?

[28] The Institute of Directors in Australia, the Law Council of Australia and Mr. Kriewaldt suggested that the provision should be expressed to cover guarantees of any obligations of the company. The Law Council of Australia suggested that the exception should go further beyond guarantees to cover all forms of third party security such as a third party mortgage given by a director to secure financial obligations of the company. Endorsement of a bill of exchange accepted by the company is another example.

[29] On the other hand, The Company Directors' Association of Australia considered that the guarantee should be declared as it would hardly be realistic for such a guarantee on behalf of the company not to be noted and minuted by the directors. The Company Directors' Association of Australia suggested that section 228(3)(a) provides an exemption not confined to cases where the director's interest is at one with the company's interest. Even on the more limited reading that the "contract or proposed contract" is the loan contract, the director could have an interest opposed to that of the company. The Committee notes that he or she could have an interest in the company giving more security than is commercially necessary.

There can be cases where a managing-director who has guaranteed the company's debt to a particular creditor administers the affairs of the company when it is failing so as to reduce his exposure to liability under the guarantee but to the unfair prejudice of other creditors. It is important that other directors should be aware of the guarantee given.

[30] The Committee **recommends** that paragraph (a) of section 228(3) be repealed.

[31] **Contract with or for the benefit of a related corporation.** Section 228(3)(b) declares that being a director of a related corporation which contracts with the company or for whose benefit or on behalf of which a contract is made or proposed to be made with the company does not count as an interest.

The theory of the exemption seems to be that where the company and the corporation are related there is wholly or substantially an identity of interest which effectively excludes any conflict of duties.

The Committee notes that in recent years there has been an emphasis in judgments on the duty of directors to take into account the interests of a company's creditors when the company is nearing insolvency. Since even a wholly-owned subsidiary company can have debts for which the parent is not liable, it is not appropriate to exclude from the need for declaration of interest an interest in a wholly-owned subsidiary.

[32] It can happen that a director of a wholly-owned subsidiary who is also a director of the parent can have an interest in the parent providing funds to the subsidiary to pay a third party's claim where the director, as director of the subsidiary, might have faced a liability; for example, liability to pay damages for breach of warranty of authority.

[33] The perception widely held in the commercial community that a parent and a wholly-owned subsidiary have an identity of interest should not exclude the need for a declaration of interest. In many cases there will in fact be an identity of interest and it may seem pointless to require a declaration but there is no great hardship in requiring a declaration to meet the occasional case where the director has a conflict in his two offices. In any case the other directors are entitled to be informed of a particular director's interest or conflict of duty (however nebulous) before their decision is made.

The Law Council of Australia supported the retention of section 228(3)(b) and proposed that it be extended to the case where the director of the deliberating company holds certain offices, other than director, in the related company (for example, executive manager or secretary) or is a shareholder in the related company.

It seems to the Committee that even a board common to both parent and wholly-owned subsidiary should have its attention drawn to the potential separate interest of either when the interests of its creditors call for consideration. Normally, the relevant declaration could be in the form of a standing declaration.

[34] The Committee has not found any exclusion similar to section 228(3)(b) in the legislation of other jurisdictions. A view favouring repeal of section 228(3)(b) was expressed by the Australian Society of Accountants, The Institute of Chartered Accountants in Australia and The Company Directors' Association of Australia.

[35] The Committee **recommends** that section 228(3)(b) be repealed.

[36] **Interest of persons connected with a director.** Discussion Paper No. 8 para 10.3 raised a question as to whether section 228 should be amended to require expressly that a director declare any interest of his or her relatives of which the director is aware.

[37] It was put to the Committee by the Law Council of Australia that the fact of family relationship does not necessarily predicate identity or sympathy of interest. Section 228(1) requires a declaration by a director "who is in any way, whether directly or indirectly, interested"

[38] An interest by reason of family relationship could be an indirect interest within section 228(1). The Committee sees one object of section 228 as being to ensure that a deliberating board should be fully-informed as to interests.

[39] The Committee recommends that the legislative definition of "interest" should refer to interest arising from family relationship. The definition suggested in para [13] does that.

[40] The standard of disclosure. The Committee raised a question in Discussion Paper No. 8 para 11.2 as to whether section 228 should prescribe some standard of disclosure. Section 228(1) requires the director to declare "the nature of his interest".

[41] The Company Directors' Association of Australia thought that the requirement is too loose and that directors should be required to "declare the interest and all particulars of the interest"

[42] One of the aims of section 228 is to ensure that a board is fully informed as to relevant interests when deciding whether it is to the benefit of the company that some action should be taken. The onus should be on the director to ensure that the board is informed. The Committee believes that a director should be required to provide such particulars of an interest as will enable the directors to carry out their duty of deciding in the light of all relevant circumstances what action should be taken in the interests of the company. The legislation should empower the other directors to require reasonably any further particulars and to ask reasonable questions.

The Committee **recommends** legislation along those lines to apply to all types of companies.

[43] If the recommendation is adopted, it should be possible to merge sub-sections (1) and (5) of section 228.

[44] **General notice in advance of possible conflict.** Section 228(4) enables compliance with section 228(1) by a general notice of future interest by reason of being an officer or member of a specified corporation or member of a specified firm with which any contract may later be made. The general notice can no longer be deemed a sufficient declaration of interest if, by the time of the later contract, the director's interest as declared has increased.

[45] The Committee **recommends** that a general notice be required to be renewed in each financial year. The aim is to ensure that directors be reminded of the need to keep the notice up to date.

[46] **Variations in minor shareholdings.** Section 228(4) requires the

general notice to state the nature and extent of the interest of a director in a corporation or firm. In connection with employee share plans and dividend reinvestment schemes there could be a need to make frequent amendments to the general notice. The new legislation on buy-backs of shares could have a similar effect.

The Institute of Directors in Australia suggested that where the director has a shareholding of less than five per cent of the voting shares it should be enough to disclose that shares are held but that the interest is less than five per cent' of the voting shares. The Committee agrees with that principle. However, it should relate to all shares, not just voting shares.

[47] The Committee **recommends** that section 228 be amended to exclude the need to state the quantity of shares, stock or stock units held in a corporation if the holding is less than five per cent in nominal value of the issued capital of that corporation at the time of the transaction. There should also be an exclusion in respect of a holding of options to subscribe for shares, stock or stock units and an exclusion of convertible securities if the holding is less than five per cent of all such options or other securities on issue. A similar exclusion should operate in respect of a holding of prescribed interests of less than five per cent in nominal

value of the total prescribed interests on issue at the time of the transaction. Where a director holds options and/or convertible securities as well as shares, the five per cent of issued capital should be calculated as if his or her options and/or convertible securities had been exercised or converted. To meet the case that a holding of less than five per cent could in some companies be a significant interest the remaining directors should be empowered to ask for more details.

[48] **Lack of quorum of disinterested directors.** In para [123] of its report on Nominee Directors and Alternate Directors (March 1989) the Committee recommended legislation making it clear that a meeting of directors must be constituted by at least two directors, notwithstanding anything in the articles.

[49] The Committee believes and **recommends** that proper administration of a company's affairs calls for the meeting to be constituted by at least two persons who are qualified to vote on all matters to be considered by the board. An interested director may be disqualified from voting by the articles or, in the case of a listed company, by ASX Listing Rule 3L(6).

[50] The Company Directors' Association of Australia suggested that where an interest has been disclosed to the board the director should not vote unless the remaining members of the board, having considered the nature and extent of the interest and the particulars supplied by the director, decide that the interest is immaterial in the light of the company's proposed act.

The Committee **recommends** that that suggestion be adopted in the form of legislation but that where the interest consists in being a director of a related corporation or a holder of an interest that is less than five per cent as explained earlier, it should be deemed to be immaterial. The legislation should leave it open to the articles or listing rules to prohibit an interested director from voting.

[51] **Directors with similar individual interests in separate transactions and having mutual voting arrangements.** In Discussion Paper No. 8 para 14.1 the Committee referred to the situation where director X, having an interest in a transaction with the company, arranges with director Y who has an interest in a similar transaction that each will vote the same way, each thereby becomes interested in the other's transaction and they are both interested in each transaction. It can happen that there is no

disinterested director able to vote.

[52] The preponderant view of respondents was that no legislation is needed to cover this issue. Under case law if the board is unable to resolve that similar interests are immaterial, the transaction will require the approval of the company in general meeting.

[53] The Committee is of the view that, apart from legislation which requires the board to consider whether declared interests are material in relation to a particular transaction, no further legislation is needed on this matter.

[54] **Acquisitions from or disposals to directors and their associates of substantial assets.** In Discussion Paper No. 8 para 15.1 the Committee noted that the problem of corporate approval for transactions in which a director is interested is dealt with to some extent by ASL Listing Rule 3J(3). That rule is based on the premise that there are some transactions with directors or their associates which should be considered by shareholders in general meeting regardless of whether there is a quorum of disinterested directors on the board and regardless of dispensations in the articles. Rule 3J(3) is concerned with acquisitions or disposals of assets where the consideration or the value of the assets exceeds 5 per cent of the total issued capital and reserves. It requires shareholders to be furnished with reports, valuations or other material from independent qualified persons sufficient to establish that the purchase or sale price of the assets is a fair price.

[55] The Committee raised the question whether that rule, or something like it, should be incorporated in legislation so as to provide better sanctions for non-observance than can be provided for non-observance of a listing rule.

[56] Most respondents considered that it was unnecessary to incorporate ASX Listing Rule 3J(3) into the legislation. Arguments against enactment of the rule so that it would apply to companies generally included:

* added transaction costs for unlisted companies in commissioning reports; and

* the existence of adequate statutory provisions for remedying oppression.

[57] No dissatisfaction with the existing legal status of Rule 3J(3) was expressed by respondents. The Committee makes no recommendation for legislation to incorporate Rule 3J(3). There may be issues about the enforceability of listing rules that deserve attention but they transcend Discussion Paper No. 8 and are outside the scope of this report.

[58] **Making of a declaration without a meeting of directors.** Articles may provide that if all the directors entitled to vote have signed a document containing a statement that they are in favour of a resolution set out in the document, such a resolution may be deemed to have been passed at a directors' meeting. See Table A regulation 77 and Table B regulation 61.

[59] In Discussion Paper No. 8 para 16.2 the Committee asked whether it should be possible for a declaration to be made in a resolution in writing signed by all directors entitled to vote.

[60] The South African Companies Act 1973 section 236 expressly excludes that way of making a declaration regardless of any provision in the articles.

[61] The Committee has come to the view that once an interest has been declared the board should collectively consider at a board meeting whether that interest is material; there should be an opportunity for board members to hear the views of each of them. The Committee does not recommend legislation allowing a declaration to be made in a resolution in writing signed by all directors.

[62] Although section 228 currently requires any declaration of interest to be made "at a meeting of the directors" there is no legal barrier to circulation of written declarations by post, facsimile or other means in advance of the meeting. In line with the Committee's recommendation that the legislation should require the board to consider whether a declared interest is material, the Committee **recommends** that section 228 be amended to require the declaration to be made "before or at a meeting of the directors" That will cater for meetings by telephone conference. The Committee recommended in its report on Nominee Directors and Alternate Directors (March 1989) para [126] that the legislation allow meetings to be held in that way.

[63] **Recording a declaration.** Section 228 imposes duties on a secretary of the company. Not every company has the secretary present at board meetings. In some companies the directors draw up the minutes.

[64] The Committee **recommends** that section 228 be amended to impose on directors a duty to record, or cause to be recorded, in the minutes of the meeting which receives the declaration the fact of the declaration having been made and the decision of the board as to whether the interest declared is material to any proposed act of the company. The provision recommended would replace section 228(7).

[65] The Committee also recommends that the legislation should require the directors to cause the company to maintain a register of interests declared by directors that are not already in other registers. The register of declared interests should be available for inspection by any director or member. It is noted that The Draft Companies Act appended to the New Zealand Law Commission's Report No. 9 entitled "Company Law Reform and Restatement" provides for the keeping of an "interests register" (section 147) and for a director interested in a company transaction to cause to be entered in that register, the nature and extent of his or her interest (section 109).

[66] **The significance of section 228 under general law and the protection of third persons.** The effect on the validity of a company transaction of a director having an interest is for the most part governed by case law. Section 228 is primarily a penal provision and only section 228(3) bears on the question of validity. The concluding words of section 228(3) - "but does not affect the operation of any provision in the articles of the company" - seem to allow the articles to provide that being a guarantor and the existence of a cross-directorship can still constitute an interest with two results. The failure to declare could be an offence under section 228(1) and would invalidate the transaction.

[67] In Discussion Paper No. 8 para 18.7 the Committee raised the question whether section 228(3) should be re-drafted so as to make entirely separate provision for the criminal offence and the validity of the transaction.

[68] Respondents favoured the view that section 228 should have no impact on the validity of the transaction. The Committee in para [30] recommends that section 228(3)(a) should be repealed. In para [35] the Committee recommends that section 228(3)(b) should be repealed. If those recommendations were adopted, section 228 would be a purely penal provision. In the Committee's view it is desirable that section 228 should not impinge upon the validity of transactions. The matter of validity should be left to the case law. The interests of third persons in having security in their dealings with companies are reconciled with the interests of the members of companies by principles of case law and section 68A of the Companies Act 1981. For the removal of all doubt, the Committee **recommends** that section 228 should provide that no act of the company is invalid by reason only of the failure of any person to comply with section 228. If that recommendation is adopted, there will be no need to legislate to clarify the application of section 68A in situations to which section 228 applies. The Law Council of Australia indicated its belief that there may be some doubt as to how section 68A operates in relation to non-compliance in the matter of making a declaration of interest. The Committee is not satisfied that there is a basis for doubt. However, if the Committee's recommendation that section 228 should declare that there is no invalidity is not adopted, the Committee recommends that if section 228 is to continue to be relevant for the validity of a transaction, it would be useful to include in section 228 some indication that section 68A protects innocent third persons from prejudice caused by a failure to comply with section 228. The Committee notes that in The Draft Companies Act appended to Report No. 9 of the New Zealand Law Commission entitled "Company Law Reform and Restatement" section 110 provides for the civil consequences of a director being interested in a transaction of the company. The Committee does not recommend the enactment of a similar provision because the whole question of civil consequences was not raised in Discussion Paper No. 8.

[69] **Common seal affixed by a person interested in the transaction and documents under the hand of a person interested in the transaction.** Section 80(3) declares that a contract or other document executed under the common seal is not invalid by reason only that a person attesting the affixing of the common seal was in any way, directly or indirectly, interested in that contract or other document or in the matter to which that contract or other document relates.

[70] The Committee **recommends** a provision like section 80(3) to the effect that a document executed on behalf of a company by a person under hand is not invalid by reason only that that person was in any way, directly or indirectly, interested in the transaction evidenced by that document.

[71] Discussion Paper No. 8 para 20.2 raised a question regarding the resolution of the board authorising the affixing of a seal. The Committee noted that in relation to transactions authorised by the board and the execution of documents under seal there are really three stages :

(1) the board of directors authorises the transaction;

(2) the board of directors authorises the affixing of the seal; and

(3) the document is executed.

Section 80(3) deals with the third stage. In Discussion Paper No. 8 the question was asked as to whether legislation is needed about the second stage. If a transaction has been properly authorised by the board, should it matter that a later resolution authorising the affixing of the seal is passed by the votes of interested directors? One answer is that the company should have the benefit of consideration by disinterested directors for the decision to affix the seal because there could be a change in circumstances creating a need to resile from the previous resolution authorising the transaction. The Committee makes no recommendation for legislation on this matter.

[72] **Disclosure of interest to a committee of the board.** In England the Court of Appeal in Guinness plc v. Saunders [1988] 2 All E.R. 940 held that disclosure of an interest to a committee of directors was not "disclosure at a meeting of directors of the company" as required by the United Kingdom equivalent of section 228(1). The Institute of Directors in Australia suggested that, on the basis of that view, section 228(1) should be amended to provide expressly that disclosure should be to a meeting of the board.

[73] The Committee has earlier recommended that the board should consider each declaration and decide whether the interest disclosed is immaterial. That question is so important that wherever possible, it should be dealt with by the board rather than a committee. However, there may be occasions when a committee of the board has to act in a transaction before the full board has had a chance to receive a declaration of interest. In those circumstances the declaration should be to the committee and to the board.

The Committee **recommends** that the legislation be framed accordingly.

[74] The Committee further **recommends** that a prior disclosure to the board should be deemed to be a disclosure to a committee on the basis that the disclosure is recorded in the register. It is necessary to keep the volume of disclosure records within reasonable bounds.

[75] **Should section 228 apply to all companies?** The Institute of Directors in Australia raised the question whether section 228 (either in present or amended form) should be subject to an exception in respect of small proprietary companies.

[76] The Committee believes that section 228 serves a useful purpose for all types of company. Even in a small exempt proprietary company with only two directors who are the only shareholders, each shareholder is entitled to know of any external interest that the other has in a company transaction. A small company that serves as a form of incorporated partnership could well be expected to attract fiduciary obligations comparable with those in a partnership. In a partnership the members stand in a fiduciary relationship to each other : no partner may benefit personally at the expense of the firm without the firm's assent. While it is not appropriate to have a general principle that shareholders occupy a fiduciary relationship inter se, it is appropriate that even small companies should attract a duty of directors to declare interests. Accordingly, the Committee does not recommend any exemption for small proprietary companies.

[77] **Representation of extraneous interests.** In its report on Nominee Directors and Alternate Directors (Report No. 8, March 1989) the Committee recommended an addition to the matters to be disclosed. Recommendation 6 was as follows:

"6. That section 228(5) of the Companies Act 1981 (Cth) be amended to require a director of a listed company to disclose to the board any arrangement or understanding with another whereby the director expects or is expected to have regard to the interests of another person in respect of:

(a) providing information about the company to a person who is not otherwise entitled to it; or

(b) when exercising powers as a director, taking into account any consideration other than the benefit of the company as a whole."

PART B - LOANS TO DIRECTORS (COMPANIES ACT s.230)

THE ISSUES AND RECOMMENDATIONS

Prohibition of loans to directors as a facet of broad principle:

[78] As noted earlier, the general law permits a director to be interested in a contract with his company if:

(1) the articles so allow;

(2) the company in general meeting approves the transaction after being fully informed; or

(3) all the members assent to it informally after being fully informed.

In general, the Companies Act does not disturb that position. But there is one type of contract between a director and the company which the Companies Act prohibits in section 230. That is a contract of loan by which the director becomes a debtor to the company. Section 230 is derived from United Kingdom legislation that was recommended by the Cohen Committee. That Committee thought that a director should not borrow from the company: if the director could offer good security, it would be no hardship to borrow from other sources; if good security could not be offered, the director should not borrow from the company.

[79] Section 230 provides:

"230(1) A company shall not, whether directly or indirectly:

(a) make a loan to:

(i) a director of the company, a spouse of such a director, or a relative of such a director or spouse;

(ii) a director of a corporation that is related to the company, a spouse of such a director, or a relative of such a director or spouse;

(iii) a trustee of a trust under which a person referred to in sub-paragraph (i) or (ii) has a beneficial interest being a loan made to the trustee in his capacity as trustee;

(iiia) a trustee of a trust under which a corporation has a beneficial interest, where a person referred to in sub-paragraph (i) or (ii) has, or 2 or more such persons together have, a relevant interest or relevant interests in shares in the corporation the nominal value of which is not less than 10% of the nominal value of the issued share capital of the corporation, being a loan made to the trustee in his capacity as trustee; or

(iv) a corporation, where a person referred to in sub-paragraph (i) or (ii) has. or 2 or more such persons together have, a relevant interest or relevant interests in shares in the corporation the nominal value of which is not less than 10% of the nominal value of the issued share capital of the corporation; or

(b) give a guarantee or provide security in connection with a loan made or to be made by another person to a natural person or corporation referred to in paragraph (a).

(2) For the purposes of sub-section (1), where:

(a) a company:

(i) makes a loan to a corporation or gives a guarantee or provides security in connection with a loan made to a corporation; or

(ii) makes a loan to a trustee of a trust under which a corporation has a beneficial interest, or gives a guarantee or provides security in connection with a loan made to a trustee of a trust under which a corporation has a beneficial interest;

(b) the company has a relevant interest or relevant interests in shares in the corporation; and

(c) a person has, or 2 or more persons together have, a relevant interest or relevant interests in shares in the company,

the matters referred to in paragraphs (b) and (c) shall be disregarded for the purpose of determining whether the person has, or the persons together have, as the case may be, a relevant interest or relevant interests in the shares referred to in paragraph (b).

(3) Nothing in sub-section (1) applies:

(a) to anything done by a company that is an exempt proprietary company;

(b) to a loan made by a company to, or a guarantee given or security provided by a company in relation to, a corporation that is related to the company if the making of the loan, the giving of the guarantee or the provision of the security has been authorized by a resolution of the directors;

(c) subject to sub-section (4), to anything done by a company to provide a person with funds to meet expenditure incurred or to be incurred by him for the purposes of the company or for the purpose of enabling him properly to perform his duties as an officer of the company;

(d) subject to sub-section (4), to anything done by a company to provide a person who is engaged in the full-time employment of the company or of a corporation that is related to the company with funds to meet expenditure incurred or to be incurred by him in purchasing or otherwise acquiring premises to be used by him as his principal place of residence;

(e) to a loan made by a company to a person who is engaged in the full-time employment of the company or of a corporation that is related to the company, where:

(i) in the case where neither sub-paragraph (ii) nor (iii) applies - the company has at a general meeting;

(ii) in the case where the company is a subsidiary of a listed corporation or listed corporations - the company and the listed corporation or listed corporations have at general meetings; or

(iii) in the case where the company is not a subsidiary of a listed corporation but is a subsidiary whose ultimate holding company is incorporated in Australia or an external Territory - the company and the ultimate holding company have at general meetings,

approved a scheme for the making of such loans and the loan is made in accordance with the scheme;

(f) to a loan made, guarantee given or security provided by a company in the ordinary course of its ordinary business where:

(i) that business includes the lending of money or the giving of guarantees or the provision of security in connection with loans made by other persons; and

(ii) the loan that is made by the company or in respect of which the company gives the guarantee or provides the security is made on ordinary commercial terms as to the rate of interest, the terms

of repayment of principal and payment of interest, the security to be provided and otherwise.

(4) Paragraph (3)(c) or (d) does not authorize the making of any loan, the entering into any guarantee or the provision of any security except:

(a) with the prior approval of:

(i) in the case where neither sub-paragraph (ii) nor (iii) applies -the company;

(ii) in the case where the company is a subsidiary of a listed corporation or listed corporations – the company and the listed corporation or listed corporations; or

(iii) in the case where the company is not a subsidiary of a listed corporation but is a subsidiary whose ultimate holding company is incorporated in Australia or an external Territory - the company and the ultimate holding company,

given at a general meeting of the company or at general meetings of the company and the listed corporation or listed corporations or of the company and the ultimate holding company, as the case may be, at which the purposes of the expenditure and the amount of the loan or the extent of the guarantee or security, as the case may be, are disclosed; or

(b) on condition that if the making of the loan, the giving of the guarantee or the provision of the security is not approved:

(i) in the case where neither sub-paragraph (ii) nor (iii) applies -by the company at or before the next annual general meeting of the company;

(ii) in the case where the company is a subsidiary of a listed corporation or listed corporations - by the company at or before the next annual general meeting of the company or by the listed corporation or by each listed corporation at or before the next annual general meeting of the listed corporation concerned; or

(iii) in the case where the company is not a subsidiary of a listed corporation but is a subsidiary whose ultimate holding company is incorporated in Australia or an external Territory - by the company at or before the next annual general meeting of the company or by the ultimate holding company at or before the next annual general meeting of the ultimate holding company,

the loan be repaid or the liability under the guarantee or security be discharged, as the case may, within 6 months after the conclusion of that meeting.

(5) Where a company makes a loan, gives a guarantee or provides security in contravention of this section, the company is, notwithstanding section 570, not guilty of an offence but:

(a) in the case of a loan made to, or a guarantee given or security provided in relation to a loan made to, a director of the company or of a corporation that is related to the company or a spouse of such a director, or a relative of such a director or spouse - the director and any officers of the company who are in default are each guilty of an offence and, in addition, are jointly and severally liable to indemnify the company against any loss arising from the making of 'the loan, the giving of the guarantee or the providing of the security, as the case may be;

(b) in the case of a loan made to, or a guarantee given or security provided in relation to a loan made to, a trustee of a trust referred to in sub-paragraph (1)(a)(iii) - any director of the company, or of a corporation that is related to the company, by virtue of whose beneficial interest under the trust the making of the loan, the giving of the guarantee or the provision of the security contravened this section, and any other officers of that company who are in default, are each guilty of an offence and, in addition, are jointly and severally liable to indemnify the company against any loss arising from the making of the loan, the giving of the guarantee or the providing of the security, as the case may be;

(ba) in the case of a loan made to, or a guarantee given or security provided in relation to a loan made to, a trustee of a trust under which a corporation (in this paragraph referred to as the "relevant corporation") has a beneficial interest in circumstances referred to in subparagraph (1)(a)(iiia) - any director of the company, or of a corporation that is related to the company, by virtue of whose relevant interest or relevant interests in shares in the relevant corporation the making of the loan, the giving of the guarantee or the provision of the security contravened this section, and any other officers of that company or of the relevant corporation who are in default, are each guilty of an offence and, in addition, are jointly and severally liable to indemnify the company against any loss arising from the making of the loan, the giving of the guarantee or the providing of the security, as the case may be; or

(c) in a case of a loan made to, or a guarantee given or security provided in relation to a loan made to, a corporation referred to in sub-paragraph (1)(a)(iv) (in this paragraph referred to as the "relevant corporation") - any director of the company, or of a corporation that is related to the company, by virtue of whose relevant interest or relevant interests in shares in the relevant corporation the making of the loan i the giving of the guarantee

or the provision of the security contravened this section, and any other officers of that company or of the relevant corporation who are in default, are each guilty of an offence and, in addition, are jointly and

severally liable to indemnify the company against any loss arising from the making of the loan, the giving of the guarantee or the providing of the security, as the case may be.

Penalty:

(d) in a case to which paragraph (e) does not apply - $5,000; or

(e) where the offence was committed with intent to deceive or defraud the company, members or creditors of the company or creditors of any other person or for any other fraudulent purpose - $20,000 or imprisonment for 5 years, or both.

(6) It is a defence to a prosecution for an offence against sub-section (5) or to a proceeding instituted in respect of a liability under that sub-section if the defendant proves that he had no knowledge of the making of the loan, the giving of the guarantee or the provision of the security.

(7) Nothing in this section operates to prevent the company from recovering the amount of, or of any interest on, any loan made, or any amount for which it becomes liable under any guarantee given or in respect of any security provided, contrary to the provisions of this section.

(8) If a person has made a loan in relation to which a company has given a guarantee or provided security in contravention of this section, the person may enforce the guarantee or security against the company if, and only if:

(a) in the case where the company is a proprietary company - a certificate signed by a director and a secretary of the company certifying that the company was an exempt proprietary company was furnished to the person before the guarantee was given or the security was provided; or

(b) in any case - a certificate signed by a director and a secretary of the company certifying that the company was not prohibited by this section from giving the guarantee or providing the security was furnished to the person before the guarantee was given or the security was provided and the person did not know, and had no reason to believe, that the certificate was incorrect.

(9) A director or secretary of a company who furnishes a person with a certificate referred to in sub-section (8) that is false is guilty of an offence.

Penalty : $5,000 or imprisonment for 1 year, or both.

(10) This section has effect in addition to, and not in derogation of, any other law in force in the Territory."

[80] Section 230 imposes the prohibition and then allows certain exceptions. It applies to a loan to a director or to certain persons

connected with a director. Section 230 also reaches the giving of a guarantee by the company in respect of a loan made by a third person to a director and the provision of security by the company in respect of such a loan.

[81] The section appears to exist for the benefit of shareholders rather than creditors, since exempt proprietary companies are not covered. The rationale of section 230 appears to be that directors should be prevented from mis-using the company's resources for the benefit of one or more directors.

[82] **Should section 230 contain a statement of the underlying principle that a company's resources may only be applied as required by law or where directors honestly and reasonably believe that the action will be for the benefit of the company as a whole?** In Discussion Paper No. 8 para 21.4 the Committee raised the question whether section 230 should be replaced or supported by a broad statutory statement of the duty of directors to apply company resources only for the benefit of the company as a whole. The arguments for making such a statement are:

* the very detailed prescriptions in section 230 may divert attention from the underlying principle; and

* at the other extreme, section 229 is expressed in terms so wide as to give little guidance.

[83] Section 230 is aimed at only one way in which the directors' control of company assets can be abused. For example, it does not reach cases where the company purchases property and allows a director to use that property. Even so, the case of a loan is deserving of special treatment in that loans can lead more readily to dissipation of company assets. However, should section 230 be changed to appear as part of a measure more general than section 230 but more specific than section 229(1)? The aim would be to remind directors of their responsibility to apply the company's property, and to commit the company to obligations, only as required by law or where they honestly and reasonably believe that the action will be for the benefit of the company as a whole.

[84] Most respondents opposed the suggestion that section 230 should be replaced by a broad statement. The Company Directors' Association of

Australia made the point that it is unrealistic to try to use statements of company law as an educative tool because "Acts are written in language which is often extremely difficult to comprehend. It is technical and voluminous as well. Directors do not read the Companies Act as a general source of information."

[85] The Institute of Directors in Australia pointed to the vagueness of the concept of "the benefit of the company as a whole" as not being clear enough to be the basis of imposition of criminal penalties. However, under section 229(1) as it now stands, directors could be held criminally liable for taking a company into a transaction which no reasonable board of directors could consider to be for the benefit of the company as a whole.

[86] The Committee believes that some provision like section 129(15) is desirable. A provision stating that the fact that a transaction falls within section 230(3) does not relieve a director of any duty to the company under section 229 or otherwise is needed. That provision could appear as a distinct sub-section and section 230(3) could be expressed to be subject to it. Section 230(10) may be directed to the same end but it is not sufficiently specific. The Committee **recommends** accordingly.

[87] **Should section 230 extend to financial accommodation for directors and persons connected with them given in a form which is substantially debt but is theoretically equity? Should the concept of a loan be defined more widely for the purposes of section 230?** Section 230 is concerned with loans. There are other forms of financing that are within the mischief at which section 230 is aimed; for example, the provision of a bill facility. There are also hybrid forms of financing such as convertible notes and some redeemable preference shares. Allowing credit on the supply by the company of goods to a director on terms which are more generous than the normal trading terms of the company is also to be considered.

[88] The Committee **recommends** that section 230 should contain language that makes it clear that it reaches financial accommodation wider than loans in the strict sense. Assistance in this regard may be obtained from the Companies Act 1985 (U.K.) which in sections 330ff (see Appendix B to this report) uses the concept of "loan", "quasi-loan" and "credit transaction". An exclusion of minor transactions not exceeding a specified amount would have merit.

The term "guarantee" used in section 230(1) should be defined to include indemnity (see Companies Act 1985 (U.K.) section 331(2)) and the endorsement of a bill of exchange.

[89] The home-purchase exception. Section 230(3)(d) excepts, subject to, in general, prior approval by a general meeting, anything done by a company to provide a full-time employee of the company or of a related corporation with funds "to meet expenditure incurred or to be incurred by him in purchasing or otherwise acquiring premises to be used by him as his principal place of residence".

[90] The reason for the exception probably lies in the needs of an employee whose employment has been re-located. There can also be a need for an employee's home to be improved to enable the employee to perform duties to the company. An example could be the installation of a security system or improved communication facilities. If section 230(3)(c) stood alone it could be that a loan for such purposes is already sanctioned by section 230(3)(c). However, because section 230(3)(d) deals expressly with expenditure "incurred ... in purchasing or otherwise acquiring premises" it may carry a negative implication that a loan for other expenditure in relation to the principal place of residence is not allowable. The difficulty could be met by inserting in section 230(3)(c) words which make it clear that the expenditure envisaged can include expenditure for the purpose of improving those premises. The Committee recommends accordingly.

[91] **Loans to directors who are full-time employees.** Section 230(3)(e) excludes from the prohibition in section 230(1) a loan to a person who is engaged in the full-time employment of the company, or a related corporation, where a general meeting has approved a scheme for the making of such loans and the loan is made in accordance with the scheme.

Section 230(3)(e) relates only to full-time employees. It has been put to the Committee that there is a need to extend section 230(3)(e) to cater for the case of a director who is also an employee but an employee on a part-time basis where the loan is needed for an employee share scheme. The point is made that section 129(9)(b) which allows a company to give financial assistance for the acquisition of its shares as part of an employee share incentive scheme is not confined to full-time employees.

[92] The acquisition of shares in a company by its employees is something to be encouraged. On the other hand the making of loans to directors should be allowed only within narrow limits. There is a need to avoid widening the exclusions from section 230(1) to the point where token part-time employment by a company of a director would enable the company to lend money to the director. The Committee believes that the legislation should not be amended and recommends accordingly.

[93] **Loan to a company in which a director has a relevant interest of 10 per cent or more.** Section 230(1) prohibits the making of a loan, the giving of a guarantee or the provision of security in respect of other entities in which a director has a prescribed level of interest. So far as a corporation is concerned the level of interest prescribed in section 230(1) is "not less than 10% of the nominal value of the issued share capital of the corporation".

[94] A question has been raised as to whether section 230(1) should apply where a loan, guarantee or security is given by a company for the benefit of another corporation that, although not related, is not controlled, on a test of effective control, by any director of the lending company. It is said that there is excessive inconvenience in the present law for a lender to a company affiliated with, but not related to, another corporation which gives a guarantee or security in respect of the loan. It has been suggested that even where a director (or connected person) holds more than 10 per cent of the share capital of the corporation benefited, the director will not be in a position to benefit personally since his or her holding does not carry effective control.

On that basis and noting the 20 per cent threshold adopted in relation to sale of control in the takeovers legislation (Companies (Acquisition of Shares Act) 1980 (Cth) section 11), the Committee considered whether to recommend that section 230(1)(a)(iv) should be amended so as to substitute 20 per cent for 10 per cent.

[95] The matter of securing equitable treatment of shareholders when a change of control is pending is different from the matter of ensuring that directors, as fiduciaries, do not benefit from the funds of the company except under a clear mandate from the shareholders. In fixing the threshold for regulation of take-overs it is necessary to reconcile various interests including the public interest in not unduly restricting the market for

control. Hence, even though a holding of 15 per cent may provide effective control in some circumstances, a compromise has been adopted by fixing the threshold at 20 per cent. But the regulation of loans to directors does not involve any reconciliation of interests. Section 230 is concerned with benefits to directors. Even if a holding of 10 per cent does not give control, a holder of that amount would normally benefit. As recommended by the Cohen Committee (see paragraph [78]), if a company in which a director holds 10 per cent equity cannot borrow from normal lending sources, why should another company with such an interested director on its board make the loan where a director has a relevant interest of 10 per cent or more in the related or affiliated borrower?

[96] It seems to the Committee that the existing threshold under section 230(1) is appropriate and the Committee does not recommend any change in the threshold.

[97] **Transactions with related corporations and affiliated corporations.** It was put to the Committee that hardship exists in the following example:

"For instance, there are a number of "groups" of companies the members of which are not all related to each other within the meaning of the Code but which, for a number of purposes, trade and arrange their affairs as if they were related. There is, of course, nothing necessarily improper about this. A simple example of the sort of situation that can arise is this: companies A and B have a number of common directors: A owns 40% of the issued shares of B, the remaining 60% of B's shares are widely held, slightly over 10% of them being held by persons who are directors of A and its related companies or spouses or relatives of such directors. In that situation, A cannot lend to B; nor, if B seeks to borrow from a bank, can A provide a guarantee or security, no matter how much it may be in the interests of the shareholder of A that A should do so. Furthermore, if A does provide a guarantee or give a security, the guarantee or security is unenforceable. None of these consequences would follow if A held not 40% but 50.01% of the shares of B."

[98] It seems to the Committee that rather than liberalise section 230 so as to cater for affiliated but non-related companies, there should be a tightening of the controls over lending as between related and affiliated companies. The exception in section 230(3)(b) in respect of related companies is too wide and is open to abuse except where the relationship is that of holding company and wholly-owned subsidiary or a related corporation being another wholly-owned subsidiary within a group of corporations.

[99] The Committee has considered a suggestion that a loan to a related or affiliated company should not be a contravention where the loan is authorised by directors who have no relevant interest in the borrowing company. The Committee thinks that would provide inadequate protection because in some cases a board is dominated by a director who derives personal benefit.

[100] If there is a minority interest in a company that minority, however small, is entitled to protection against the company making a loan to any other corporation in which a director has a relevant interest of not less than ten per cent of the nominal value of the issued share capital. The Committee is aware that there are potential lending companies in which a small minority (usually holding non-voting securities) refuses to be bought out by the majority holder except for an exorbitant price. That may cause hardship to the majority holder if it is, or is deemed to be, a director of the lending subsidiary by operation of section 5(1) of the Companies Act but, if so, the fault lies in the legislation governing compulsory acquisition of minority interests. Any such hardship would not justify departure from the principle favoured by the Committee in its application to section 230. The Committee recognises that if the legislation on compulsory acquisition remains unchanged some holding companies (even those holding all voting shares) subject to a small minority interest may be denied potential cost-savings through inter-group lending.

[101] The Committee **recommends** that section 230(3)(b) should be qualified so as to apply only where the loan is made, the guarantee is given or the security is provided by a wholly-owned subsidiary[2] to or in relation to any of its holding companies or any wholly-owned subsidiary of any of its holding companies.

2. It is necessary to consider wholly-owned subsidiaries in relation to section 230 even though no individual director has a relevant interest in shares. There could be a case where the parent itself is a director of the wholly-owned subsidiary by force of the definition of "director" in section 5(1) of the Companies Act 1981.

[102] The Committee notes that the Companies and Securities Advisory Committee (established under the Australian Securities Commission Act 1989) has announced that it will be dealing with the issues relating to loans by public company groups to directors and associates and loans between related corporations. The present report by CSLRC is the outcome of a review of the topic of loans to directors considered as part of the problem of self-dealing by directors. That in turn is part of the reference on directors' duties which CSLRC received from the Ministerial Council. In its Discussion Paper No. 8 CSLRC did not focus on the much wider issue of improper diversion of corporate resources in the course of inter-company transactions, and so chooses to make no comment on this aspect.

[103] **Protection of third persons who act in good faith**. If there is a failure to observe the prohibition in section 230 directors and officers are subject to a penalty: section 230(5) and (6).

[104] In the absence of legislative provision another consequence could be that the loan, guarantee or security (as the case may be) is tainted with illegality so that the amount of the loan could not be recovered, or the guarantee or the security could not be enforced.[3] Since the prohibition is for the benefit of the company it would not make sense to allow the borrower to be able to plead illegality by way of defence. Accordingly, section 230(7) excludes that defence and enables the company to recover the amount of a loan or any amount for which it becomes liable under any guarantee given or in respect of any security provided.

[105] There is then a question of whether the taint of illegality is to affect the right of another person to enforce a guarantee or a security given by the company. Section 230(8) protects some persons who take a guarantee or a security.

[106] Section 230(8) provides:

"If a person has made a loan in relation to which a company has given a guarantee or provided security in contravention of this section, the person may enforce the guarantee or security against the company if, and only if:

3. On contracts prohibited by statute, see Greig and Davis The Law of Contract (1987) pages 1114ff.

(a) in a case where the company is a proprietary company - a certificate signed by a director and a secretary of the company certifying that the company was an exempt proprietary company was furnished to the person before the guarantee was given or the security was provided; or

(b) in any case - a certificate signed by a director and a secretary of the company certifying that the company was not prohibited by this section from giving the guarantee or providing the security was furnished to the person before the guarantee was given or the security was provided and the person did not know, and had no reason to believe, that the certificate was incorrect."

[107] Section 230(8) is not entirely clear on the question of whether the certificate can be given before the loan has been made. The ambiguity lies in the words "If a person has made a loan".

[108] There can be cases in which a person negotiates a loan and the borrower issues unsecured notes payable to bearer which the company guarantees. An agent of the borrower authenticates the notes. If section 230(8) does not allow the certificate to be given before the loan is made and a note is issued the original taker of the note will not be "a person who has made a loan" within section 230(8) and cannot be protected by a certificate of compliance originally given.

[109] Even if section 230(8) allows a certificate to be issued before the loan is made there is a further problem that section 230(8) does not appear to protect a person who becomes a holder of a note by assignment from an original taker.

[110] It seems desirable that all innocent third parties who give value should be protected.

[111] The Committee **recommends** the enactment of a general protective provision to the effect that a guarantee given or a security provided in contravention of section 230 may be enforced by:

(a) the original taker of the guarantee or security; or

(b) any other person who acquires the benefit of the guarantee or security

for value in good faith without notice of the contravention.[4]

The existing procedure for the obtaining of a certificate that is provided for in section 230(8) should remain available to the original taker of a guarantee or security. The effect will be that an original taker who obtains a certificate will be protected without having to prove that he took for value in good faith without notice whereas later takers and original takers who do not obtain a certificate would be subject to the normal burden of proving that defence.

H A J FORD (Chairman)
G W CHARLTON
D A CRAWFORD
A B GREENWOOD
D R MAGAREY

22 November 1989

Z-005HF.REPORT NO.9

4. Compare Canada Business Corporations Act section 44(3).

APPENDIX A

LIST OF RESPONDENTS

Australian Society of Accountants

and

The Institute of Chartered Accountants in Australia

(joint response)

Mr. J Kriewaldt

Law Council of Australia

Nicholas Brash & Associates

The Company Directors' Association of Australia

The Institute of Directors in Australia

APPENDIX B

LEGISLATION OVERSEAS COMPARABLE TO COMPANIES ACT 1981 SS 228 AND 230

(1) STATE OF DELAWARE (USA): GENERAL CORPORATION LAW:

S.144. Interested directors; quorum

(a) No contract or transaction between a corporation and 1 or more of its directors or officers, or between a corporation and any other corporation, partnership, association, or other organization in which 1 or more of its directors or officers, are directors or officers, or have a financial interest, shall be void or voidable solely for this reason, or solely because the director or officer is present at or participates in the meeting of the board or committee which authorizes the contract or transaction, or solely because his or their votes are counted for such purpose, if:

(1) The material facts as to his relationship or interest and as to the contract or transaction are disclosed or are known to the board of directors or the committee, and the board of committee in good faith authorizes the contract or transaction by the affirmative votes of a majority of the disinterested directors, even though the disinterested directors be less than a quorum; or

(2) The material facts as to this relationship or interest and as to the contract or transaction are disclosed or are known to the shareholders entitled to vote thereon, and the contract or transaction is specifically approved in good faith by vote of the shareholders; or

(3) The contract or transaction is fair as to the corporation as of the time it is authorized, approved or ratified, by the board of directors, a committee or the shareholders.

(b) Common or interested directors may be counted in determining the presence of a quorum at a meeting of the board of directors or of a committee which authorizes the contract or transaction.

S.143. Loans to employees and officers; guaranty of obligations of employees and officers.

Any corporation may lend money to, or guarantee any obligation of, or otherwise assist any officer or other employee of the corporation or of its subsidiary, including any officer or employee who is a director of the corporation or its subsidiary, whenever, in the judgment of the directors, such loan, guaranty or assistance may reasonably be expected to benefit the corporation. The loan, guaranty or other assistance may be with or without interest, and

may be unsecured, or secured in such manner as the board of directors shall approve, including, without limitation, a pledge of shares of stock of the corporation. Nothing in this section contained shall be deemed to deny, limit or restrict the powers of guaranty or warranty of any corporation at common law or under any statute.

(2) CANADA: BUSINESS CORPORATIONS ACT

120(1) Disclosure of interested director contract

A director or officer of a corporation who

(a) is a party to a 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.

120(2) Time of disclosure for director

The disclosure required by sub-section (1) shall be made, in the case of a director,

(a) at a meeting at 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.

120(3) Time of disclosure for officer

The disclosure required by sub-section (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.

120(4) Time of disclosure for director or officer

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 fortwith after the director or officer becomes aware of the contract or proposed contract.

120(5) Voting

A director referred to in sub-section (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.

120(6) Continuing disclosure

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.

120(7) Avoidance of standards

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 of directors that authorized the contract, if the director or officer disclosed his interest in accordance with sub-section (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.

120(8) Application to Court

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, upon the application of the corporation or a shareholder of the corporation, set aside the contract on such terms as it thinks fit.

44(1) Prohibited loans and guarantees

Subject to sub-section (2), a corporation or any corporation with which it is affiliated shall not, directly or indirectly, give financial assistance by means of a loan, guarantee or otherwise

(a) to any shareholder, director, officer or employee of the corporation or of an affiliated corporation or to an associate of any such person for any purpose, or

(b) to any person for the purpose of or in connection with a purchase of a share issued or to be issued by the corporation or affiliated corporation,

where there are reasonable grounds for believing that

(c) the corporation is or, after giving the financial assistance, would be unable to pay its liabilities as they become due, or

(d) the realizable value of the corporation's assets, excluding the amount of any financial assistance in the form of a loan and in the form of assets pledged or encumbered to secure a guarantee, after giving the financial assistance, would be less than the aggregate of the corporation's liabilities and stated capital of all classes.

44(2) Permitted loans and guarantees

A corporation may give financial assistance by means of a loan, guarantee or otherwise

(a) to any person in the ordinary course of business if the lending of money is part of the ordinary business of the corporation;

(b) to any person on account of expenditures incurred or to be incurred on behalf of the corporation;

(c) to a holding body corporate if the corporation is a wholly-owned subsidiary of the holding body corporate;

(d) to a subsidiary body corporate of the corporation; and

(e) to employees of the corporation or any of its affiliates

(i) to enable or assist them to purchase or erect living accommodation for their own occupation, or

(ii) in accordance with a plan for the purchase of shares of the corporation or any of its affiliates to be held by a trustee.

44(3) Enforceability

A contract made by a corporation in contravention of this section may be enforced by the corporation or by a lender for value in good faith without notice of the contravention.

(3) ONTARIO : BUSINESS CORPORATIONS ACT, 1982

132(1) Disclosure : Conflict of interest

A director or officer of a corporation who,

(a) is a party to a material contract or transaction or proposed material contract or transaction 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 transaction or proposed material contract or transaction 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.

132(2) Disclosure by director

The disclosure required by sub-section (1) shall be made, in the case of a director,

(a) at the meeting at which a proposed contract or transaction is first considered;

(b) if the director was not then interested in a proposed contract or transaction, at the first meeting after he becomes so interested;

(c) if the director becomes interested after a contract is made or a transaction is entered into, at the first meeting after he becomes so interested; or

(d) if a person who is interested in a contract or transaction later becomes a director, at the first meeting after he becomes a director.

132(3) Disclosure by officer

The disclosure required by sub-section (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 transaction or proposed contract or transaction is to be considered or has been considered at a meeting of directors;

(b) if the officer becomes interested after a contract is made or a transaction is entered into, forthwith after he becomes so interested; or

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

132(4) Where contract or transaction does not require approval

Notwithstanding sub-sections (2) and (3), where sub-section (1) applies to a director or officer in respect of a material contract or transaction or proposed material contract or transaction that, in the ordinary course of the corporation's business, would not require approval by the directors or shareholders, the 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 transaction or proposed contract or transaction.

132(5) Director not to vote

A director referred to in sub-section (1) shall not vote on any resolution to approve the contract or transaction unless the contract or transaction 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 136; or

(d) one with an affiliate.

132(6) General notice of interest

For the purposes of this section, a general notice to the directors by a director or officer disclosing 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 or by any transaction entered into with that person, is a sufficient disclosure of interest in relation to any contract so made or transaction so entered into.

132(7) Effect of Disclosure

Where a material contract is made or a material transaction is entered into between a corporation and a director or officer of the corporation, 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,

(a) the director or officer is not accountable to the corporation or its shareholders for any profit or gain realized from the contract or transaction; and

(b) the contract or transaction is neither void or voidable,

by reason only of that relationship or by reason only that the director is present at or is counted to determine the presence of a quorum at the meeting of directors that authorized the contract or transaction, if the director or officer disclosed his interest in accordance with sub-section (2), (3), (4) or (6), as the case may be, and the contract or transaction was reasonable and fair to the corporation at the time it was so approved.

132(8) Confirmation by shareholders

Notwithstanding anything in this section, a director or officer, acting honestly and in good faith, is not accountable to the corporation or to its shareholders for any profit or gain realized from any such contract or transaction by reason only of his holding the office of director or officer, and the contract or transaction, if it was reasonable and fair to the corporation at the time it was approved, is not by reason only of the director's or officer's interest therein void or voidable, where

(a) the contract or transaction is confirmed or approved by special resolution at a meeting of the shareholders duly called for that purpose; and

(b) the nature and extent of the director's or officer's interest in the contract or transaction are disclosed in reasonable detail

in the notice calling the meeting or in the information circular required by section 112.

132(9) Court setting aside contract

Subject to sub-sections (7) and (8), where a director or officer of a corporation fails to disclose his interest in a material contract or transaction in accordance with this section or otherwise fails to comply with this section, the corporation or a shareholder of the corporation, or, in the case of an offering corporation, the Commission may apply to the court for an order setting aside the contract or transaction and directing that the director or officer account to the corporation for any profit or gain realized and upon such application the court may so order or make such other order as it thinks fit.

20(1) Financial assistance by corporation

Except as permitted under sub-section (2), a corporation or any corporation with which it is affiliated, shall not, directly or indirectly, give financial assistance by means of a loan, guarantee or otherwise,

(a) to any shareholder, director, officer or employee of the corporation or affiliated corporation or to an associate of any such person for any purpose; or

(b) to any person for the purpose of or in connection with a purchase of a share, or a security convertible into or exchangeable for a share, issued or to be issued by the corporation or affiliated corporation,

where there are reasonable grounds for believing that,

(c) the corporation is or, after giving the financial assistance, would be unable to pay its liabilities as they become due; or

(d) the realizable value of the corporation's assets, excluding the amount of any financial assistance in the form of a loan and in the form of any secured guarantee, after giving the financial assistance, would be less than the aggregate of the corporation's liabilities and stated capital of all classes.

20(2) Idem

A corporation may give financial assistance by means of a loan, guarantee or otherwise,

(a) to any person in the ordinary course of business if the lending of money is part of the ordinary business of the corporation;

(b) to any person on account of expenditures incurred or to be incurred on behalf of the corporation;

(c) to its holding body corporate if the corporation is a wholly owned subsidiary of the holding body corporate;

(d) to a subsidiary body corporate of the corporation;

(e) to employees of the corporation or any of its affiliates,

(i) to enable or assist them to purchase or erect living accommodation for their own occupation, or

(ii) in accordance with a plan for the purchase of shares of the corporation or any of its affiliates.

20(3) Validity of contract

A contract made by a corporation in contravention of this section may be enforced by the corporation or by a lender for value in good faith without notice of the contravention.

(4) NEW ZEALAND:

(A) COMPANIES ACT 1955:

Section 199: Disclosure by Directors of Interests in Contracts.

199(1) [Disclosure of interest]

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.

199(2) [Timing of declaration]

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.

199(3) [General notice]

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.

199(4) [Fine]

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

199(5) [Rule of law not prejudiced]

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.

Section 199A: Interested Directors may affix Seal.

199A(1) [Company seal on document]

Notwithstanding any rule of law but subject to any express provision to the contrary in the articles of association of the company, a director of a company who is interested in a contract or arrangement of or relating to the company may affix, or attest the affixing of, the common seal of the company to any document relating to the contract or arrangement to the same extent

as if he were not so interested (whether or not he is entitled to vote in respect of that contract or arrangement at a meeting of directors of the company).

199A(2) [Application]

This section shall apply in respect of every affixing, or attestation of the affixing, of the common seal of a company to a document whether performed before or after the commencement of this section.

Section 190: Prohibition of Loans to Directors.

190(1) [Unlawful]

It shall not be lawful for a company to make a loan to any person who is its director or a director of its holding company, or to enter into any guarantee or provide any security in connection with a loan made to such a person as aforesaid by any other person:

Provided that nothing in this section shall apply either:

(a) **(Repealed)**

(b) Subject to sub-section (2) of this section, to anything done to provide any such person as aforesaid with funds to meet expenditure incurred or to be incurred by him for the purposes of the company or for the purpose of enabling him properly to perform his duties as an officer of the company; or

(c) In the case of a company whose ordinary business includes the lending of money or the giving of guarantees in connection with loans made by other persons, to anything done by the company in the ordinary course of that business.

190(2) [Approval of company]

Paragraph (b) of the proviso to sub-section (1) of this section shall not authorise the making of any loan, or the entering into any guarantee, or the provision of any security, except either:

(a) With the prior approval of the company given at a general meeting at which the purposes of the expenditure and the amount of the loan or the extent of the guarantee or security, as the case may be, are disclosed; or

(b) On condition that, if the approval of the company is not given as aforesaid at or before the next following annual general meeting, the loan shall be repaid or the liability under the

guarantee or security shall be discharged, as the case may be, within 6 months from the conclusion of that meeting.

190(3) [Directors liable to indemnify]

Where the approval of the company is not given as required by any such condition, the directors authorising the making of the loan, or the entering into the guarantee, or the provision of the security, shall be jointly and severally liable to indemnify the company against any loss arising therefrom.

(B) DRAFT COMPANIES ACT; APPENDIX TO REPORT NO. 9 OF N.Z. LAW COMMISSION, "COMPANY LAW - REFORM AND RESTATEMENT" (JUNE 1989):

Part 7: Directors and their powers and duties:

.....

99 Major transactions

(1) A company may not enter into a major transaction (as defined in sub-section (2)), unless the transaction is

(a) of a kind expressly permitted by the constitution of the company; or

(b) approved by special resolution or contingent upon approval by special resolution.

(2) In this section

"assets" includes property of any kind, whether tangible or intangible;

"major transaction" in relation to a company, means

(a) the acquisition of (or an agreement to acquire, whether contingent or otherwise) assets equivalent to the greater part of the assets of the company before the acquisition; or

(b) the disposition of (or an agreement to dispose of, whether contingent or otherwise) the whole or the greater part of the assets of the company.

Directors' Duties:

101 Fundamental duty

The fundamental duty of every director of a company, when exercising powers or performing duties as a director, is to act in good faith and in a manner that he or she believes on reasonable grounds is in the best interests of the company.

102 Existing shareholders

A director of a company must not, when exercising powers or performing duties as a director, act or agree to the company acting in a manner that unfairly prejudices or unfairly discriminates against any existing shareholder of the company, unless the

director believes on reasonable grounds that the duty set out in section 101 [Fundamental duty] requires him or her to do so.

103 Creditors and employees

A director of a company may, when exercising powers or performing duties as a director, have regard to the interests of creditors and employees of the company, but nothing in this section limits the duties or obligations of directors set out in this Act.

104 Compliance with constitution and this Act

A director of a company must not act or agree to the company acting in a manner that contravenes the constitution of the company or this Act.

105 Solvency

(1) A director of a company must not agree to the company entering into a contract or arrangement or acting in any other manner unless he or she believes at that time on reasonable grounds that the act concerned does not involve an unreasonable risk of causing the company to fail to satisfy the solvency test.

(2) A director of a company must not agree to the company incurring an obligation unless he or she believes at that time on reasonable grounds that the company will be able to perform the obligation when required to do so.

106 Standard of care of directors

Every director of a company, when exercising powers or performing duties as a director, must exercise the care, diligence and skill reasonably to be expected of a director acting in like circumstances.

107 Use of information and advice

Every director of a company, when exercising powers or performing duties as a director, may accept as correct, reports, statements, financial data and other information prepared, and professional or expert advice given, by any of the following persons to the extent only that the director acts in good faith, after reasonable inquiry when the need for inquiry is indicated by the circumstances, and without knowledge that would cause such acceptance to be unwarranted:

(a) any employee of the company whom the director believes on reasonable grounds to be reliable and competent in relation to the matters concerned:

(b) any professional or expert person in relation to matters which the director believes on reasonable grounds to be within the person's professional or expert competence:

(c) any other director, or committee of directors upon which the director did not serve, in relation to matters within the director's or committees designated authority.

108 Meaning of "interested"

(1) Subject to sub-section (2), for the purposes of this Act, a director of a company is to be treated as interested in a transaction to which the company is a party if and only if the director:

(a) is a party to or will or may derive a material financial benefit from the transaction; or

(b) has a material financial interest in another party to the transaction; or

(c) is a director, officer or trustee of another party to, or person who will or may derive a material financial benefit from, the transaction (not being a party or person that is a related company of the company); or

(d) is the parent, child, or spouse of another party to, or person who will or may derive a material financial benefit from, the transaction; or

(e) is otherwise directly or indirectly materially interested in the transaction.

(2) For the purposes of this Act, a director of a company is not to be treated as interested in a transaction to which the company is a party if the transaction comprises only the giving by the company of any security to a third party which is unconnected with the director, at the request of the third party, in respect of a debt or obligation of the company for which the director or another person has personally assumed responsibility in whole or in part under a guarantee, indemnity or by the deposit of a security.

(3) Sections 109 [Disclosure of interest] and 110 [Transaction may be avoided] do not apply:

(a) to any remuneration or other benefit given to a director in accordance with section 124 [Remuneration and other benefits]; or

(b) to any indemnity given or insurance provided in accordance with section 125 [Indemnity and insurance].

109 Disclosure of interest

(1) A director of a company who is interested in a transaction or proposed transaction with the company, must forthwith after becoming aware of the transaction or proposed transaction cause to be entered in the interests register, and disclose to the board of the company, the nature and extent of the director's interest.

(2) For the purposes of sub-section (1), a general notice entered in the interests register or disclosed to the board to the effect that a director is a shareholder, director, officer or trustee of another named company or other person and is to be regarded as interested in any transaction which may, after the date of the entry or disclosure, be entered into with that company or person, is a sufficient dis-closure of interest in relation to any such transaction.

(3) A failure by a director to comply with sub-section (1) does not affect the validity of any transaction entered into by the

company or the director, but the director may be convicted of an offence under section 277(2) [Failure to comply with Act].

110 Transaction may be avoided

(1) A transaction entered into by the company in which a director of the company is in any way interested may be avoided by the company within three months of the transaction being disclosed to all the shareholders (whether by means of the company's annual report or otherwise), unless the company receives fair value under the transaction.

(2) For the purposes of sub-section (1), the question whether a company receives fair value under a transaction shall 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.

(3) If a transaction is entered into by the company in the ordinary course of its business and on usual terms and conditions, the company is presumed to receive fair value under the transaction.

(4) For the purposes of sub-section (1)

(a) where a person seeking to uphold a transaction knew of the director's interest at the time the transaction was entered into, the onus of establishing fair value is on that person;

(b) in any other case, the company has the onus of establishing that it did not receive fair value.

(5) Subject to sub-section (l) and to the constitution of a company, no transaction entered into by the company in which a director is interested shall be liable to be avoided, nor shall any director be liable to account to the company for any profit realised by any such transaction by reason only of such interest.

(6) The avoidance by a .company of any transaction under this section does not affect the title or interest of a person in property which that person has acquired

(a) from a person other than the company; and

(b) for valuable consideration; and

(c) without knowledge of the circumstances of the transaction under which the second-mentioned person acquired the property from the company.

111 Interested director may vote etc.

Subject to the constitution of a company, a director of the company who is interested in a transaction entered into or to be entered into by the company may:

(a) vote in respect of the transaction; and

(b) attend any meeting of directors and be included amongst the directors present for the purpose of a quorum; and

(c) sign any documents relating to the transaction on behalf of the company; and

(d) do any other thing in his or her capacity as a director in relation to the transaction

as if he or she was not so interested.

112 Use of company information or opportunity

(i) Where a director of a company has information in his or her capacity as a director or employee of the company (being information that would not otherwise be available to him or her), the director must not disclose that information to any person, or use or act on the basis of that information, other than:

(a) for the purposes of the company; or

(b) as required by law; or

(c) in accordance with sub-section (2) or sub-section (3); or

(d) in accordance with section 109 [Disclosure of interest].

(2) A director of a company may disclose any information to any person who is named in the interests register as a person in accordance with whose directions or instructions the director may be required or is accustomed to act in respect of his or her duties and powers as director.

(3) A director of a company may disclose, use, or act on the basis of any information if particulars of such disclosure, use, or act are entered in the interests register and the director is authorised to do so by the board and the company receives fair value in respect of the disclosure, use, or act.

(4) In this section, the term "director" includes the persons referred to in section 96(1)(d) [Meaning of "director"].

113 Directors' share dealings

(i) A director of a company who acquires or disposes of shares or other securities issued by the company or a related company, or a direct or indirect interest in such shares or other securities, must

(a) forthwith after the acquisition or disposal is made, disclose to the board the number and type of shares acquired or disposed of, the consideration paid or received therefor and the date of acquisition or disposal; and

(b) ensure that particulars of the acquisition or disposal are forthwith entered in the interests register.

(2) Where a director of a company has information in his or her capacity as a director or employee of the company or a related company (being information that would not otherwise be available

to him or her) and that information is material to an assessment of the value of the shares or other securities issued by the company or a related company, the director may acquire or dispose of any such shares or other securities, or a direct or indirect interest therein, only if

(a) in the case of an acquisition, the consideration given for the acquisition is not less than the fair value of the securities or interest acquired; or

(b) in the case of a disposition, the consideration received for the disposition is not more than the fair value of the securities or interest disposed of.

(3) For the purposes of sub-section (2), the fair value of any securities or interest therein is to be arrived at on the basis of all information known to the director or publicly available.

(4) Sub-section (2) shall not apply in respect of any security or interest acquired or disposed of by a director only as a nominee for the company or any related company.

(5) For the purposes of this section and without limiting the meaning of the term "interest", a director of a company has an interest in securities if another body corporate holds or has an interest in them and either

(a) that body corporate, or its board, are accustomed or required to act in accordance with the director's directions or instructions; or

(b) the director is entitled to exercise or control the exercise of one-third or more of the voting power at a meeting of that body corporate.

(6) In this section, the term "director" includes the persons referred to in section 96(1)(d) [Meaning of "director"].

(5) SOUTH AFRICA: COMPANIES ACT 1973:

Interests of directors and officers in contracts.

234. Duty of director or officer to disclose interest in contracts.

(1) A director of a company who is in any way, whether directly or indirectly, materially interested in a contract or proposed contract referred to in sub-section (2), which has been or is to be entered into by the company or who so becomes interested in any such contract after it has been entered into, shall declare his interest and full particulars thereof as provided in this Act.

(2) The provisions of sub-section (1) shall apply to any contract or proposed contract which is of significance in relation to a company's business and which is entered into or to be entered into:

(a) in pursuance of a resolution taken or to be taken at a meeting of directors of a company; or

(b) by a director or officer of the company who either alone or together with others has been authorized by the directors of the company to enter into such contract or any contract of a similar nature.

(3)(a) For the purposes of sub-section (1), a general notice in writing given to the directors of a company by a director thereof 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 and before the date of its expiry be made with that company or firm, shall be deemed to be a sufficient declaration of interest in relation to any contract or proposed contract so made or to be made, if:

(i) the nature and extent of the interest of the said director in such company or firm is indicated in the said notice; and

(ii) at the time the question of confirming or entering into the contract in question is first considered or at the time such director becomes interested in a contract after it has been entered into, the extent of his interest in such company or firm is not greater than is stated in the notice.

(b) a general notice under paragraph (a) may from time to time be amended and shall not be effected beyond the end of the financial year of the company but may from time to time be renewed.

(4) Any director or officer of a company who fails to comply with any provision of this section, shall be guilty of an offence.

(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.

235. Manner of and time for declaration of interest.

(1) No declaration of interest by a director under section 234 shall be of any effect unless it is made at or before the meeting of directors at which the question of confirming or entering into the contract is first taken into consideration and, if in writing, is read out to the meeting or each director present states in writing that he has read such declaration.

(2) If for any reason it is not possible for a director to make any such declaration at or before a particular meeting of directors, he may make it at the first meeting of directors held thereafter at which it is possible for him to do so and shall in that event state the reason why it was not possible to make it at such particular meeting.

236. Written resolution where director interested.

Subject to the provisions of section 36 and notwithstanding any provision in the articles of a company permitting the taking of a resolution by way of a written resolution signed by directors, no such resolution which concerns contracts or proposed contracts referred to in section 234 shall be valid unless the provisions of that section and section 235 are complied with.

237. Disclosure by interested director or officer acting for company.

(1) A director or officer referred to in section 234(2)(b) who is in any way, whether directly or indirectly, materially interested in any proposed contract to be entered into by him on behalf of the company, shall, before entering into such contract, declare his interest and the full particulars thereof at a meeting of directors as prescribed by section 235, and shall not enter into such contract unless and until a resolution has been passed by the directors approving thereof.

(2) Any such officer who becomes materially interested in any contract entered into by him on behalf of the company after it was entered into, shall forthwith declare his interest and the full particulars thereof by a written notice given to the directors.

(3) A notice referred to in sub-section (2) may be delivered to the secretary of the company, if the company has a secretary, and the secretary shall forthwith transmit it to the directors for whom it is intended.

(4) Nothing in this section shall be taken to prejudice the operation of any rule of law restricting an officer of a company from having an interest in contracts with the company.

(5) Any director or officer of a company who fails to comply with any provision of this section, shall be guilty of an offence.

238. When particulars of interest to be stated in notice of meeting.

(1) If a director of a company is in any way, whether directly or indirectly, materially interested in a contract or proposed contract which is placed before the company at any meeting thereof for confirmation or authorization, the notice convening any such meeting shall state the full particulars of the interest in such contract of the director concerned.

(2) A company which fails to comply with the provisions of sub-section (1) and any director who is a party to such failure, shall be guilty of an offence.

239. Minuting of declarations of interest.

(1) Every declaration of interest made under section 234, 235 or 237(1) shall be recorded in the minutes of the meeting of directors at which the declaration is made, and any declaration of interest by an officer under section 237(2) shall be recorded in the minutes of the first meeting of directors held after the date of that declaration.

(2) Where any such declaration is made in writing, the company shall, unless copies of the minutes are circulated to the directors, cause the minute recording the declaration to be read out at the first meeting of directors held after the meeting in the minutes of which the declaration was recorded.

(3) Any company which fails to comply with any provision of this section, shall be guilty of an offence.

240. Register of interests in contracts of directors and officers and inspection thereof.

(1) Every company shall keep at its registered office or at the office where it is made up a register of interests in contracts in one of the official languages of the Republic, and shall enter

therein the particulars of any declarations of interest made under section 234, 235 or 237, including any amendments under section 234(3)(b).

(2) The provisions of section 110 as to the place where the register of members of a company shall be kept and of section 113 as to the inspection of and copies of or extracts from that register, shall apply **mutatis mutandis** to the register to be kept under this section.

241. Duty of auditor as to register of interests in contracts.

The auditor of any company shall satisfy himself that the register of interests in contracts has been kept as required by section 240 and that every declaration of interest recorded therein has been minuted as required by section 239.

226. Prohibition of loans to, or security in connection with transactions by, directors and managers.

(1) No company shall directly or indirectly make a loan to:

(a) any director or manager of:

(i) the company; or

(ii) its holding company; or

(iii) any other company which is a subsidiary of its holding company; or

(b) any other company or other body corporate controlled by one or more directors or managers of the company or of its holding company or of any company which is a subsidiary of its holding company;

or provide any security to any person in connection with an obligation of such director, manager, company or other body corporate.

(1A) For the purposes of sub-section (1):

(a) "loan" includes:

(i) a loan of money, shares, debentures or any other property; and

(ii) any credit extended by a company, where the debt concerned is not payable or being paid in accordance with normal business practice in respect of the payment of debts of the same kind; and

(b) one or more directors or managers of a company contemplated in sub-section (1)(b) shall be deemed to control another company or body corporate only if:

(i) such director or manager or his nominee is a member or such directors or managers or their nominees are members of such other company or body corporate and the composition of its board of directors is controlled by such director, manager or nominee or such directors, managers or nominees, and such composition shall

be deemed to be so controlled if such director or manager or his nominee or such directors or managers or their nominees may, by the exercise of some power and without the consent or concurrence of any other person, appoint or remove the majority of the directors concerned, and such director, manager or nominee or such directors, managers or nominees shall be deemed to have power to appoint a director where a person cannot be appointed as a director without his or their consent or concurrence; or

(ii) more than one-half of the equity share capital of that other company or body corporate or if that other body corporate is a corporation as defined in section 1 of the Close Corporations Act 1984 (Act No. 69 of 1984), more than 50 per cent of the interest in such corporation is held by such director, manager or nominee or such directors, managers or nominees; and

(c) "security" includes a guarantee.

(1B) The provisions of sub-section (1) and of paragraph (b) of sub-section (1A) shall not be construed as prohibiting a company from making a loan to, or providing security to any person in connection with an obligation of, its holding company or subsidiary or a subsidiary of such holding company.

(2) The provisions of sub-section (1) shall not apply:

(a) In respect of:

(i) the making of a loan by a company to its own director or manager;

(ii) the provision of security by a company in connection with an obligation of its own director or manager;

(iii) the making of a loan by a company to any other company or other body corporate controlled by one or more of the directors or managers of the first-mentioned company; or

(iv) the provision of security by a company in connection with an obligation of any other company or other body corporate controlled by one or more of the directors or managers of the first-mentioned company,

with the consent of all the members of the company or in terms of a special resolution relating to a specific transaction; or

(b) subject to the provisions of sub-section (3), in respect of anything done to provide any director or manager with funds to meet expenditure incurred or to be incurred by him for the purposes of the company concerned or for the purpose of enabling him properly to perform his duties as director or manager of that company; or

(c) in respect of anything done bona fide in the ordinary course of the business of a company actually and regularly carrying on the business of the making of loans or the provision of security; or

(d) to the provision of money or making of loans by a company for the purposes contemplated in section 38(2)(b) and (c); or

(e) to the making of a loan or the provision of security with the approval of the company in general meeting for housing for its director or manager; or

(f) in respect of:

(i) the making of a loan by a company to a director or manager of its subsidiary; or

(ii) the provision of security by a company to another person in connection with an obligation of a director or manager of its subsidiary;

provided such director or manager is not also a director or manager of such company itself.

(3) No loan shall be made or security provided by virtue of the provisions of sub-section (2)(b), except

(a) with the prior approval of the company given at a general meeting at which the amount of the loan or the extent of the security and the purposes thereof are disclosed; or

(b) on condition that, if the approval of the company is not given as aforesaid at or before the next annual general meeting of the company, the loan shall be repaid or the liability under the security shall be discharged, within six months from the conclusion of that annual general meeting.

(4) Any director or officer of a company who authorizes, permits or is a party to the making of any loan or the provision of any security contrary to the provisions of this section, shall:

(a) be liable to indemnify the company and any other person who had no actual knowledge of the contravention, against any loss directly resulting from the invalidity of such loan or security; and

(b) be guilty of an offence.

(5) For the purposes of sub-section (4) "director or officer of a company" includes, where the company is a subsidiary, any director or officer of its holding company.

(6) UNITED KINGDOM: COMPANIES ACT 1985:

SEC. 317 Directors to disclose interest in contracts.

317(1) [Duty to declare interest at directors' meeting]

It is 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.

317(2) [Declaration of interest re proposed contract]

In the case of a proposed contract, the declaration shall be made:

(a) at the meeting of the directors at which the question of entering into the contract is first taken into consideration; or

(b) 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 declaration shall be made at the first meeting of the directors held after he becomes so interested.

317(3) [General notice deemed sufficient declaration of interest re contracts]

For purposes of this section, a general notice given to the directors of a company by a director to the effect that:

(a) 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; or

(b) he is to be regarded as interested in any contract which may after the date of the notice be made with a specified person who is connected with him (within the meaning of section 346 below),

is deemed a sufficient declaration of interest in relation to any such contract.

317(4) [Requirements for sec. 317(3) notice to be of effect]

However, no such notice is 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.

317(5) [Interpretation]

A reference in this section to a contract includes any transaction or arrangement (whether or not constituting a contract) made or entered into on or after 22nd December 1980.

317(6) [Further interpretation]

For purposes of this section, a transaction or arrangement of a kind described in section 330 (prohibition of loans, quasi-loans etc. to directors) made by a company for a director of the company or a person connected with such a director is treated (if it would not otherwise be so treated, and whether or not it is prohibited by that section) as a transaction or arrangement in which that director is interested.

317(7) [Penalty on default]

A director who fails to comply with this section is liable to a fine.

317(8) [Application to shadow director]

This section applies to a shadow director as it applies to a director, except that a shadow director shall declare his interest, not at a meeting of the directors, but by a notice in writing to the directors which is either:

(a) a specific notice given before the date of the meeting at which, if he had been a director, the declaration would be required by sub-section (2) to be made; or

(b) a notice which under sub-section (3) falls to be treated as a sufficient declaration of that interest (or would fall to be so treated apart from sub-section (4)).

317(9) [Rules of law etc.]

Nothing in this section prejudices the operation of any rule of law restricting directors of a company from having an interest in contracts with the company.

SEC. 330 General Restrictions on loans etc. to directors and persons connected with them

330(1) [Prohibitions, Exceptions]

The prohibitions listed below in this section are subject to the exceptions in sections 332 to 338.

330(2) [Loans etc]

A company shall not:

(a) make a loan to a director of the company or of its holding company;

(b) enter into any guarantee or provide any security in connection with a loan made by any person to such a director.

330(3) [Quasi-loans etc.]

A relevant company shall not:

(a) make a quasi-loan to a director of the company or of its holding company;

(b) make a loan or a quasi-loan to a person connected with such a director;

(c) enter into a guarantee or provide any security in connection with a loan or quasi-loan made by any other person for such a director or a person so connected.

330(4) [Credit Transactions etc.]

A relevant company shall not:

(a) enter into a credit transaction as creditor for such a director or a person so connected;

(b) enter into any guarantee or provide any security in connection with a credit transaction made by any other person for such a director or a person so connected.

330(5) [Shadow Director]

For purposes of sections 330 to 346, a shadow director is treated as a director.

330(6) [Prohibition of certain assignments]

A company shall not arrange for the assignment to it, or the assumption by it, of any rights, obligations or liabilities under a transaction which, if it had been entered into by the company, would have contravened sub-section (2), (3) or (4); but for the purposes of sections 330 to 347 the transaction is to be treated as having been entered into on the date of the arrangement.

330(7) [Prohibition of further arrangements]

A company shall not take part in any arrangement whereby:

(a) another person enters into a transaction which, if it had been entered into by the company, would have contravened any of sub-sections (2), (3), (4) or (6); and

(b) that other person, in pursuance of the arrangement, has obtained or is to obtain any benefit from the company or its holding company or a subsidiary of the company or its holding company.

SEC. 331 Definitions for sec. 330 ff.

331(1) [Interpretation of sec. 330 to 346]

The following sub-sections apply for the interpretation of sections 330 to 346.

331(2) ["Guarantee"]

"Guarantee" includes indemnity, and cognate expressions are to be construed accordingly.

331(3) [Quasi-loans]

A quasi-loan is a transaction under which one party ("the creditor") agrees to pay, or pays otherwise than in pursuance of an agreement, a sum for another ("the borrower") or agrees to reimburse, or reimburses otherwise than in pursuance of an agreement, expenditure incurred by another party for another ("the borrower"):

(a) on terms that the borrower (or a person on his behalf) will reimburse the creditor; or

(b) in circumstances giving rise to a liability on the borrower to reimburse the creditor.

331(4) [Borrower under Quasi-loan]

Any reference to the person to whom a quasi-loan is made is a reference to the borrower; and the liabilities of a borrower under a quasi-loan include the liabilities of any person who has agreed to reimburse the creditor on behalf of the borrower.

331(5) (Repealed by Banking Act 1987, sec. 108(2) and Sch. 7, Pt.1 as from 1 October 1987)

331(6) ["Relevant Company"]

"Relevant Company" means a company which:

(a) is a public company, or

(b) is a subsidiary of a public company, or

(c) is a subsidiary of a company which has as another subsidiary a public company, or

(d) has a subsidiary which is a public company.

331(7) [Credit Transactions]

A credit transaction is a transaction under which one party ("the creditor")

(a) supplies any goods or sells any land under a hire-purchase agreement or a conditional sale agreement;

(b) leases or hires any land or goods in return for periodical payments;

(c) otherwise disposes of land or supplies goods or services on the understanding that payment (whether in a lump sum or instruments or by way of periodical payments or otherwise) is to be deferred.

331(8) ["Services"]

"Services" means anything other than goods or land.

331(9) [Transactions etc. for a person]

A transaction or arrangement is made "for" a person if:

(a) in the case of a loan or quasi-loan, it is made to him;

(b) in the case of a credit transaction, he is the person to whom goods or services are supplied, or land is sold or otherwise disposed of, under the transaction;

(c) in the case of a guarantee or security, it is entered into or provided in connection with a loan or quasi-loan made to him or a credit transaction made for him;

(d) in the case of an arrangement within sub-section (6) or (7) of section 330, the transaction to which the arrangement relates was made for him; and

(e) in the case of any other transaction or arrangement for the supply or transfer of, or of any interest in, goods, land or services, he is the person to whom the goods, land or services (or the interest) are supplied or transferred.

331(10) ["Conditional Sale Agreement"]

"Conditional Sale Agreement" means the same as in the Consumer Credit Act 1974.

SEC. 332 Short-term Quasi-loans

332(1) [Certain Quasi-loans possible to Directors]

Sub-section (3) of section 330 does not prohibit a company ("the creditor") from making a quasi-loan to one of its directors or to a director of its holding company if:

(a) the quasi-loan contains a term requiring the director or a person on his behalf to reimburse the creditor his expenditure within 2 months of its being incurred; and

(b) the aggregate of the amount of that quasi-loan and of the amount outstanding under each relevant quasi-loan does not exceed Pounds Stg. 1,000.

332(2) [Quasi-loan relevant for sec. 332(1)]

A quasi-loan is relevant for this purpose if it was made to the director by virtue of this section by the creditor or its subsidiary or, where the director is a director of the creditor's holding company, any other subsidiary of that company; and "the amount outstanding" is the amount of the outstanding liabilities of the person to whom the quasi-loan was made.

SEC. 333 Inter-company loans in same group

333 In the case of a relevant company which is a member of a group of companies (meaning a holding company and its subsidiaries), paragraphs (b) and (c) of section 330(3) do not prohibit the company from:

(a) making a loan or quasi-loan to another member of that group; or

(b) entering into a guarantee or providing any security in connection with a loan or quasi-loan made by any person to another member of the group,

by reason only that a director of one member of the group is associated with another.

SEC. 334 Loans of small amounts

334 Without prejudice to any other provision of sections 332 to 338, paragraph (a) of section 330(2) does not prohibit a company from making a loan to a director of the company or of its holding company if the aggregate of the relevant amounts does not exceed Pounds Stg. 2,500.

SEC. 335 Minor and business transactions

335(1) [Exception to sec. 330(4)]

Section 330(4) does not prohibit a company from entering into a transaction for a person if the aggregate of the relevant amounts does not exceed Pounds Stg. 5,000.

335(2) [Conditions for Exception]

Section 330(4) does not prohibit a company from entering into a transaction for a person if:

(a) the transaction is entered into by the company in the ordinary course of its business; and

(b) the value of the transaction is not greater, and the terms on which it is entered into are no more favourable, in respect of the person for whom the transaction is made, than that or those which it is reasonable to expect the company to have offered to or in respect of a person of the same financial standing but unconnected with the company.

SEC. 336 Transactions at behest of holding company

336 The following transactions are excepted from the prohibitions of section 330:

(a) a loan or quasi-loan by a company to its holding company, or a company entering into a guarantee or providing any security in connection with a loan or quasi-loan made by any person to its holding company;

(b) a company entering into a credit transaction as creditor for its holding company, or entering into a guarantee or providing any security in connection with a credit transaction made by any other person for its holding company.

SEC. 337 Funding of director's expenditure on duty to company

337(1) [Exception to sec. 330]

A company is not prohibited by section 330 from doing anything to provide a director with funds to meet expenditure incurred or to be incurred by him for the purposes of the company or for the purpose of enabling him properly to perform his duties as an officer of the company.

337(2) [Extension of sec. 337(1)]

Nor does the section prohibit a company from doing anything to enable a director to avoid incurring such expenditure.

373(3) [Conditions for sec. 337(1), (2)]

Sub-sections (1) and (2) apply only if one of the following conditions is satisfied:

(a) the thing in question is done with prior approval of the company given at a general meeting at which there are disclosed all the matters mentioned in the next subsection;

(b) that thing is done on condition that, if the approval of the company is not so given at or before the next annual general meeting, the loan is to be repaid, or any other liability arising under any such transaction discharged, within 6 months from the conclusion of that meeting;

but those sub-sections do not authorise a relevant company to enter into any transaction if the aggregate of the relevant amounts exceeds Pounds Stg. 10,000.

337(4) [Matters to be disclosed under sec. 337(3)(a)]

The matters to be disclosed under sub-section (3)(a) are:

(a) the purpose of the expenditure incurred or to be incurred, or which would otherwise be incurred, by the director,

(b) the amount of the funds to be provided by the company, and

(c) the extent of the company's liability under any transaction which is or is connected with the thing in question.

SEC. 338 Loan or quasi-loan by money-lending company

338(1) [Exception to sec. 330]

There is excepted from the prohibitions in section 330:

(a) a loan or quasi-loan made by a money-lending company to any person; or

(b) a money-lending company entering into a guarantee in connection with any other loan or quasi-loan.

338(2) ["Money-lending company"]

"Money-lending company" means a company whose ordinary business includes the making of loans or quasi-loans, or the giving of guarantees in connection with loans or quasi-loans.

338(3) [Conditions for sec. 338(1)]

Sub-section (1) applies only if both the following conditions are satisfied

(a) the loan or quasi-loan in question is made by the company, or it enters into the guarantee, in the ordinary course of the company's business; and

(b) the amount of the loan or quasi-loan, or the amount guaranteed, is not greater, and the terms of the loan, quasi-loan or guarantee are not more favourable, in the case of the person to whom the loan or quasi-loan is made or in respect of whom the guarantee is entered into, than that or those which it is reasonable to expect that company to have offered to or in respect of a person of the same financial standing but unconnected with the company.

338(4) [No authorisation in sec. 338(1) if amounts over Pounds Stg. 50,000]

But sub-section (1) does not authorise a relevant company (unless it is an authorised institution) to enter into any transaction if the aggregate of the relevant amounts exceed Pounds Stg. 50,000.

338(5) [Determination of sec. 338(4) aggregate]

In determining that aggregate, a company which a director does not control is deemed not to be connected with him.

338(6) [Extent of condition in sec. 338(3)(b)]

The condition specified in sub-section (3)(b) does not of itself prevent a company from making a loan to one of its directors or a director of its holding company:

(a) for the purpose of facilitating the purchase, for use as that director's only or main residence, of the whole or part of any dwelling-house together with any land to be occupied and enjoyed with it;

(b) for the purpose of improving a dwelling-house or part of a dwelling-house so used or any land occupied and enjoyed with it;

(c) in substitution for any loan made by any person and falling within paragraph (a) or (b) of this sub-section,

if loans of that description are ordinarily made by the company to its employees and on terms no less favourable than those on which the transaction in question is made, and the aggregate of the relevant amounts does not exceed Pounds Stg. 50,000.

SEC. 339 ""Relevant amounts"' for purposes of sec. 334 ff

339(1) [Defining relevant amount for exceptions]

This section has effect for defining the "relevant amounts" to be aggregated under sections 334, 335(1), 337(3) and 338(4); and in relation to any proposed transaction or arrangement and the question whether it falls within one or other of the exceptions provided by those sections, "the relevant exception" is that exception; but where the relevant exception is the one provided by section 334 (loan of small amount), references in this section to a person connected with a director are to be disregarded.

339(2) [Relevant amounts for proposed transaction or arrangement]

Subject as follows, the relevant amounts in relation to a proposed transaction or arrangement are:

(a) the value of the proposed transaction or arrangement,

(b) the value of any existing arrangement which:

(i) falls within sub-section (6) or (7) of section 330, and

(ii) also falls within sub-section (3) of this section, and

(iii) was entered into by virtue of the relevant exception by the company or by a subsidiary of the company or, where the proposed transaction or arrangement is to be made for a director of its holding company or a person connected with such a director, by that holding company or any of its subsidiaries;

(c) the amount outstanding under any other transaction:

(i) falling within sub-section (3) below, and

(ii) made by virtue of the relevant exception, and

(iii) made by the company or by a subsidiary of the company or, where the proposed transaction or arrangement is to be made for a director of its holding company or a person connected with such a director, by that holding company or any of its subsidiaries.

339(3) [Transactions under sec. 339(2)]

A transaction falls within this sub-section if it was made:

(a) for the director for whom the proposed transaction or arrangement is to be made, or for any person connected with that director; or

(b) where the proposed transaction or arrangement is to be made for a person connected with a director of a company, for that director or any person connected with him;

and an arrangement also falls within this sub-section if it relates to a

transaction which does so.

339(4) [Sec. 338 transaction - authorised institution]

But where the proposed transaction falls within section 338 and is one which an authorised institution proposes to enter into under sub-section (6) of that section (housing loans, etc.), any other transaction or arrangement which apart from this sub-section would fall within sub-section (3) of this section does not do so unless it was entered into in pursuance of section 338(6).

339(5) [Exception to sec. 339(3) re certain subsidiaries etc.]

A transaction entered into by a company which is (at the time of that transaction being entered into) a subsidiary of the company which is to make the proposed transaction, or is a subsidiary of that company's holding company, does not fall within sub-section (3) if at the time when the question arises (that is to say, the question whether the proposed transaction or arrangement falls within any relevant exception), it no longer is such a subsidiary.

339(6) [Values under sec. 339(2)]

Values for purposes of sub-section (2) of this section are to be determined in accordance with the section next following; and "the amount outstanding" for purposes of sub-section (2)(c) above is the value of the transaction less any amount by which that value has been reduced.

SEC. 340 "Value" of transactions and arrangements

340(1) [Application]

This section has effect for determining the value of a transaction or arrangement for purposes of sections 330 to 339.

340(2) [Loan]

The value of a loan is the amount of its principal.

340(3) [Quasi-loan]

The value of a quasi-loan is the amount, or maximum amount, which the person to whom the quasi-loan is made is liable to reimburse the creditor.

340(4) [Guarantee or security]

The value of a guarantee or security is the amount guaranteed or secured.

340(5) [Sec. 330(6) or (7) arrangement]

The value of an arrangement to which section 330(6) or (7) applies is the value of the transaction to which the arrangement relates less any amount by which the liabilities under the arrangement or transaction of the person for whom the transaction was made have been reduced.

340(6) [Arrangement not under sec. 340(2) to (5)]

The value of a transaction or arrangement not falling within sub-sections (2) to (5) above is the price which it is reasonable to expect could be obtained for the goods, land or services to which the transaction or

arrangement relates if they had been supplied (at the time the transaction or arrangement is entered into) in the ordinary course of business and on the same terms (apart from price) as they have been supplied, or are to be supplied, under the transaction or arrangement in question.

340(7) [Where value not able to be expressed as specific sum]

For purposes of this section, the value of a transaction or arrangement which is not capable of being expressed as a specific sum of money (because the amount of any liability arising under the transaction or arrangement is unascertainable, or for any other reason), whether or not any liability under the transaction or arrangement has been reduced, is deemed to exceed Pounds Stg. 50,000.

SEC. 341 Civil Remedies for Breach of Sec. 330

341(1) [Contravening provision voidable]

If a company enters into a transaction or arrangement in contravention of section 330, the transaction or arrangement is voidable at the instance of the company unless:

(a) restitution of any money or any other asset which is the subject matter of the arrangement or transaction is no longer possible, or the company has been indemnified in pursuance of sub-section (2)(b) below for the loss or damage suffered by it, or

(b) any rights acquired bona fide for value and without actual notice of the contravention by a person other than the person for whom the transaction or arrangement was made would be affected by its avoidance.

341(2) [Liability of directors and connected person to account or indemnify]

Where an arrangement or transaction is made by a company for a director of the company or its holding company or a person connected with such a director in contravention of section 330, that director and the person so connected and any other director of the company who authorised the transaction or arrangement (whether or not is has been avoided in pursuance of sub-section (1)) is liable:

(a) to account to the company for any gain which he has made directly or indirectly by the arrangement or transaction; and

(b) (jointly and severally with any other person liable under this sub-section) to indemnify the company for any loss or damage resulting from the arrangement or transaction.

341(3) [Extent of sec. 341(2)]

Sub-section (2) is without any prejudice to liability imposed otherwise than by that sub-section, but is subject to the next two sub-sections.

341(4) [Exception to sec. 341(2) - all reasonable steps taken etc.]

Where an arrangement or transaction is entered into by a company and a person connected with a director of the company or its holding company in contravention of section 330, that director is not liable under sub-section (2) of this section if he shows that he took all reasonable steps to secure

the company's compliance with that section.

341(5) [Exception to sec. 341(2) - no knowledge]

In any case, a person so connected and any such other director as is mentioned in sub-section (2) is not so liable if he shows that, at the time the arrangement or transaction was entered into, he did not know the relevant circumstances constituting the contravention.

SEC. 342 Criminal Penalties for Breach of Sec. 330

342(1) [Offence by director]

A director of a relevant company who authorises or permits the company to enter into a transaction or arrangement knowing or having reasonable cause to believe that the company was thereby contravening section 330 is guilty of an offence.

342(2) [Offence by relevant company]

A relevant company which enters into a transaction or arrangement for one of its directors or for a director of its holding company in contravention of section 330 is guilty of an offence.

342(3) [Offence of procuring contravention by relevant company]

A person who procures a relevant company to enter into a transaction or arrangement knowing or having reasonable cause to believe that the company was thereby contravening section 330 is guilty of an offence.

342(4) [Penalty]

A person guilty of an offence under this section is liable to imprisonment or a fine, or both.

342(5) [Exception for relevant company]

A relevant company is not guilty of an offence under sub-section (2) if it shows that, at the time the transaction or arrangement was entered into, it did not know the relevant circumstances.

SEC. 343 Record of Transactions not disclosed in Company Accounts

343(1) [Application re authorised institutions and sec. 344 exceptions]

The following provisions of this section:

(a) apply in the case of a company which is, or is the holding company of, an authorised institution, and

(b) are subject to the exceptions provided by section 344.

343(2) [Register of transactions etc. to be kept]

Such a company shall maintain a register containing a copy of every transaction, arrangement or agreement of which particulars would, but for paragraph of Schedule 6, be required by section 232 to be disclosed in the company's accounts or group accounts for the current financial year and for each of the preceding 10 financial years.

343(3) [Transactions etc. not in writing]

In the case of a transaction, arrangement or agreement which is not in writing, there shall be contained in the register a written memorandum setting out its terms.

343(4) [Statement re transactions etc. to be available at registered office]

Such a company shall before its annual general meeting make available at its registered office for not less than 15 days ending with the date of the meeting a statement containing the particulars of transactions, arrangements and agreements which the company would, but for paragraph 4 of Schedule 6, be required by section 232 to disclose in its accounts or group accounts for the last complete financial year preceding that meeting.

343(5) [Inspection by members]

The statement shall be so made available for inspection by members of the company; and such a statement shall also be made available for their inspection at the annual general meeting.

343(6) [Auditors' report on statement]

It is the duty of the company's auditors to examine the statement before it is made available to members of the company and to make a report to the members on it; and the report shall be annexed to the statement before it is made so available.

343(7) [Statement in auditors' report etc.]

The auditors' report shall state whether in their opinion the statement contains the particulars required by sub-section (4); and, where their opinion is that it does not, they shall include in the report, so far as they are reasonably able to do so, a statement giving the required particulars.

343(8) [Offence, penalty, defence: shadow director]

If a company fails to comply with any provision of sub-sections (2) to (5), every person who at the time of the failure is a director of it is guilty of an offence and liable to a fine; but:

(a) it is a defence in proceedings against a person for this offence to prove that he took all reasonable steps for securing compliance with the sub-section concerned; and

(b) a person is not guilty of the offence by virtue only of being a shadow director of the company.

343(9) [Application to certain loans and quasi-loans]

For purposes of the application of this section to loans and quasi-loans made by a company to persons connected with a person who at any time is a director of the company or of its holding company, a company which a person does not control is not connected with him.

SEC. 344 Exceptions from Sec. 343

344(1)]Certain transactions etc. less than Pounds Stg. 1,000]

Section 343 does not apply in relation to:

(a) transactions or arrangements made or subsisting during a financial year by a company or by a subsidiary of a company for a person who was at any time during that year a director of the company or of its holding company or was connected with such a director, or

(b) an agreement made or subsisting during that year to enter into such a transaction or arrangement,

if the aggregate of the values of each transaction or arrangement made for that person, and of each agreement for such a transaction or arrangement, less the amount (if any) by which the value of those transactions, arrangements and agreements has been reduced, did not exceed Pounds Stg. 1,000 at any time during the financial year. For purposes of this sub-section, values are to be determined as under section 340.

344(2)]Certain UK subsidiary authorised institutions]

Section 343(4) and (5) do not apply to an authorised institution which is the wholly-owned subsidiary of a company incorporated in the United Kingdom.