

Companies (Clarification of Dividend Rules in Companies) Amendment Bill

Member's Bill

Explanatory note

General policy statement

This Bill amends the Companies Act 1993 (the **principal Act**) to give clarification of dividend rules outlined in sections 36 and 53. There is currently doubt about the ability of a company constitution to provide for “dry shares” (shares which do not carry dividend rights in prescribed circumstances). The classic example is shares in a co-operative where the holder ceases supplying the co-operative, but the issue is broader than this. The uncertainty arises because of the interplay between sections 36 and 53 of the principal Act.

Section 36 provides the shareholder with the right to 1 vote on a poll at a meeting of the company on any resolution, the right to an equal share in dividends authorised by the board, and the right to an equal share in the distribution of the surplus assets of the company. However, subsection (2) provides for these rights to be negated, altered, or added to by the constitution of the company or in accordance with the terms on which the share is issued. The flexibility provided for in subsection (2) is subject to section 53.

Section 53(2) prevents the board of a company from authorising a dividend in respect of some but not all the shares in a class, or 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, unless 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.

There are different views within the legal profession about the effect of section 53(2). On 1 view it prevents the board from exercising a discretion to authorise a dividend in respect of some shares in a class but not others (the “dry shares”), but it does not pre-

vent the constitution from containing a rule that some holders of shares in a class (for example, non-suppliers) are not entitled to receive dividends on those shares; in those circumstances the board is not exercising its powers in a way that discriminates between shareholders, but is simply giving effect to the rule in the constitution. However other experienced lawyers consider that section 53(2) prevents the constitution from containing provisions of this kind, as that would result in the board authorising dividends in respect of some shares in the class (the “wet shares”) but not other shares in the same class (the “dry shares”).

The former view is probably the better view, but the uncertainty is problematic. This uncertainty can be removed by adding a new *subsection (2A)* to section 53 to remove doubt about “dry share” provisions, providing that 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.

This would clarify that the constitution of a company can provide for shares in the same class to carry different entitlements to dividends in different circumstances—in particular, where the holder is no longer a supplier to the company. Such provisions do not raise any concern about discrimination among shareholders by the directors, which is the concern that section 53 is aimed at. They enable companies and their shareholders to tailor their mutual rights and obligations to give effect to their commercial objectives. There are good reasons to permit this flexibility in structuring commercial arrangements, and no good reasons to limit it.

Note also that the potential for unfair treatment of shareholders by amending a company constitution to include a dry share provision is addressed by the interest group and minority buy-out provisions in the principal Act. Shareholders who object to the change can vote against it, and if the resolution passes they are entitled to be bought out at a fair price.

Clause by clause analysis

Clause 1 is the Title clause.

Clause 2 provides that the Bill comes into force on the day after the date on which it receives the Royal assent.

Clause 3 provides that the Bill amends the Companies Act 1993 (the **principal Act**).

Clause 4 amends section 53 of the principal Act to insert *new subsection (2A)*.

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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

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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)

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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.

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Companies) Amendment Bill**

Wellington, New Zealand:

Published under the authority of the House of Representatives—2018