10 of 1977

No. 3 of 1977

IN THE PRIVY COUNCIL

ON APPEAL

FROM THE COURT OF APPEAL OF NEW ZEALAND

BETWEEN **THE TAUPO TOTARA TIMBER COMPANY LIMITED**
Appellant

AND **DARCY KEVIN ROWE**
Respondent

CASE FOR APPELLANT

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Record

1. THIS is an Appeal from a Judgment dated the 5th July, 1976 of the Court of Appeal of New Zealand (Richmond P., Woodhouse and Cook, JJ.), allowing Appeal from decision of the Supreme Court of New Zealand (Moller J.) dated the 21st October, 1975 dimissing the Respondent's claim and giving Judgment for the Appellant.

2. THERE appears to be little or no dispute between the parties as to factual matters.

3. THE circumstances out of which this Appeal arises are summarised in the Reasons for Judgment of Moller J., and also in the early part of the Reasons for Judgment of Richmond P. in the Court of Appeal. It is, however, convenient as part of the Case of the Appellant to record the prinicpal matters of factual background. pp. 21-24 pp. 32-33

4. PRIOR to his resignation in 1973, the Respondent was the Managing Director of the Appellant. His resignation was completely voluntary and stated by the Respondent to be "for strictly personal reasons and with regret". The Respondent was then aged 50 and as the Managing Director of the Appellant had been in receipt of an annual salary, subject however to tax, of not less than $13,500.00. The Respondent had been a Director of the Appellant Company since 1964. Prior to his appointment to the office of Managing Director in December 1971, he had also held office as General Manager of the Appellant. p.11, ll. 13 & 14 p. 148, ll. 19 p. 11, ll. 4 & 9 p. 93, ll. 20 p.6, ll. 20 & 21

5. ON the 20th January, 1972, the Appellant and the Respondent entered into a Service Agreement providing for the employment of the Respondent by the Appellant for a term of five years computed from the 9th December, 1971. Under Clause 5 of the Agreement the Respondent was given a remedy in damages in the event of the Appellant giving him notice of termination of his employment. By Clause 7 of the Service Agreement, however, there was a purported provision of a very different nature predicated to take effect only in the event of a change of shareholding or "take-over" of the Appellant Company. It is sufficient at this stage to say that Clause 7 purported to give the Respondent at his election the right to choose not to serve the Company after a take-over and to receive a lump-sum of $67,500.00 free of tax in his hands equivalent to five times his gross annual salary. There was, of course, an additional purported obligation on the Appellant to meet the Respondent's tax liability otherwise, which would serve to p.124, ll. 13 & 14 p.124, ll. 35-39

about double the Appellant Company's total liability.

6. ON the 28th January, 1972 a take-over proposal was intimated on behalf of N.Z. Forest Products Limited. p.15, ll. 23-25

7. ON the 20th April, 1972, the Appellant's then Directors decided to recommend acceptance of the take-over proposal. p.107, ll. 13-15 & pp. 126-129

8. AT no time before, during or after the take-over were the Respondent's special rights in the event of a take-over disclosed to the members of the Appellant Company, nor their approval in General Meeting sought. p.9, ll. 29-32 & p. 17, ll. 19-20

9. BY July, 1972, the N.Z. Forest Products Limited offer had been accepted by virtually all the Appellant's then shareholders and noteholders, and on the 20th July, 1972, N.Z. Forest Products Limited representatives were in attendance at the meeting of the Appellant Company's Directors. p. 112

10. ON the 23rd August, 1972, the transfer of 5,657,150 shares to N.Z. Forest Products Limited was recorded in the Appellant's Share Register. p. 20, ll.24-26

11. ON the 28th May, 1973, the Respondent gave notice of his resignation "to take effect as at the 31st August, 1973". p.148, ll. 15-17

12. ON the 25th July, 1973, the Appellant wrote the Respondent accepting his resignation to take effect as at the 31st August, 1973, but at the same time advising that the Board of Directors as then constituted considered that the terms of the resignation precluded the Respondent from entitlement to receive any lump-sum payment. p.151

13. ON the 8th August, 1973, the Respondent's solicitors sent a letter of demand to the Appellant, and subsequently issued proceedings out of the Supreme Court of New Zealand. p. 154

14. ON the pleadings in their final state, the Respondent made two alternative claims:- pp. 1, 2 & 3

(a) That the Respondent's letter of 23rd May, 1973 giving notice of his intention to resign his office as Managing Director as at the 31st day of August, 1973, was a sufficient compliance with Clause 7 of the Service Agreement.

(b) In the alternative, that the Appellant's letter dated the 25th day of July, 1973 was a notice of termination of employment also sufficient to comply with the provisions of Clause 7 of the Service Agreement.

15. THE Appellant by its pleadings subsequently denied liability on three grounds:- pp. 4 & 5

(a) That the facts alleged by the Respondent did not constitute a sufficient compliance with Clause 7 of the Service Agreement, more particularly because:-

(i) The Respondent's "resignation" was not within twelve months of the take-over.

(ii) The Respondent was late in giving the requisite three months notice of his desire to resign.

(b) That on the facts, payment of the amount of $67,500.00 claimed under Clause 7 of the Service Agreement would contravene Section 191 of the Companies Act 1955, inasmuch as the Respondent was a Director of the Appellant Company and the proposed payment had neither been disclosed to members of the Appellant Company, or the proposal approved by the Company in General Meeting.

(c) That the arrangement provided by Clause 7 of the Service Agreement was ultra vires as constituting a payment not justified by either the Appellant's Memorandum of Association or the powers given to the Directors of the Appellant by its Articles of Association. The Appellant's contention was and remains that a five-year tax-free lump-sum payable in the event of voluntary retirement from service by the Respondent was not in the Appellant Company's interests nor reasonably necessary or incidental to the Company continuing in business. In the Appellant's submission, the giving away or even prospective disbursement of so much of the Company's funds was inimical to the Company's welfare and the interests of shareholders. It did not affect the Respondent's security of employment. It gave no benefit to the Company other than as a discouragement to possible changes of shareholding and of the then existing directorate. The defect, if otherwise curable by disclosure to and the assent of shareholders, remained undisclosed. It will be submitted that Directors are not entitled to protect their own position or even that of staff at the cost (albeit in the future) of the Company.

16. THE Respondent's action was heard in Rotorua on the 25th and 26th August, 1975 before His Honour Mr. Justice Moller. In a reserved Judgment delivered on the 21st October, 1975, Moller J. held in favour of the Appellant on the first of the three main Grounds of defence. He did not consider it necessary to give any ruling on the Appellant's other two grounds. pp. 21-24

17. THE Respondent then appealed to the Court of Appeal of New Zealand. The Appeal was heard on the 1st June, 1976. By Judgment dated the 5th July, 1976, the Court of Appeal allowed the Respondent's Appeal and rejected all three grounds then advanced on behalf of the Appellant.

18. IN the Court of Appeal the particular issues which then remain to be resolved were quite correctly summarised by Richmond P. when he posed four questions:-

"1. Was Mr. Rowe's letter of 28th May, 1973, an effective notice as provided by Clause 7? Moller J. held that it was not.

"2. Was the company's letter of 25th July, 1973, a notice of termination of Mr. Rowe's employment as referred to in Clause 7? Again the Judge held that it was not.

"3. Is Clause 7 of the contract unlawful having regard to the provisions of ss. 191 to 194 inclusive of the Companies Act 1955?

"4. Was Clause 7 of the contract ultra vires the powers of the company under its Memorandum of Association, or alternatively, ultra vires the powers of the Board of Directors of the Company?" p.34, ll. 9 -19

19. CLAUSE 7 of the Service Agreement was in the following terms:-

"7. NOTWITHSTANDING the foregoing provisions of this agreement, in the event of any person or other company or companies or any person or organisation or group of persons on their behalf acquiring either by means of a take-over offer or otherwise not less than 50% of the issued capital of the company, the employee shall be entitled at any time within a period of twelve months from and after the date of acquisition of capital as aforesaid, to resign his office upon giving to the company not less than three months notice in writing of his desire to do so. Should the employee resign his office pursuant to the right conferred on him by, and in the circumstances as mentioned in this paragraph 7 hereof, or should he receive from the company at any time during the said period of twelve months, notice of termination of hs employment for any cause whatsoever then and in either such case the employee shall be entitled to receive from the company (in addition to any superannuation benefits or other rights to which he is entitled) on the date on which he ceases to be employed by the company and the company shall pay to the employee on that date a sum of money equivalent to five times the gross annual salary being paid by the company to the employee immediately prior to the date of the acquisition of such share capital of the company as aforesaid AND IT IS EXPRESSLY DECLARED that all income and other taxes on the sum of money to be paid to the employee pursuant to this paragraph 7 shall be payable by the company to the end and intent that the said sum of money will not be taxable in the hands of the employee at any time after the date of the receipt thereof by him." p.125, ll. 9-30

20. ACCEPTING Richmond P's summary, the first issue in the Case remains whether the Plaintiff's letter of 28th May, 1973 was an effective notice within Clause 7. Moller J in the Supreme Court summed up his approach and view of the matter very briefly when he said:-

"I think that what I have to do is to look at this particular agreement, considering carefully the wording of Clause 7 itself but also keeping that clause in proper perspective by surveying the document as a whole. I have done this, and I have reached the view that Mr. Dillon's contentions should not be accepted. I think that, in this case, the draftsman has been careful to distinguish between the final act of resignation, the factual handing over of the Plaintiff's office, and the prior notice to Totara of his desire to do this at some time in the future.

"I therefore hold that the Plaintiff's first cause of action fails." p.23, ll. 19-26

21. IT is a critical part of the reasoning of Moller J. that the words "to do so" can only mean "to resign", and that this was something the Respondent was

required to do only within twelve months of the take-over, if he wished to claim a lump sum under Clause 7. Moller J. thought that the wording contemplated a resignation within twelve months and a prior notice given not less than three months earlier. He was not disposed to treat the qualifying clause as mere surplusage.

22. IN the Court of Appeal, Richmond P. reached a contrary view and, while he referred on no less than four occasions to his difficulties, he rejected Moller J's conclusion on two grounds:-

(i) That the clause so construed would involve two separate steps to be taken by the Respondent:-

(a) The giving of notice of his desire to resign; and

(b) The Respondent's actual resignation without it being necessary for the Respondent to take the second step of actually relinquishing office. p.35, ll. 25-46

Richmond P. thought that this was not the intention of the parties. The Appellant agrees, but does not agree that language used or the interpretation adopted by Moller J. has this implication or result. It is submitted that the Respondent under Clause 7 had a right to resign, and theAppellant could not do anything other than accept his notice. In any event the Appellant submits that the acceptance on 25th July, 1973, of the resignation made it fully p.151, ll. 18-20 effective and binding on both parties. The words used by the Respondent are consistent with a firm and final election by him binding him to resign on the expiry of the notice. Moller J's interpretation of Clause 7 did not require that the Respondent's notice be revocable as part of a two-stage affair. It merely required that both the giving up of office and the notice of intention to give up office should be within the requisite twelve-month period. Richmond P's imputation and/or final construction would in effect amount to only notice of notice being given within twelve months, rather than on single and effective notice.

(ii) That the Clause so construed would mean that the right to resign, in the sense of actually and presently surrendering office, would only be exercise-able within the latter nine months of the twelve-month period.
Richmond P. thought that this derogated from the Respondent's right otherwise to resign "at any time within a period of twelve months" from after p.36, ll. 5-16 the date of acquisition of capital aforesaid. Richmond P. did not consider that the clause contemplated a notice given in anticipation of a take-over. The Appellant, with respect, concurs with the view of the learned President in the latter regard, but in its submission this is no reason why there should not be an effective restriction of the right to resign to the last nine months of the twelve-month period. In the Appellant's submission, the right to resign within twelve months on the clear wording was qualified by the requirement of not less than three months notice. It is accepted that Richmond P. was right in saying that resignation in the context meant resigning "in the sense of actually and presently surrendering office". It is submitted, however, that there was no surrendering or relinquishing until the date when the resignation was to and did become effective, i.e. as at the 31st August, 1973.

Richmond P. adverts to the difficulty that the notice is only required to be "not less than" three months, so that on the construction he adopted notice could be given on the last day of the twelve-month period to take effect at a later stage and conceivably twelve months or even a number of years later. The Appellant considers that this difficulty is of considerably more importance than the two other alleged difficulties suggested by the learned President.

23. IN the Court of Appeal, Cooke J. considered that there were three factors which carried weight as to the result intended to be achieved by Clause 7.

In the first place he said that the broad purpose of the Clause was to give either the Respondent or the Appellant, in the event of a change of control, twelve months in which to determine the relationship with compensation, and went on to say " . . . . there is no obvious reason why the Company should have wished to insist not only on the giving, but also on the expiry of any such notice within twelve months". It is respectfully submitted that it was the date of the expiry of the notice which determined the date of the practical managerial change-over, and this was a matter of obvious and vital commercial importance to the Appellant in arranging the appointment of a new Managing Director and ensuring continuity of control of its business. If the Respondent were free to give any length of notice in excess of three months there could be a long period of uncertainty. p.41, ll. 25-32 p.36, ll. 23-33

Secondly, Cooke J. referred to the ordinary legal rule that, once notice to terminate has been given, it cannot be withdrawn except by consent, and that he was reluctant to impute to the parties "the unusual intention that notice by the employee is to be a mere condition precedent to a resignation". It is accepted that this approach is quite correct, but it is submitted that the construction placed on the clause by Moller J. did not require that the notice should be revocable, but merely that it should take full effect within the requisite twelve-month period. This major point does not appear to be adverted to in any of the Judgments in the Court of Appeal. p.41, ll. 34-47 p.42, l. 1

Thirdly, Cooke J. went on to say that " 'to resign' and 'upon giving' are closely linked in the clause. Grammatically and naturally they suggest that the two things are to be done at the same time, rather than that the first may not be done until at least three months after the second". With the greatest of respect, this otherwise valid comment is not at all helpful as to the date upon which the resignation must take effect. The particular notice sent by the Respondent stated that date, namely the 31st August, 1973. p.42, ll. 2-5

24. IN the Court of Appeal, Woodhouse J. in his comparatively short "Reasons for Judgment" said that in his opinion "there could be no sensible purpose in granting a right to resign at any time within a period of twelve months from [take-over] and in the next few words to go on to whittle down the period to nine months or less by intending that the resignation should be complete not when the document had been tendered but only at the final moment of employment". In the Appellant's submission there were two very sensible purposes, namely:- p.45, ll. 8-13

(a) that if there were to be a change of Managing Director it must be effected within twelve months of the take-over and not at some indefinite time there-

after; and

(b) that the Appellant was to be given three months warning of the change so that it could make arrangements for a replacement.

25. WOODHOUSE J. also indicated his view that "in the context the words 'upon giving' notice are to be read as 'by giving notice', so that Taupo Totara would have notice of his written decision to resign at least three months before the resignation became effective, in the sense that his office was finally given up". With respect, the learned Judge has by the device of implying only a single criterion ignored the plain dual effect of the language as used by the parties. p.45, ll. 21-24

26. IT remains the Appellant's respectful submission that the Respondent's letter of the 28th May, 1973 and his resignation from office on 31st August, 1973 did not give him any entitlement under the provisions of Clause 7 of the Service Agreement.

27. THE next question posed by the Appeal is whether the Appellant's letter of 25th July, 1973 constituted a notice of termination of the Respondent's employment. Neither Moller J. in the Supreme Court nor Richmond P. in the Court of Appeal were of the view that the letter was no more than an acceptance of the Respondent's resignation. The Appellant respectfully concurs. p.24, ll. 12-16 & p.37, ll. 1-9

28. THE third question posed by Richmond P. is whether Sections 191 to 194 of the Companies Act 1955 made unlawful the lump-sum payment claimed by the Respondent. Section 191 of the Companies Act 1955 is in the following terms:-

"191. Approval of company requisite for payment by it to director for loss of office, etc. – It shall not be lawful for a company to make to any director of the company any payment by way of compensation for loss of office, or as consideration for or in connection with his retirement from office, without particulars with respect to the proposed payment (including the amount thereof) being disclosed to members of the company and the proposal being approved by the company in general meeting."

29. IN the Court of Appeal Richmond P. concluded that the Section should be read as being concerned only with payments made to Directors as such in relation to loss or retirement from office as a Director. In the Appellant's submission this is an incorrect interpretation. p.38, ll. 29-31

30. IT is noted that the Section itself refers to payments to "any director of the company" and there is no exception allowed by reason of dual status. It will also be remembered that the Section does not impose an absolute prohibition on payments to Directors but merely requires the sanction of a General Meeting of shareholders. In the Appellant's submission the construction which best accords with the provisions of Section 5(j) of the Acts Interpretation Act 1924 is that the Section exists to provide protection for shareholders from Directors. It is accepted that the normal fiduciary duties of Directors can normally be modified by

express provision in the Company's Memorandum of Association. The statutory purpose sought to be achieved by Sections 191 to 194, however, is to restore the basic equitable principal invalidating directors' contracts, such as that provided by Clause 7. In the Appellant's submission the true distinction is not, as suggested by Hudson J. in the **Lincoln Mills (Aust) Ltd. v Gough** [1964] V.R. 193, between the offices of a Director and Managing Director, but between the offices of a Director and a Manager. The term "Managing Director" does not appear to have any legislative origin, but is merely a convenient description for a man who is at the same time both Manager of a Company and a Director of it. The Service Agreement in this case treats these two functions as being combined in a single office and there is nothing in the Agreement to suggest that the Respondent could have resigned one and retained the other. He did not seek to do so. The Appellant's respectful submission is that the Respondent is unable to assert that the compensation payable to him relates to one office to the exclusion of the other. Even if such a distinction can be validly drawn, there remain the words "**or in connection** with his retirement from office." If these words add anything to those which precede them (and it is submitted that they should ordinarily be so construed), then they indicate that even some lesser association or link between retirement and the payment in question is sufficient to fall within the statutory prohibition. Sections 195 to 199 of the Companies Act appear to have a similar general purpose to that indicated by Sections 191 to 194. While genuine payments by way of damages for breach of contract are not affected, Section 194 read as a whole would seem designed to prevent evasion by the pretence of separating payments of compensation from the arrangements for transfer.

31. THE payment of $67,500.00 is by any standard a very large one, which it is submitted is difficult for the Respondent to justify in the context of the remaining portion of his five-year term of engagement. It is not submitted that the fact that the payment was to be tax free in itself renders same unlawful under New Zealand law. Under the Land and Income Tax Act 1954, it appears that the gross financial benefit received by the Respondent would normally have been taxable at the then maximum rate of 50%. It would follow that the $67,500.00 tax free amounts to a sum in his hands equivalent to ten years normal taxable income, and that the total cost to the Appellant Company of the Respondent's voluntary resignation would be in the region of twice the amount paid to him, i.e. approx. $130,000.00. Sections 191 to 194 do not permit a construction influenced by any possible feeling of sympathy for the Respondent. It is noted that payment to the Respondent in **Lincoln Mills (Aust) Ltd. v Gough** (supra) related only to his uncompleted term of office. Notwithstanding, it is the Appellant's submission that **Lincoln Mills** was wrong and should not have been followed by the Court of Appeal.

p.18, ll. 6-8

32. THE final question posed by this Appeal is whether Clause 7 of the Service Agreement was ultra vires the powers of the Company under its Memorandum of Association or alternatively ultra vires the powers of the then Board of Directors of the Company.

33. RICHMOND P., after reference to **Parker v The Daily News** [1962] 2 All E.R. 99, concluded that in his opinion "the arrangement was a bona fide one and was reasonably incidental to the carrying on of the Company's business". He was further of the opinion "that it was entered into by the Board of Directors for what they believed and were entitled to believe were the best interests of the Company". The other members of the Court of Appeal concurred in this view, and Cooke J. paid particular attention to the fact that similar Service Agreements were entered into with several other members of the staff and had been adopted by the Respondent as a matter of policy for several years.

p.39, ll. 22-24

p.32, ll. 22-24

p.43, ll. 17-19

34. IT is respectfully submitted that the Court of Appeal did not sufficiently apprehend either the true nature of the payment being sought or the special position of the Respondent. It is quite true, as noted by Woodhouse J., that the tax-free lump sum payment envisaged by Clause 7 was not "a curiously inspired anticipation of the proposals for take-over made by N.Z. Forest Products". It must be borne in mind, however, that the possible entitlement of the Respondent at the expense of the Appellant was entirely predicated on there being a take-over. Reference has already been made to the basic equitable principle enunciated in **Aberdeen Rly. v Blaikie Brothers** (1854) 1 Macq. (H.L.) 461; 2 Eq. Rep. 128; 23 L.T. (o.s.) 315, falls most heavily upon Directors. Unless there is clear authorisation to the contrary, Directors wishing to obtain benefits must make full disclosure to and obtain the assent of their shareholders. This was not done by the Respondent. It is submitted that the principle has particular application to Directors in a take-over situation. They owe a duty to the Company, including both present and future members, on the basis that the Company will continue as a going concern. Prima facie, at least, it is submitted that a Director is not entitled to any personal benefit arising from a take-over. In **Parke v The Daily News Ltd.** (supra) it was argued that, while the prime duty in a take-over situation was to shareholders, Directors must take into consideration their "duties" to employees. Plowman J. rejected this submission. It is submitted that Plowman J. was right and that the Respondent as a working director has no better case for favoured treatment than the unfortunate employees in the **Parke Case**.

p.44, ll. 10 & 11

35. IT is finally submitted that the payment sought by the Respondent is in effect a dressed-up gift, of the sort sometimes loosely referred to as "a golden handshake". The Respondent, both as a Director and Manager of the Appellant Company, owed a duty of loyalty to the Company, yet Clause 7 purports to give him a right to decide not to serve the Company and receive very much more for doing so than if he served the remaining portion of his five-year engagement. The cost is at the expense of the Company and its shareholders.

36. THE Memorandum of Association contains no authorisation or dispensation for payments to either employees or Directors. Richmond P. considered that Articles 96, 116 and 117 of the Appellant's Articles of Association delegated sufficient powers to the Directors to enter into the contract with the Respondent. In the Appellant's submission these provisions point in the opposite direction by dealing expressly with the questions of appointment of Managing Director and payments to a Director, without authorising the type of gratuitous payment

p.40, ll. 6-8

sought by the Respondent.

37. RICHMOND P. in the Court of Appeal considered that the arrangement was entered into bona fide to attempt to hold senior employees and to influence their staying with the Company, even when faced with a fear of take-over. It is impossible to be precise as to the motivation of the Directors when they agreed to the special terms of the Respondent's Service Agreement. They may well have been influenced, to some degree at least, by sentiments of sympathy or benevolence towards loyal employees. Equally, being aware of the possibility of a take-over, they may have wished to deter or at least discourage same and thus preserve their own personal position. They may even have been genuine in thinking that their actions were in the interests of the Company and its shareholders at the time. In the Appellant's submission, however, the special benefit claimable by the Respondent after a take-over did not serve to induce the Respondent to continue in service, but rather was a positive incentive for him to do the opposite. It did not in any way ensure the Respondent's continued security of employment. It was not necessary or even reasonably incidental to carrying on the business of the Company and could not in any way be said to serve to promote the benefit or prosperity of the Company. p.39, ll. 16-18

38. THE Appellant respectfully submits that the Judgment of the Court of Appeal of New Zealand was wrong and ought to be reversed for the following:

REASONS

1. Because the Respondent had no entitlement under the terms of Clause 7 of the Service Agreement.

2. Because payment of the amount claimed would contravene Section 191 of the Companies Act 1955.

3. Because the Agreement provided by Clause 7 was not justified by the Appellant's Memorandum and Articles of Association or otherwise.