THE GOVERNMENT DIRECTOR AND HIS CONFLICTING DUTIES[1]

Introduction:

The extent to which Government should intervene in private industry can be a politically contentious issue. The arguments for and against go to the very basis of a democratic free enterprise society and occasionally become irrational and highly emotive.[2] In the New Zealand context, however, the direct participation of the State in the affairs of private enterprise has been justified almost exclusively on economic grounds.

The motive for State intervention has at times been a strictly utilitarian one; the desire to utilise the country's natural resources by way of incorporating a major industrial company.[3] At other times the initiative has come from private industry itself in the form of requests for financial aid.[4] The form of participation or assistance by the State will vary according to the circumstances but is likely to include some combination of taxation benefits, government guarantees, subsidies, loans, outright monetary grants and import licensing advantages.

The acquisition of a private company's shares and the appointment of Government nominees to its board is another method by which the area of public control may be extended.[5] In such circumstances the Government is able to maintain close supervision over the affairs of internal management while at the same time allowing the Company to operate as a normal profit-making concern and to achieve its maximum growth potential. But when civil servants represent the State on the Board of Directors they are theoretically supposed to follow the instructions of their superiors, while at the same time respecting the interests of the Company. Conflicts of duties may arise from this situation and in such cases the position of the nominees will be an invidious one. The reconciliation of these conflicting obligations, the legal aspects of the appointment of a Government director, his role and his responsibilities are the concern of this paper.[6]

1 The information upon which the material in this paper is based was derived from interviews with five Government appointed directors who each answered questions on all aspects of their position as a company director.

2 For two particularly comprehensive works giving a comparative study of the relationship between the public and private sectors in all its forms refer Shonfield, *Modern Capitalism The Changing Balance of Public and Private Power,* O.U.P., London, 1965; and Friedman & Garner, *Government Enterprise — A Comparative Study,* Stevens, London, 1970.

3 E.g., New Zealand Steel Limited and Tasman Pulp and Paper Co. Limited.

4 E.g., New Zealand Wool Pack & Textiles Co. Limited.

5 Refer to Appendix for list of companies whose share capital is subscribed wholly or partly by Government or Governmental agencies.

6 It is not proposed to explore the well known constitutional relationship between a civil servant and his Minister, although, as will appear, the relationship in the case of a civil servant director can be crucial. The general principle is that the civil servant is bound to obey the instructions of his Minister except in the most extreme circumstances, the scope of which remains unclear. See Street, *Government Liability;* D. P. Neazor, *Crown Liability in Tort in New Zealand,* V.U.W. LL.M. thesis, 1967; Scott, *The New Zealand Constitution,* Oxford, 1962, Ch. 5.

Government and Private Enterprise:

The New Zealand Government has in the past preferred to leave the development of commerce to private enterprise. Its role in the commercial world has been passive and external, confined mainly to promulgating standards of corporate behaviour, delineating the bounds of corporate activity and providing adequate safeguards for those who wish to risk their capital in the promotion of private industries.

Notwithstanding its reluctance to become actively involved in any one company, the Government has on rare occasions been obliged to intervene. Thus the sheer size of the undertakings[7] necessary to develop the forestry and iron and steel industries and their potential importance to the national economy dictated the need for positive financial support from the Government from the very early stages of their development. In both these industries it was hoped that the Government initiative in purchasing shares and underwriting unallocated shares would generate sufficient confidence in their future to ensure that the backing of Government would eventually be replaced by private financial interests.[8]

The post-war shortage of power in the North Island, the economics of developing open-cast mines in preference to other forms of power, and the availability of large quantities of coal in land jointly owned by the Crown and by Glenafton Collieries Limited led to the establishment of the Marumarua Coal Fields Company Limited. Similarly the desire to encourage domestic production rather than rely on expensive imported materials and the need to strengthen an industry of importance both locally and nationally prompted Government intervention in the flax industry at Foxton.[9]

As already observed, Government participation in a private company can take a variety of forms. The decision to acquire shares in preference to other forms of control will be based on a large number of factors. The desire to retain the flexibility and related advantages offered by a body corporate in preference to the often unwieldy and inflexible nature of a State Corporation or Board, the degree of continuous control over the company's affairs provided by the appointment of Government Directors, and the hope of securing a share of future profits are amongst the more important factors. The political advantages gained from combining public capital and expertise with that of the private sector and the consequent spreading

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7 Viz. Tasman Pulp and Paper Co. Limited and New Zealand Steel Limited. These two companies are the largest and most important in terms of Government participation as a shareholder. The ensuing discussion is based for the most part on the duties of the Government nominees on the Boards of these companies.

8 In New Zealand Steel Limited the original Government shareholding represented 40 percent of the total share issue and has now decreased to just over 29 percent.

9 New Zealand Woolpack and Textiles Limited.

of risk also carries considerable weight.[10] Extensive though the Government's financial stake in mixed enterprise companies[11] may be its importance depends in large measure upon the supervision exercised by the Government Director himself.

Appointment and Removal of Government Directors:

It is of significance to observe firstly that Government directors have always been appointed in accordance with the relevant provisions of the Articles of Association. In so far as the appointment is viewed as merely another weapon in the Government's armoury of fiscal, monetary and other economic measures, his imposition on the Board of a mixed enterprise company could conceivably be effected by Order in Council. The political implications of such a course, however, render it unlikely. The actual form of appointment supports the view that Government has intended that its appointees should function in precisely the same manner as the other directors.[12]

Although he may in practice exercise considerable influence on his fellow board members, there is little in the Articles of any of the mixed enterprise companies to indicate that his role is in any way superior to or different from that of his fellow directors except possibly in respect of the provisions relating to security of tenure. For example in both New Zealand Steel[13] and Tasman Pulp & Paper Co. Ltd.,[14] the provisions of the Articles concerning rotation, re-appointment and removal of directors have no application to those appointed by the Government. There are, however, no provisions which purport to invest these directors with powers of veto[15] or which entitle them to act solely in the interests of the body which appointed them, namely the Government.[16]

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10 Political and strategic considerations for State intervention in the United Kingdom weighed heavily in the case of British Petroleum and Cable and Wireless Limited — see Daintith in Ch. 3 of *Government Enterprise — A Comparative Study*, supra, n. 2.

11 For the purposes of this paper the term "mixed enterprise" company is used to describe an enterprise the capital of which has been subscribed in part by private interests and in part by Government and in which the Government has a measure of control by its possession of a right to nominate one or more directors.

12 All of the directors interviewed answered the following question in the negative: "Notwithstanding the difference in the interests which you represent, do you consider that your function on the Board is in any way different from that of your fellow directors?"

13 Article 76(5).

14 Article 81(9).

15 The Government directors on the U.K. Board of British Petroleum appear to have such a power, although it is not so drastic as it may at first seem. For it can be used only in emergencies; its effect is suspensory and requires Government confirmation before it becomes permanent — refer Daintith, op cit, supra., n. 10, pp. 63-64.

16 In view of the provisions of s. 204 of the Companies Act 1955 the effectiveness of such an article is doubtful but see Gower, *Modern Company Law* (3rd ed., 1970), p. 523, n. 4.

Where the Government's share interest is a minority one, it will always be a matter for concern that the supervision exercised by its appointees is not impaired by attempts to amend the Articles so as to remove either them or their right to sit on the board. An apparently effective solution to this problem is to be found in the Memorandum and Articles of Association of New Zealand Steel Limited.[17] The Articles there provide that, subject to certain specified conditions, the Crown has the right to nominate and appoint two directors and may revoke these appointments and substitute other directors or appoint alternate directors. The directors (including those appointed by the Crown) may not exercise their powers to appoint additional directors to the board in derogation of any powers vested in the Crown.

These provisions by themselves appear sufficient to forestall a bid by a majority of the directors to remove their Government counterparts. The interesting solution is that an attempt to alter the Articles so as to achieve this result is effectively prevented by the proviso to cl. 3 of the Memorandum of Association which in brief provides that where the Crown holds any share in the Company, any alteration in the Articles purporting to deprive the Crown of its right to nominate and appoint directors is of no effect unless previously approved in writing by the Crown. It is true that under certain circumstances a company's Memorandum of Association may be altered[18] but there is no provision in the Act which would enable a clause such as the present one to be altered or deleted except for the rather remote possibility of an application being made to the court under s. 205 of the Act for a reconstruction or by way of a petition alleging oppression under s. 209.

Although the right to nominate and appoint Government directors

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17 Article 3:

"Subject to the provisions of the Companies Act, 1955, the Company may from time to time alter or add to its Articles of Association provided however that when and so long as either:—

(1) Her Majesty the Queen or any agency of the Crown holds any security from the Company; or

. . . .

(4) Any share in the capital of the Company is held by Her Majesty the Queen or by any agency of the Crown or by any nominee for the time being duly authorised in writing by the Minister of Industries and Commerce

then no alteration of or addition to the Company's Articles of Association which would:—

A. deprive or have the effect of depriving Her Majesty the Queen of her right to nominate and appoint Directors of the Company as set out in its original Articles of Association or any provision adopted in amendment thereof or in substitution therefor; or

B. . . . .

shall have any validity unless in either case Her Majesty the Queen consents to the alteration or addition in writing given under the hand of the Minister of Industries and Commerce for the time being or of such other person as may from time to time be designated by Her Majesty the Queen in that regard."

18 Pursuant to s. 17 and 18 of the Companies Act 1955.

may be secured in the above manner, the shareholders retain their statutory right to remove one or more of the directors by ordinary resolution, subject to compliance with the special notice provision.[19] In major industrial enterprises where the shareholding is spread amongst thousands of small investors, the possibility of directors being removed from office by resolution of the shareholders is remote. In such cases the board of directors by their control of the proxy machinery are able to control a majority of the voting shares and, therefore, the composition of the board. The possibility is much more real in the case both of New Zealand Steel and of Tasman Pulp and Paper where a very large share capital is spread amongst a few large shareholders.

However, the effect of s. 187(1) may yet be avoided by allotting to each of the shareholders "class" shares.[20] In the case of Tasman Pulp and Paper, for example, the share capital is divided into six classes; the Government is the sole owner of all Class B shares and as such has the sole right to nominate and appoint three directors to represent its interests. Each of the other classes of shareholders has a similar right to appoint a specified number of directors. If for some reason reliance was sought to be placed on this section the meaning of the term "ordinary resolution" would become important. Although not defined in the Companies Act 1955, it could be argued that its meaning is, by analogy to that given to "extraordinary resolution" in s. 145, as follows:—

> A resolution shall be an ordinary resolution when it has been passed by a majority of . . . such members as, being entitled so to do, vote in person, . . .

The result of this paraphrased definition is that only those members who have the right to appoint directors under the Articles may vote for their removal. In other words, only the Government, being the sole holder of Class B shares, is able to remove its own appointees. It thus appears that the combined effect of the Memorandum and Articles of Association may operate to entrench the position of the Government director and may secure particular appointees from the removal power granted under the Companies Act.

The Position of the Civil Servant as a Government Director:

In almost every mixed enterprise company the present Government

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19 S. 187 of the Companies Act 1955 (which does not apply to private companies — s. 354).

20 The argument here advanced is based on the views expressed by Afterman, *Company Directors and Controllers,* Law Book Co., Sydney, 1970, page 28 ff. Caution must be taken, as Afterman noted, to ensure that such a scheme is not avoided by amendments to the Articles designed to abolish classified voting, to increase the size of the Board or to authorise the issue of further shares within a class. Refer also to s. 81 of the Act which provides for the rights of special classes of shares.

appointees are senior civil servants.[21] The Government is not obliged by the Articles or for any other reason to appoint civil servants and has in the past appointed men from outside the civil service[22] and has even retained a retired civil servant on the board of directors.[23] Obviously, however, persons appointed from outside the service are less subject to the direct control and guidance of Government and do not have the ready access to the vast quantities of information available to civil servants. A further reason for preferring the latter as Government nominees, particularly in the case of New Zealand Steel and Tasman Pulp and Paper, lies in the fact that they are able to attend and participate in both departmental and Cabinet committees on the forestry and iron and steel industries. In this way the flow of information and communication between Government and company can be greatly facilitated. In addition their background appreciation of all facets of the industry and economy generally gained through years of experience in this field ensure that Government policy towards the companies is fully understood and conveyed to the respective Boards. In both these cases the Government appointees advise their Minister regularly on all matters pertaining to his particular portfolio and it is not unusual for the Minister to communicate directly with his appointee.

The mechanics of the actual appointment are generally fairly simple. Once the Government has decided to subscribe for shares in a particular company the appropriate Minister will discuss informally with his Secretary likely appointees. The director-elect will normally be informed of his pending appointment and if all parties are in agreement a formal recommendation will be made to the Minister and if necessary referred to Cabinet or even the Executive Council.[24] Although the Crown's shareholding is generally registered in the name of the current Minister of Finance, the latter does not necessarily have the right to nominate and appoint all Government directors.[25] Once approved, the director-elect will receive a brief letter from his Minister advising him of his appointment but rarely giving him any further guidance as to how his future duties as a director should be carried out. A similar procedure is followed when it becomes necessary to re-appoint or replace a serving director.

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21 As the conflicting duties of Government directors have most meaning where the appointees are civil servants, the ensuing discussion proceeds on this basis. However, the result is the same in the case of non civil servants.

22 None of the directors of Dominion Salt Limited are civil servants.

23 Mr. E. L. Greensmith sat on the Board of Tasman Pulp and Paper Co. Limited for three years after his retirement from the position of Secretary to the Treasury.

24 In the case of New Zealand Steel Limited the Government directors are appointed under the Articles by Her Majesty the Queen.

25 Although the Minister of Industries and Commerce normally exercises this right in the case of both New Zealand Steel and Tasman Pulp and Paper, he would always heed the recommendations of the Ministers of Finance and Forestry in respect of their nominees.

General Obligations of Government Directors:

It is frequently true that only after being appointed to a board of directors will the Government appointee begin to acquire an intensive knowledge of company law. He tends to view his duty to the board as being not inherently different from that owed to the multitude of committees and working parties on which he has participated throughout the course of his public service. In each such case he regards his prime responsibility as being to protect and further the public interest. In the case of every Government director interviewed, their obligations to the Minister or to Government generally were regarded as paramount although all directors appeared, at least, to be aware of the principle of company law which requires a director to act bona fide in the interests of his company.[26] It was frequently pointed out, however, that the interests of the public and those of the company will almost always be consistent with each other. In the very rare case where they might conflict, the Government director will find himself confronted with a difficult choice of priority.

In simple terms the function of the Government appointee is to look after Government investments:

> Government Directors are appointed for the purpose of representing such Government interests as may be involved in connection with the Company concerned and the selection of individuals is determined by this consideration.[27]

This formulation of his duties gives the Government appointee considerable scope for manoeuvre. It is obviously in the Government's interests that the mixed enterprise company should continue to prosper. Acts done in the interests of the company in the widest meaning of that term[28] will always satisfy the public interest criterion. In rare cases, however, a course of action proposed by one or more members of the Board may be contrary to a specific policy decision of Government or for some other reason be contrary to the public interest. The conflict here is not so much one between competing obligations of the one Government appointee, but a problem involving competing class interests. In such cases the underlying notion requiring directors to act in the interests of the company is of little practical difficulty for the views of both parties may well satisfy this criterion. It will then be necessary for both sides to negotiate, to make concessions and reach compromises so as to achieve a solution in the long term interests of the company as well as being satisfactory to the majority of the members of the board.

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26 None of the directors regarded the possibility of a conflict of interest as a serious one, but three conceded that should such a situation arise their choice of loyalties could be difficult. The other two came down clearly in favour of their obligations to their Minister.

27 Ernest Davies, *Government Directors of Public Companies — a Brief Survey*, (1938) Political Quarterly, Vol. IX, 421.

28 See text following note 31.

None of the Directors interviewed regarded themselves as merely front-men, silent watchdogs maintaining a big brother watch over the affairs of the board. On the contrary they considered themselves actively involved in the running of the company.[29] It is true in the case of the two major public companies that the Government appointees are obliged to keep their respective Ministers informed on all matters which come before the board and which are likely to involve Government policy considerations. Matters such as domestic and external loan finance, major building expansions, dividend policies, new share issues, salary increases and senior staff appointments are but some of the items which would always fall into this category. In this respect the Government director provides a convenient channel by which information, views and proposals can pass between Government and company.

It is equally true, however, that the Government director can and does play a far more constructive role in the company's affairs. At the board meeting itself he may be asked to indicate the likely response of Government to a proposed course of action. On matters which fall within his particular sphere of competence he is considered, at least by the other directors, to be an "on the spot Government spokesman". His influence behind the scenes is also considerably greater. He consults regularly with other officers of his department whose work entails continuous review of these and other industries. He attends Cabinet and inter-department committee meetings and is frequently asked to venture his opinion on the merits of recommendations or decisions which, for example, may bear on New Zealand Steel Limited and the effect which they may have on that company's trading activities. Far from merely advising and reporting, he is actively involved in the entire decision-making process. In the final result the decision is always that of Government but the formulation of the options and the recommendations on which that decision is based lie very much within the province of the Government appointee.

The nature and success of the other smaller mixed enterprise companies such as Marumarua Coal Fields Co. Limited and Dominion Salt Co. Limited render intimate Government supervision largely unnecessary. The Government Directors always attend board meetings but unless the State's financial interests are really in jeopardy, it is not thought necessary continually to seek Ministerial guidance. These companies are to all intents and purposes operated as ordinary private companies in which Government involvement is purely fortuitious.

Where two or more Government nominees sit on the same Board the usual practice is for the nominee who is most concerned with the

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29 The impotence of the Presidential nominees on the Communications Satellite Corporation Board was one of the principal justifications for the criticisms by Schwartz of the effectiveness of such nominees. In that case only three out of the fifteen members represented the "broad public interest". Refer Schwartz, *Governmentally Appointed Directors in a Private Corporation — The Communication Satellites Act of 1962* (1965), 79 Harv. L.R. 350.

particular issue being discussed to present the Government case. Where this item on the agenda involves finance, the position is a little different for there the Treasury appointee wields considerably more power than any other single director. Few activities proposed by these or any other Boards do not require finance of some sort or other. In view of the very extensive financial involvement of Government in both these large companies, it is not surprising that sooner or later the members of the board will turn to the Treasury appointee. For it is largely upon his shoulders that responsibility for the protection of the public's money must rest. If the economics of the proposal before the board do not meet with his approval his influence is such as to effectively veto the project. Even though the Government's actual shareholding in New Zealand Steel, for example, is less than 30 percent of the issued share capital, its total financial involvement and influence is much greater.[30] It is largely for this reason that there is no need to provide in the Articles for the Government directors to be able to exercise a power of veto over a proposed course of action which they consider to be contrary to the public interest.

Legal Obligations of Government Directors:

As already noted the Government nominees upon appointment assume certain legal obligations as company directors. At no time, however, have their legal responsibilities ever been judicially defined. Moreover, as will appear shortly, it is most unlikely that court proceedings involving conflicting duties of Government directors will ever arise. What few statements there are on the role of Government directors[31] appear to assume without discussion that their legal duties are on a par with those imposed by the law on nominee directors generally. Certainly there is no reason in principle or in logic which would demand a different standard of care and skill in the exercise of their duties. Nor did the appointees themselves think that any such distinction was warranted.

It may be asked, then, what precisely are the interests to which Government directors, in particular, should have regard. It may be in the interests of the company for a Government director to act in the interests of the general public, in which case the two "interests" are co-extensive. On the other hand, the two "interests" could conceivably be diametrically opposed.

The phrase "interest of the company" itself has never been judicially defined but has been generally understood to encompass the interests of the shareholders *in toto* who are, of course, the real

30 As at 31 March 1970 the Government's total financial involvement amounted to $43.8 million of which only $4.1 million was invested in shares. Loans took up $11 million, capitalised interest $1 million, and guarantees $27.7 million — first report of the Controller and Auditor-General for the year ended 31 March 1970, page 60.

31 Refer Daintith, op. cit., n. 10 supra.

beneficiaries.[32] In certain circumstances the law regards the company and its shareholders as distinct entities but in the present context it is difficult to envisage a course of action proposed by the directors which would not be advantageous to the company without inevitably being of benefit to the members of that company and vice versa. Hence in the words of the Inspector appointed by the Board of Trade to investigate the Savoy Hotel dispute:[33]

> "The Company" does not mean the sectional interest of some of the present members or even of all the present members, but of present and future members of the company . . . on the footing that it would be continued as a going concern (balancing) a long term view against short term interests of present members.

Even if the directors are obliged to have regard to the interests of shareholders, it has been held that they owe no duty as such to individual shareholders either present or, a fortiori, future.[34] This latter proposition needs to be modified to some extent where directors enter into a special relationship either contractual or fiduciary with existing shareholders for a specific purpose such as negotiating on their behalf with a potential take-over bidder. Moreover, the rule in *Percival* v. *Wright* was severely criticised by the Cohen Committee[35] and may yet disappear if any notice is taken of recommendations of the Jenkins Committee.[36]

A proper decision of the board will thus be one which considers and weighs up each of the legally recognised interests — those of the company, of the shareholders, present and future, and of the minority. What is quite clear is that the ambit of legitimate interests extends no wider than these.[37]

If this rather restrictive view of the legal obligations of directors to their companies was always dutifully observed, their position would soon become impossible for, as Gower observes,

> ". . . rebellious staff, hostile Trade Unions, dissatisfied customers and an aggrieved public or Government are not conducive to the future prosperity of the company."[38]

In practice, however, as is well known, the company director is frequently obliged to consider the interests of employees, consumers,

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32 See the judgment of Evershed M.R. in *Greenhalgh* v. *Arderne Cinemas Ltd.* [1951] 1 Ch. 286 at 291; *Allen* v. *Gold Reefs of West Africa* [1900] 1 Ch. 656 at 671; *Re Smith* v. *Fawcett* [1942] Ch. 304 at 306 and *Hogg* v. *Cramphorn* [1967] Ch. 254.

33 Afterman, op. cit., supra n. 20, p. 45. See also Gower, *Corporate Control: The Battle for the Berkeley*, 68 Harv. L.R. 1176 (1955).

34 *Percival* v. *Wright* [1902] 2 Ch. 421. But where directors are also shareholders in the same company they are naturally permitted to consider their interests as such.

35 Cmd. 6659 paras. 86 and 87.

36 Cmnd. 1749 paras. 89 and 99(b).

37 *Parke* v. *Daily News Ltd.* [1962] Ch. 927 at 963.

38 Gower, op. cit. n. 16, p. 522.

the State and many others who have calls on or grievances against the company. He reconciles his legal duty to act in the interest of the company with his obligations enforced in practice by regarding each of the latter as secondary to the over-riding consideration of the former. By balancing these competing secondary interests the board eventually achieves agreement on a proposed course of action which satisfies at least a majority of the members of the board as well as fulfilling their legal obligation to the company.

The role of the Government director in such circumstances is potentially difficult for he is clearly and openly expected at all times to safeguard the interests of Government which, as already observed, is not a proper interest for him to consider at least at the expense of the abovementioned legitimate interests.

Before considering the conflicting obligations of Government directors in practice, however, mention should be made of the manner in which the law has endeavoured to resolve difficulties over conflict of duty situations involving the ordinary nominee director.

Conflicting Duties of Nominee Directors:

The possibility of a conflict of duty becomes relevant only when the extent of the voting interests which directors represent is such as to enable them to exercise a measure of influence on the board. As to be expected the Government appointee is always in such a position.[39] The invidious nature of his position stems from the fact that failure to act in the interests of the company may render him liable to an action for breach of fiduciary duty while failure to act in the interests of the Government may imperil his position both on the board and within the Civil Service.

In spite of the frequency with which nominees are appointed to the board of directors in practice disputes involving conflicting duties of nominees that have found their way into the courts are very few. This may be a reflection of the virtual absence of conflict in practice or it may, more likely, indicate a reluctance to issue court proceedings largely for fear of the repercussions from adverse publicity.

The position of the nominee director is not explicitly recognised in the Companies Act 1955[40] but his existence is not unknown to the

39 This is so even though the Government's total shareholding may be less than 50 percent of the company's total issued share capital. In some cases the financial interest of the State takes a variety of forms apart from share subscription. In other cases the Government as a potential source of finance renders the position of its appointee more important than usual.

40 The position appears implicit in the very definition of a director in the Companies Act:

> "Director includes any person occupying the position of director, by whatever name called".

S. 120 of the Australian Uniform Companies Act specifically provides for the removal of a nominee director in the following terms:

> A public company may by ordinary resolution remove a director before the expiration of his period of office . . . but where any director so removed was appointed to represent the interests of any particular class of shareholders or debenture holders the resolution to remove him shall not take effect until his successor has been appointed.

law. Thus in a case concerned, inter alia, with the obligations of persons subject to conflicting fiduciary duties, Lord Denning observed, obiter, and by way of analogy:[41]

> "Or take a nominee director, that is, a director of a company who is nominated by a large shareholder to represent his interests. There is nothing wrong in it. It is done every day. Nothing wrong, that is, so long as the director is left free to exercise his best judgment in the interests of the company which he serves. But if he is put upon terms that he is bound to act in the affairs of the company in accordance with the directions of his patron, it is beyond doubt unlawful, . . . or if he agrees to subordinate the interests of the company to the interests of his patron, it is conduct oppressive to the other shareholders for which the patron can be brought to book."

Debenture trust deeds frequently provide for the appointment of a director to represent the interests of the debenture holders, but the more common example of a nominee director occurs where one company purchases a substantial share of another and appoints nominees to the board usually in proportion to its new shareholding. Where all or the greater part of the share capital of one company is purchased or owned by another, a parent-subsidiary relationship arises. In such cases it is not uncommon for the composition of the boards of both companies to be identical in which case conflicting duties can and have caused difficult problems.

Thus in *Scottish Co-operative Wholesale Society Limited* v. *Meyer*[42] the House of Lords was concerned with the application of the equivalent of our s. 209 in relation to oppression of a subsidiary company by its parent company which had appointed nominees to the board of directors of the subsidiary company. Their Lordships held that as the nominee directors of the parent company had acted in bad faith, the petitioners were entitled to relief. In dealing with the position of the nominee directors, Lord Denning observed that:[43]

> . . . so soon as the interests of the two companies were in conflict the nominee directors were placed in an impossible position . . . they probably thought that "as nominees" of the [holding company] their first duty was to the [holding company]. In this they were wrong. By subordinating the interests of the [subsidiary company] to those of the [holding company] they conducted the affairs of the [subsidiary company] in a manner oppressive to the other shareholders.

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41 *Boulting* v. *Association of Cinematograph, Television and Applied Technicians* [1963] 2 Q.B. 606 at 626-627.

42 [1959] A.C. 324.

43 Ibid., 367. Even if the nominee director in such a situation abstained from voting he might still be liable on the ground that he has a positive duty to advance the interests of the company — per Lord Denning, ibid.

In that case the nominee directors constituted a majority on the Board and there had been a long history of oppression by them. Where, however, the nominee directors constitute a minority on the board the possibility of oppressive conduct is remote. Moreover, whether or not the nominees can be said to have conducted themselves improperly or oppressively depends, it would seem, on whether *they* bona fide believe that the parent company would act in the interests of the company as a whole.[44] In other words if the nominee considered that his nominator (in this case the parent company) was acting in its own interests to the detriment of those of the subsidiary, he would be obliged to vote against the parent company.

A possible reconciliation of a nominee's legal duties was suggested by Jacobs J. in *Levin* v. *Clark*.[45] The Court was there concerned with a complex set of facts resulting from an application by the plaintiff to restrain the defendant from giving effect to certain resolutions passed by the latter while purporting to act as governing directors of the second defendant company. In reply to an argument that the defendants had not acted in the interests of the company, his Honour observed:[46]

> "It is, of course, correct to state as a general principle that directors must act in the interests of the company . . . however that leaves open the question in each case — what is the interests of the company? It is not uncommon for a director to be appointed to a Board of Directors in order to represent an interest outside the company — a mortgagee or other trader of a particular shareholder. It may be in the interests of the company that there be upon the Board of Directors one who will represent these other interests and

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44 This appears to be the view of Jacobs J. in *Re Broadcasting Station 2GB Pty. Ltd.* (1964-65) N.S.W.R. 1648 where His Honour was called upon to consider the merits of a petition brought by minority shareholders claiming oppressive conduct by the majority. The case involved a parent-subsidiary relationship wherein the parent's nominee directors were alleged to have acted in the parent's interest and to the detriment of the subsidiary. His Honour's views are worth citing in full.

> . . . the newly appointed (nominee) directors . . . (of the subsidiary) . . . were prepared to . . . follow the wishes of the . . . (holding company's) . . . interest without a close personal analysis of the issues . . . but I see no evidence of a lack in them of a bona fide belief that the interests of the . . . (parent) . . . were identical with the interests of the (subsidiary) company as a whole. I realise that upon this approach, I deny any right in the (subsidiary) company as a whole to have each director approach each company problem with a completely open mind, but I think that to require . . . (otherwise) . . . is to ignore the realities of company organisation. Also, such a requirement would . . . make the position of a nominee or representative director an impossibility . . . The view which I take of the conduct of the directors does not in my approach to this matter amount to oppression of any shareholder nor to improper conduct so long as they bona fide believed that . . . (parent) would act in the interests of the company as a whole.

45 [1962] N.S.W.R. 686.

46 Ibid. at p. 700.

> who will be acting solely in the interests of such a third party and who may in that way be properly regarded as acting in the interests of the company as a whole. To argue that the director particularly appointed for the purposes of representing the interests of a third party cannot lawfully act in the interests of that third party, is in my view to apply the broad principle governing the fiduciary duty to directors, to a particular situation where the breadth of the fiduciary duty has been narrowed by agreement amongst the body of the shareholders."

As long as the law continues to deny a director the right to have regard to the special interest to which he owes his appointment the nominee will run the risk of legal proceedings being brought against him. A further consequence of any such proceedings is likely to be the invalidation of acts done by the nominee in accordance with his instructions so that his nominator will also be concerned to ensure that the discretion of his nominee is not absolutely fettered.[47]

The difficult position of the nominee director in such circumstances is a real one and clearly calls for reform, for as Gower observes:[48]

> "To deny a director openly appointed under the Articles to represent a particular class the right to think primarily of the interests of that class, instead of exclusively of the members as a whole, may be to defeat the whole object of the appointment."

The compromise solution suggested above by Jacobs J. appears to overcome the impasse in which a nominee director might otherwise find himself. The solution is all the more attractive in that it accords so closely with what actually happens on the boards of both New Zealand Steel and Tasman Pulp and Paper.

Conflicting Obligations of Government Directors in Practice:

As already noted the civil servant appointee on a board of directors clearly regards his constitutional duty to carry out the wishes of Government as having first call upon his loyalty. On the other hand as a nominee director he is obliged in terms of company law to give prime consideration to the interests of the company on the board of which he sits as a director. In theory, therefore, the Government director is constantly confronted with a dilemma — whether to side with his Minister or with the company. In practice, however, the conflict between constitutional law and company law is

47 Even though the nominee does not stand to gain personally from so acting and irrespective of the presence or absence of improper motives, agreements binding directors to vote in a particular manner whether as between themselves or with third parties will be held invalid. Refer Gower, op. cit. n. 16, p. 525, and see *Thorby* v. *Goldberg* (1964) 112 C.L.R. 597.

48 Gower op. cit. n. 16, p. 523.

more apparent than real for the Government directors interviewed all agreed that the interests they represented and were required to foster were one and the same — that acting in the interests of the public and in the interests of the company were alternative sides of the same coin.

Irrespective of the purposes or nature of a body corporate, every company director openly presses and is expected by his fellow board members to press his own interests or those of his nominators. Each director fully appreciates the size and importance of the interests behind the other directors and acts accordingly. In this respect the unique position of the Government appointee is not inherently different from that of the other directors.

His function is to protect the multi-million dollar investment of public money in a company which operates at least on a long term basis to achieve a satisfactory dividend for its shareholders and for the general public, both in terms of a return on the investment, and in terms of potential contribution to the national economy. When he considers that a particular proposal suggested at the board meeting is likely to be detrimental to the public interest he will say so and will consider it his duty to press for its modification or defeat. In doing so the Government director openly admits to acting in the interests of the public but, should his conduct be questioned, he will deny the presence of any conflict between the interests of the public and those of the company. It was the unanimous view of all Government directors interviewed that, although there were often marked differences of opinion within the board, there were never any matters that could not ultimately be resolved to the satisfaction of all interests concerned.

It should be remembered that the scope of potential conflict of duty situations which might arise particularly on the boards of the major mixed enterprise companies is extremely limited. Most of the Government appointees interviewed found it difficult even to envisage such a possibility. It might be expected that in the mixed enterprise companies the private directors will seek to secure some form of favourable treatment from their Government counterparts. In such circumstances the latter may be caught, for Government may decide to reject any such favouritism. Although the final veto decision lies with the Government itself the position of the Government director in such a dilemma is unclear. His hands are tied by the decision of Government which he would, of course, be obliged to follow[49] even though such a course was, in the eyes of the private directors, contrary to the interests of the company. At all events it was regarded as in the highest degree improbable that legal action would in such circumstances ever be taken against the appointee. An essential prerequisite for a successful company is a strong and unified board free from

49 Provided he valued his status and position and security as a civil servant above that of a company director — surely a reasonable assumption.

personal animosities and pettiness. Government's financial support is a *sine quanon* in the major mixed enterprise companies and allegations of breaches of fiduciary duties amongst its nominees are unlikely to achieve anything but adverse publicity. In the words of one Government director:

> If the dispute cannot be resolved over a plate of oysters and a glass of wine, a toll call to the Minister will do the trick.

It is conceivable that disputes amongst directors in the fixing of dividends might give rise to problems of clashing interests for the Government appointee.[50] For example he may be under pressure from his Minister to urge a policy of dividend restraint by the directors in line with Government's general economic policy of wage and price control. The other members of the board may, however, favour a high dividend payment to ensure that the interests they represent receive a satisfactory return on their investment. Again where employees choose to strike for increased wages, the Government Directors may be compelled to resist demands for large increases in accordance with current economic policy on wage stabilisation. The remaining members of the board may consider that the loss to the company in terms of wasted working days, lost production and consequent loss of profits together with the spectre of industrial disharmony, far outweigh the loss that would be sustained by agreeing to the workers' demands.

These examples, like most hypothetical situations[51] suffer to some extent from a lack of realism but they help to indicate that the conflicts, if any, between the public and the private members of the board represent merely a difference in emphasis or view-point as between different members of the board rather than a reflection of a conflict between competing obligations of the one Government director. No-one would seriously suggest that the Government directors by opposing inflationary wage demands were not acting in the interests of the company any more than that the other members of the board could be said to be advancing too strongly the interests which they represent to the possible detriment of the company. In these situations each director consciously presses his own solution to the particular issue being discussed. It goes without saying that he bona fide believes his solution to be in the best interests of the company. The same goes for the Government director. He necessarily views the company's problems from a different angle and may recommend solutions which differ from those of the other directors. At all times, however, he regards himself as acting in the combined interests of the company and of the public.[52]

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50 Afterman, op. cit. supra. n. 20, p. 50 refers to this possibility but appears to think it rather remote in the case of the large public corporations.

51 It is stressed that these examples are strictly hypothetical and are in no way based upon actual situations.

52 Daintith op. cit. supra. n. 10, p. 66 refers to the obligations of the Government appointee in the following terms:

> The responsibility does not rule out the taking of a slightly different approach to problems coming before the board — this may be expected

For the sake of completeness mention should be made here of certain other respects in which a director may occasionally find himself in breach of his fiduciary relationship with the company.

In the first place the principle that a director may not use his position to make a personal gain without the approval of the company would not appear to have any practical application to the case of the Government director.[53] There is no reason why the first arm of this principle, which requires a director to disclose fully to the board the nature of any contracts entered into between him and the company, should not also apply to the Government director. In practice, however, his position as a civil servant would militate against such a practice. It should be remembered that the Government directors on the boards of all the mixed enterprise companies are senior civil servants. As such they are subject to strict departmental rules and a high standard of ethical conduct is expected of them, not only by the public but also by their fellow civil servants and their Ministers. They are in continual touch with the Minister and are privy to much confidential information. Their deeply ingrained sense of service to the public and to Government and their natural desire not to commit acts likely to jeopardise the security of their position or of their future promotion, makes a breach of their fiduciary duties in this direction virtually unthinkable.

Similarly, with the other arm of the above principle, that a director may not make a secret profit from the company without the ratification of the members in general meeting. It is to be remembered that civil servants do not receive personally any remuneration for their services on the board although a sum equal to that paid to the remaining directors is paid by the company into the Consolidated Fund. Nevertheless if a Government director chooses to accept a benefit whether in the form of a bribe or a commission or any other benefit obtained by virtue of his position as a director he would, it is submitted, be held liable on the same principle as would be the case with any other director to account for this benefit to the company unless, of course, his action had been ratified by the company in general meeting.[54] However, once again the very nature of his position as a civil servant and the high degree of trust and confidence reposed in him makes such a possibility once again remote .

A further possibility is that of a Government appointee being appointed to the boards of directors of two or more competing

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of the Government Director by reason of his special awareness of the needs of the public interest — but it does demand, as a minimum, that he should not do anything to impair the achievement of the ordinary commercial objectives of profit, expansion and stability that the shareholders, among whom the Government may be included, would wish to see pursued.

53 Civil servants do not receive any remuneration for their services on the Boards of mixed enterprise companies.

54 It was thought unlikely in the extreme for such an indiscretion to be disclosed to the members at a general meeting.

companies. There is nothing in law to prevent a director from acting on the boards of rival companies[55] although in such cases he will need to exercise extreme care in the use he makes of either company's property or trade secrets.[56] Although the possibility is, in the present context, of academic interest only as there are no Government directors in such a position it is once again difficult to envisage a potential breach of trust or conflict of duties situation arising in practice. Apart from the high degree of integrity expected of him and the threat of departmental reprimands looming over him, it should be remembered that in such a case the information derived from the board would enure for the benefit of his shareholding principal, the Government, and not personally to the director himself. It is difficult to envisage the scope of the information of which advantage might be taken in such circumstances or the use to which it might be put but one possibility is for a Government director on the boards, for example, of both Tasman Pulp and Paper and New Zealand Forest Products to obtain certain information from one of the boards which he knows may materially affect the operations and share prices of the other company. In such a case he may be tempted to sell or purchase that company's shares in the hope of making a profit on the side. This course of action is even now open to senior officers of most Government Departments but it appears never to have been a source of anxiety. Here again the Public Service Manual and the civil servant's code of ethics combine to render the possibility a remote one; even more so considering that it is based on the unlikely hypothesis that Government would either subscribe for shares in rival companies or appoint the one nominee to represent its interests on two or more competing Boards.

Conclusion:

It should by now be abundantly clear that the possibility of conflicting obligations amongst Government directors in the New Zealand context is more apparent than real. In practice there is little scope for conflict for their duty to act bona fide in the interests of the company tends to merge with their obligation to consider the wider interests of the public.

In the English context the appointment of Government nominees to the board of directors of private or public companies has been criticised either as portending a further blow against the cause of

55 *London and Mashonaland Exploration Co.* v. *New Mashonaland Exploration Co.* (1891) W.N. 165, approved by Lord Blanesburgh in *Bell* v. *Lever Bros.* [1932] A.C. 161 at 195. Directors may be prevented from sitting on the boards of rival companies by the Articles of Association but no such provision appears in the Articles of either New Zealand Steel or Tasman Pulp and Paper.

56 Refer *Bell* v. *Lever Bros.* [1935] A.C. 161 and *Measurer Bros. Ltd.* v. *Measurer* [1910] 2 Ch. 248.

free enterprise[57] or as a somewhat objectionable form of golden hand-shake.[58] In a commentary on the only recent American example of Government appointees participating at the management level of a mixed enterprise company it has been said:[59]

> "Both the practicalities of life and the lessons of history lead us to the conclusion that the appointment of Government Directors to a private Board cannot effectively protect the public interests against private abuse."

Fortunately, however, there appears to be no cause for either the suspicion or the despair evinced in these statements in the New Zealand examples of mixed enterprise companies.

Apart from the two major public companies,[60] the incorporation and continued existence of which would not have been possible without strong Government backing, the number of mixed enterprise companies in New Zealand is too few and their economic importance in relation to all other public and private companies too negligible to countenance any serious allegations of socialism. Nor has there ever been any suggestion that the private directors on these companies have been able to ride rough-shod over their public counterparts or that these companies have received benefits, financial or otherwise, which have not been available to private companies.

Moreover any suggestion that the Government appointees are able to control these companies by urging their fellow directors to accede to a particular course of action with the big stick of Government threatening in the background is without foundation. On the contrary, the history of each of the mixed enterprise companies in New Zealand illustrates a successful union of public and private funds and managerial expertise. It would be quite wrong to claim that the directors of either New Zealand Steel or Tasman Pulp and Paper are nothing but Government lackeys, or that either of these companies was but a Government-financed appendage.

True the size of Government's financial involvement entitles its appointees to a greater say in the affairs of the company but it does not follow from this that the interests of the State always, usually, or even frequently, prevail over those of the company. The conflict, if any, is not between acting in the interests of the State as opposed to those of the company but rather between the interests of the State and the interests represented by the other directors. The overriding

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57 Refer S. Gardiner and A. Martin (ed.), *Law Reform Now* (1964) p. 195, where it is also proposed that directors be appointed by the Government to "Enterprises of National Interest". This idea has been criticised by C. A. R. Crosland in *The Future of Socialism* (1956) Chap. XVII where he remarks that "Government nominees on a private board must either 'go native' or remain suspect" (p. 358).

58 See Davies, supra. n. 27.

59 Schwartz, op. cit. n. 29, p. 363.

60 Viz, New Zealand Steel Ltd. and Tasman Pulp and Paper Co. Ltd.

or primary obligation of all directors, public and private alike, is to act bona fide in the interests of the company but in so doing no appointee can realistically be denied the right to pay some regard to the interests of his nominators. As it happens, in the case of the Government appointees the interests of the public are to all intents and purposes co-extensive with those of the company. Even if this were not so, the injurious effects of adverse publicity and the adequacy of the sanctions within the civil service render remote the possibility of a breach of fiduciary duty on the part of a Government director being aired outside the board room, let alone in open court.

For these reasons, any suggestion of reform, having as its sole object the aim of allowing Government directors to have special regard to the interests which they represent, in addition to those of the company, is unnecessary. The present state of the law which precludes directors from paying special or exclusive regard to the interests of employees, creditors, consumers or the State even though on a broad interpretation such a view might be consistent with the interests of the company is anomalous but appears to cause no great hardship in practice.

APPENDIX

List of Mixed-Enterprise Companies

	Number of Directors Appointed by Government	
	Civil Servant	Non Civil Servant
Tasman Pulp & Paper Co. Ltd.	3	–
N.Z. Steel Ltd.	2	–
Dominion Salt Co. Ltd.	–	3
Marumarua Coalfields Co. Ltd.	3	–
N.Z. Woolpack & Textiles Co. Ltd.	2	–
Auckland Intercontinental Properties Co. Ltd.	2	2
N.Z. Overseas Trading Co. Ltd.	1	–

Note: In addition, the shares of the following companies incorporated under the Companies Act 1955 or its predecessor are wholly owned by the New Zealand Government:

Air New Zealand Limited
New Zealand Wool Topmaking Investigating Co. Ltd.
Waikato Carbonisation Limited.

None of the directors of these companies are civil servants although Mr. J. D. Lang, Assistant Secretary to the Treasury, is a de facto director of Air New Zealand Limited, in the sense that he frequently attends board meetings as the representative of the Minister of Finance and holds by proxy all the voting shares which the Government possesses in that company.

The Bank of New Zealand Limited is a statutory company in which the Government owns all the shares. Its directors are paid out of the company's income and receive no remuneration from the Government. In a sense they are Government directors, though not civil servants. Their duties are owed to the company and its shareholders so that no possibility of conflicting obligations can arise. It is understood that the Development Finance Corporation and its board of directors will shortly be in a similar position to that of the Bank of New Zealand Limited.

The Government also owns shares on a co-operative basis in the following fertiliser companies:

Bay of Plenty Co-operative Fertiliser Co. Ltd.
East Coast Farmers Fertiliser Co. Limited.
Southland Co-operative Phosphate Co. Limited.

There are no Government-appointed directors on these companies.

In the case of Auckland Intercontinental Properties Limited the Government shareholding is registered in the names of Air New Zealand Limited and the Tourist Hotel Corporation, each of which has the right to appoint a nominee to the board of directors in addition to the two nominees appointed directly by Government.

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