Companies (Clarification of Dividend Rules in Companies) Amendment Bill

Member's Bill

As reported from the Primary Production Committee

Commentary

Recommendation

The Primary Production Committee has examined the Companies (Clarification of Dividend Rules in Companies) Amendment Bill and recommends that it be passed with the amendments shown.

About the bill as introduced

The Companies (Clarification of Dividend Rules in Companies) Amendment Bill is a Member's bill in the name of Todd Muller MP. The bill seeks to reconcile the dividend rules set out in sections 36 and 53 of the Companies Act 1993 by removing uncertainty about whether a company constitution can provide for "dry shares" and "wet shares" within the same class of shares.

"Dry shares" are shares that are not linked to supply and therefore may have no, or limited, rights to dividends. "Wet shares" are shares that are aligned to supply and therefore have a right to dividends when declared by the board.

A classic example of the use of wet and dry shares is in agricultural co-operative type companies where shareholders are current or former suppliers to the company. In this situation, current suppliers hold wet shares, while former suppliers hold dry shares that may not have a right to dividends, or may have a right to a reduced dividend.

Section 36(1) of the Act provides a shareholder with the right to an equal share in dividends authorised by the board (among other rights). However, section 36(2) provides that, subject to section 53, the constitution of the company can negate, alter, or add to, these rights.

With some exceptions, section 53(2) of the Act prevents a board from authorising differential dividends within any class of shares. That is, the board must not authorise a dividend for some but not all of the shares in a class, nor authorise a dividend that is greater in value for some shares than for others of the class.

We understand that the intent of this provision is to prohibit a company's board from discriminating between shareholders within a class.

Uncertainty about the effect of section 53(2)

The bill's explanatory note states that there are different views within the legal profession about the effect of section 53(2). One view is that the section prevents a board from exercising discretion when authorising a dividend for some shares in a class but not others. However, according to this view, it does not prevent a company's constitution from containing a rule that some holders of shares in a class are not entitled to receive dividends on those shares. If this is the case, a board that authorises dividends, where the constitution provides that these must be paid on a differential basis, would not be discriminating between shareholders. It would instead be giving effect to the rule in the constitution.

Conversely, other lawyers consider that section 53(2) prevents a constitution from containing such a rule. This is because it would result in a board authorising dividends for some of the shares in the class (the wet shares) but not the other shares in the same class (the dry shares), which is thought to be prohibited by this section.

To remove this uncertainty, the bill as introduced would insert section 53(2A). This new section would specify that section 53(2) does not prevent the constitution of a company providing for differential dividends in the circumstances stipulated in the constitution.

Proposed amendments

This commentary covers the main amendments we recommend to the bill as introduced. We do not discuss minor or technical amendments.

Allowing differential dividends

We note that under clause 4 of the bill as introduced, a company's constitution could provide for some shares to receive no dividend. However, we consider that the bill is unclear as to whether a company's constitution could provide for an increased or reduced dividend entitlement for some shares compared with others. Therefore, we recommend replacing this clause to set out when a constitution could authorise a different level of dividends for some shares than for others of a class.

Our proposed new clause 4 would replace section 53(2), and would:

- retain the three existing exclusions for when a board may authorise a differential dividend, as currently set out in section 53(2) of the Act
- make it clear that a company's constitution may provide for differential dividends and that the board may authorise a dividend in accordance with the constitution.

Differential dividends to be based on objective criteria

We do not consider that the policy intent of the bill is to allow a company's board to exercise discretion or an opinion about which circumstances would lead to shares receiving different dividends. Therefore, we recommend inserting new section 53(2A). This new section would make it clear that a company's constitution could only provide for shares in a class to receive differential dividends if this is based on objective criteria.

Definition of "differential dividend"

We recommend including a definition of "differential dividend" by amending clause 4 to insert section 53(4). This definition is based on the current content of section 53(2)(a) and (b) of the Companies Act.

Appendix

Committee process

The Companies (Clarification of Dividend Rules in Companies) Amendment Bill was referred to the committee on 8 August 2018. The closing date for submissions was 27 September 2018. We received and considered four submissions from interested groups and individuals. We heard oral evidence from one submitter.

We received advice from the Ministry of Business, Innovation and Employment and the Ministry for Primary Industries.

Committee membership

Hon David Bennett (Chairperson)

Kiritapu Allan

Hon Nathan Guy

Kieran McAnulty

Mark Patterson

Stuart Smith

Rino Tirikatene

Hamish Walker

Todd Muller took part in the consideration of this item of business.

Key to symbols used in reprinted bill

As reported from a select committee

text inserted unanimously

~~text deleted unanimously~~

Todd Muller

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Contents

The Parliament of New Zealand enacts as follows:

1 Title

This Act is the Companies (Clarification of Dividend Rules in Companies) Amendment Act **2018**.

2 Commencement

This Act comes into force on the day after the date on which it receives the Royal assent.

3 Principal Act

This Act amends the Companies Act 1993 (the **principal Act**).

~~**4 Section 53 amended (Dividends)**~~

~~In section 53, after subsection (2), insert:~~

~~(2A) To avoid doubt, nothing in subsection (2) prevents the constitution of a company providing that shares in a class do not confer a right to receive dividends in the circumstances specified in the constitution.~~

4 Section 53 amended (Dividends)

(1) Replace section 53(2) with:

(2) The board of a company must not authorise a differential dividend unless—

(a) the amount of the dividend in respect of a share of that class is in proportion to the amount paid to the company in satisfaction of the liability of the shareholder under the constitution of the company or under the terms of issue of the share or is required, for a portfolio tax rate entity, as a result of section HL 7 of the Income Tax Act 2004; or

(b) the company's constitution provides for differential dividends as permitted by **subsection (2A)** and the dividend is authorised in accordance with the constitution.

(2A) The constitution of a company may provide for differential dividends in respect of the shares in a class of shares, which may be determined on any differential basis, but only if the differential basis is based on objective criteria and not on the exercise of a discretion by, or an opinion of, the board of the company.

Example

Company Z is an agricultural company whose class A shareholders are all current or former growers and suppliers to the company. The company's constitution could confer on holders of class A shares a right to differential dividends based on whether or not they are currently growing and supplying produce to the company.

The company's constitution could not provide for dividends based on a discretionary criterion, such as whether a shareholder had adequately upheld the reputation of the company.

(2) After section 53(3), insert:

(4) In this section, **differential dividend** means a dividend—

(a) in respect of some but not all the shares in a class; or

(b) that is of a greater value per share in respect of some shares of a class than it is in respect of other shares of that class.

Legislative history

5 April 2018	Introduction (Bill 52–1)
8 August 2018	First reading and referral to Primary Production Committee

Wellington, New Zealand:

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