New Zealand Law Society
Te Kāhui Ture o Aotearoa

Companies (Directors Duties) Amendment Bill

21/12/2022

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1 Introduction

1.1 The New Zealand Law Society | Te Kāhui Ture o Aotearoa (**Law Society**) welcomes the opportunity to comment on the Companies (Directors Duties) Amendment Bill (the **Bill**).

1.2 The Bill seeks to amend section 131 of the Companies Act 1993 (the **Act**), to enable directors to consider a range of matters (set out expressly) when determining the best interests of the company. The Bill is an attempt to bring to a head, at a policy level, the debate in company law over "shareholder primacy" versus "stakeholder theory".

1.3 This submission has been prepared with input from the Law Society's Commercial and Business Law Committee.[1]

1.4 The Law Society **wishes to be heard** on the Bill.

2 Summary

2.1 The Law Society is of the view this Bill should not proceed. Company directors can already consider the matters outlined in in clause 4, and any attempt to reiterate or reinforce this by amending the legislation is inappropriate when done in this ad-hoc manner. This is a fundamental element of New Zealand corporate law, and as a member's bill this has not had the benefit of a thorough and comprehensive law reform process, including early public consultation. To allow the Bill to proceed risks unintended and unconsidered consequences to other aspects of New Zealand law.

2.2 We have expanded on these points further below.

3 The Bill seeks to solve a problem that does not exist

3.1 The Act already allows companies and their directors to take into account "wider matters other than the financial bottom line", including all the factors the Bill seeks to set out, and others. This is evidenced by the many not-for-profit entities in existence, which are structured as companies and run by boards of directors in accordance with current company law.

3.2 The Supreme Court, in *Debut Homes v Cooper*[2] confirmed that the legislative test in section 131 is subjective, allowing directors to consider all the factors described in the Bill – and others – if that is what the director believes to be in the company's best interests.

3.3 At paragraph 112, the Court said:

> …. The test is subjective. This follows from the wording of s 131 (expressed subjectively) and the legislative history (the fact that the Law Commission's reasonableness requirement was not enacted). This aligns with the common law test and policy considerations. Courts are not well equipped, even with the benefit of expert evidence, to second-guess the business decisions made by directors in what they honestly believed to be in the best interests of the company. …

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1 More information regarding this committee is available on the Law Society's website: https://www.lawsociety.org.nz/branches-sections-and-groups/law-reform-committees/.

2 *Madsen-Ries and Levin as liquidators of Debut Homes Ltd v Cooper* [2020] NZSC 100.

3.4 Accordingly, there is simply no need to add the statements proposed by the Bill to section 131.

3.5 We do not agree that the current formulation of section 131 means directors can ignore factors such as the environmental impact of the company's activities, how it treats its employees, or recognising the other stakeholder interests listed in the Bill.

3.6 If there is a real area of uncertainty, it is the extent to which a board can prioritise those wider stakeholder interests over the (arguably narrower) economic interests of shareholders. Use of term 'arguably' is deliberate: in the 21st century, it seems increasingly unlikely that considering wider stakeholder interests (about everything ranging from embracing diversity and inclusiveness to reducing greenhouse gas emissions) is inconsistent with the interests of shareholders, given a company can 'make or break' its reputation through environmental and social-focussed commitments and actions.

4 We strongly caution against ad-hoc changes to the directors' duties regime

4.1 The Bill brings into the Parliamentary sphere the debate in corporate law between the "shareholder primacy" and "stakeholder governance" theories, and in doing so, potentially alters a fundamental premise of the Act.

4.2 As with all other significant changes to the company law regime in the past, any change to the directors' duties should come after a thorough and considered review of the status quo, the rationale for change, and the wider legal or commercial implications of the proposed change. Drafting changes should be made in a way that eliminates uncertainty for all parties concerned (including directors themselves).

4.3 The Law Society has concerns about:

- How the newly expressed section 131 will impact director liability. There is already confusion about how the suite of directors' duties applies – particularly in an insolvency situation. Goddard J, in the Court of Appeal judgment in the *Mainzeal* case[3] commented that the legislation governing insolvent trading in New Zealand is "*unsatisfactory in a number of respects*" and that it should be reviewed "*to ensure that it provides a coherent and practically workable regime for the protection of creditors where directors decide to keep trading in circumstances where a company is insolvent or near-insolvent*".
- What is meant by "recognised environmental, social and governance factors." There is no indication of what "recognised" means in this context: by whom it must be recognised, and to what extent. Directors must be able to conduct company business against a background of 'confident compliance'.
- Although clause 4 is intended to be permissive ('and for the avoidance of doubt'[4]), in the context of the section 131 duty there is a real risk that it will nonetheless come to function as a standard of behaviour amongst directors, despite one of the basic tenets

[3] *Yan v Mainzeal Property and Construction Ltd (in liq)* [2021] NZCA 99.

[4] As noted in this submission, we do not consider that there is room for doubt – and New Zealand company directors, when considering the best interests of a company, are permitted to take account of factors that go beyond the interests of shareholders (and arguments about maximising short-term profits).

of company law being that a company is run by the directors in the manner they see fit. Shareholders may remove directors if they do not like how the directors are operating, but otherwise (except as provided by the company's constitution) the board is responsible for the management of the company.

5 Overseas extensions of directors' duties

5.1 There have been a number of drivers for a review of the formulation and operation of the 'best interests' duty in Australia. Most recently, the Australian Institute of Company Directors (AICD) commissioned a review of the duty and a comparison with the equivalent duty in a number of comparable jurisdictions.[5] The AICD has one eye on international developments, such as the 2019 changes to the Canada Business Corporations Act (**CBCA**) that may point to a need for directors' duties to embrace a consideration of stakeholders other than shareholders in board decision-making. In turn, the 2019 changes to the CBCA appear to have a number of difficulties that may take some time to resolve.

5.2 In the Law Society's view, it is preferable that there is a consistent approach in this area between New Zealand and Australia where possible. Making significant changes that may impact how companies will operate imposes costs and risks for doing business in New Zealand and adds to the comparative advantages of the much larger economy across the Tasman. Instead, any move to consider embracing the interests of wider stakeholders should be part of the type of considered review to which we refer above.

5.3 It may be that the Bill is an attempt to replicate the effect of section 172 of the UK Companies Act 2006. If so, we consider it is unlikely to achieve that.

5.4 The change to the relevant element of UK company law came as part of a wider review of UK company law and policy, and directors' duties in particular, in 2006. The duty itself is (now, 12 years later) accompanied by a reporting requirement, which is likely to prompt the actual change that the UK Act was attempting to effect when it was initially passed. The Bill does not go this far.

5.5 The UK Act is a comprehensive code of company law (including seven then-new statutory duties for directors, previously common law duties), making changes to virtually every facet of law in relation to companies in the UK. The 2006 Act amended and restated the 1985 Act and, when passed, was the single longest piece of legislation passed by the UK Parliament.

5.6 Section 172(1) of the 2006 Act provides as follows:

> **Duty to promote the success of the company**
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> (1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to—
>
> (a) the likely consequences of any decision in the long term,

[5] Directors' and Officers' Duties Evaluation of the 'best interests' duty 26 May 2022. https://www.aicd.com.au/content/dam/aicd/pdf/news-media/research/2022/Allens-research-the-best-interests-duty-26-05-2022.pdf

(b) the interests of the company's employees,

(c) the need to foster the company's business relationships with suppliers, customers and others,

(d) the impact of the company's operations on the community and the environment,

(e) the desirability of the company maintaining a reputation for high standards of business conduct, and

(f) the need to act fairly as between members of the company.

5.7 In 2018, the section 172(1) duty was 'backed up' by a regulation requiring certain large companies to disclose in annual reports how directors have had regard to the matters set out in sections 172(1)(a)-(f), a so-called "Section 172(1) statement". A similar reporting requirement appears in the UK Corporate Governance Code.

5.8 The impact of section 172 has been the subject of fierce debate in the UK. Whilst we do not attempt to summarise the various criticisms, one significant objection is that section 172 is viewed as imposing a duty to have regard to various factors without guidance as to how those interests are to be weighed, prioritised and reconciled. Risks like this cannot be ignored in relation to the Bill as proposed. A thorough review of the existing law, and the need for change is essential to help minimise these risks.

6 Law reform should focus on changing the right law, for appropriate reasons

6.1 It may be that the Bill is intended to achieve more substantive change to the company law regime, albeit through what appears to be a rather simple amendment. The Law Society is strongly of the view that such change should follow a full policy development process (as outlined above), and be clear in its intended effect.

6.2 If the Bill seeks to promote meaningful progress on such issues as reducing adverse environmental impacts then, in the context of the sort of all-embracing review to which we refer above, targeted and clear legal obligations (coupled with efficient enforcement mechanisms) are likely to have a more realistic chance of doing so than what is proposed.

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