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NBCP

IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

CP No.544/86

LOW PRIORITY

1237

BETWEEN EDWIN PETER HIGGINSON of 18 Kallista Place, Auckland, Company Director

Plaintiff

A N D FIDELITY LIFE ASSURANCE COMPANY LIMITED a duly incorporated Company having its registered office at 65-67 Wakefield Street, Auckland.

Defendant

Hearing: 7, and 8 September 1989

Counsel: Mr Olphert for Plaintiff
Mr Stewart for Defendant

Oral Judgment: 8 September 1989

ORAL JUDGMENT OF GAULT J.

The defendant is an unlisted public company engaged in the business of life insurance. The plaintiff, after having been employed as general manager of the defendant since 1983, entered into a service agreement with the defendant on 18 October 1985.

By clause 1 of that agreement the defendant was to continue to employ the plaintiff as general manager and the general manager was to continue to serve the company, upon and subject to the terms and conditions set out in the agreement.

The first part of clause 2 specified that the engagement

would extend for a minimum period of three years from 1 August 1985, subject to determination as subsequently provided. Clause 11 of the agreement reads -

> "TRANSFER OF THE COMPANY'S BUSINESS
>
> If the Company's business shall be transferred to any other person firm or company and/or the shareholding change materially and/or effective control of the Company shall pass to any other person firm or company during the continuance of this agreement the General Manager shall be at liberty to decline to continue as General Manager under such other person firm or company and if the General Manager shall decline to do so then and in such event the Company shall forthwith pay the General Manager the greater of his then current fixed salary for (a) the remainder of the term of this agreement and (b) twelve months salary as and by way of liquidated damages."

On 23 December 1985 the plaintiff wrote to the defendant company advising that he declined to continue in the office of general manager in view of material changes in shareholding that had occurred since the contract was signed. His employment terminated in February 1986.

The plaintiff now claims from the defendant the sum of $145,000, as the amount of salary accruing but unpaid for the balance of the period of three years specified in clause 11 of the agreement.

The changes of shareholding upon which the plaintiff relies as being material were first, the acquisition of a substantial holding by a Mr Belton, and parties under his control, and secondly, the move from a minority to a majority shareholding by one of the founders of the company and a director, Mr Watson. The shares owned or controlled by Mr

Watson were registered in the names of a number of parties, in addition to members of his family.

The dispute between the parties turns upon the correct construction of clause 11 of the service agreement and, in particular, the phrase "shareholding change materially".

Mr Olphert, for the plaintiff, submitted that a change of shareholding is material if it is substantial and he referred to the Overseas Investment Regulations which includes one of numerous provisions in which certain consequences flow from the acquisition of a shareholding of 25% of a company. It was his submission that the shareholding materially changed in the two respects I have already referred to and, initially, his argument was that a substantial change in the number of shares held by existing or new shareholders, would be sufficient. However, he did acknowledge that materiality cannot be just a matter of increase or reduction in the number of shares held by individual shareholders as indicated in the company's share register. He accepted that a transfer of a substantial holding from one trustee to another, with no change in beneficial ownership, would not be material.

Mr Stewart submitted that the phrase dealing with a material change of shareholding in clause 11 must be construed in its context and he referred to the accompanying alternative or cumulative expressions, "if the company's business shall be transferred to any other person firm or company" and, "effective control of the company shall pass to any other

person firm or company". It was his argument that in that context the reference to a material change of shareholding necessarily means a change that results in a change of control. He emphasised also the heading to clause 11 which reads, "Transfer of the Company's Business" as suggesting the nature of any change having materiality.

In my view a material change of shareholding must be a change that matters; a change that has significant effect. It is not just a matter of quantum. A small change in shareholding, in some circumstances, may have very significant effect and, to the contrary, a substantial change of shareholding in other circumstances may have minimal or no effect.

In this context a change of shareholding, to be material, would be one having a significant effect on the control and operation of the company's business and consequences for the role of the general manager. That view is supported by what appears subsequently in clause 11 of the agreement where it states -

> "...shall be at liberty to decline to continue as General Manager <u>under such other person firm or company</u>".

Accordingly, to be material the change of shareholding must be one which would have the result of the general manager being placed in the position where he is required to serve under persons different from those previously controlling the business. I do not exclude a change in shareholding or

company structure that would give rise to a change in control so as to give the ability to direct management, even though it has not yet been exercised, but that does not seem to be relevant in the circumstances of this case.

It is next necessary to consider the period over which the change of shareholding is to be examined.

Mr Olphert, for the plaintiff, submitted that the appropriate period is that between 1 August 1985, when the plaintiff's engagement pursuant to the agreement commenced, and 23 December 1985 when he tendered his resignation.

Mr Stewart, on the other hand, submitted that the period would commence no earlier than 26 August 1985 when the directors resolved to execute the agreement. In my judgment the period is dictated by the terms of clause 11. The change giving rise to the right to discontinue employment must occur "during the continuance of this agreement". The agreement, although specifying that the engagement would run from 1 August 1985, did not become of contractual effect until it was executed on 18 October 1985. Accordingly the period of the continuance of the agreement commenced on that date. That view is consistent with the wording of the letter of resignation by the plaintiff in which he referred to changes "since the contract was signed".

The agreement, in its provisions, appears to draw a distinction between the period of continuance of the agreement

on the one hand, and the period of engagement in accordance with the terms set out in the document on the other hand. Clause 3 of the agreement, directed to remuneration, refers to a salary which, on the evidence, was not fixed until September of 1985 and the clause provides that that remuneration applies "at the date hereof", which clearly refers to the date on which the agreement was executed.

Clause 4 of the document provides for certain rights to concessional mortgage finance and expressly applies "during his employment hereunder". It is therefore my view that the commencement of the period of the agreement, to be distinguished from the period of the engagement, was the date of execution of the document. Indeed it would be somewhat surprising to construe Clause 11 otherwise, so as to enable events that had already occurred without protest to be relied upon. However, in case I am wrong in the conclusion I have reached as to the relevant period, I review the changes in shareholding from 1 August 1985.

As at that date there were 250,000 shares in the defendant company that had been allotted. There were just over 80 shareholders. There were four directors, two of whom together held, or controlled, more than 50% of the shares. The two other directors had small holdings. The only other substantial shareholding was that of the company secretary or his family, holding 29,000 shares.

Mr Watson, who was one of the directors, owned or

controlled, at 1 August 1985, just under 50% of the shares. However, because these were registered in the names of trustees or nominees, that was not known to the plaintiff. It was his assessment that at 1 August 1985 Mr Watson owned or controlled some 37% of the shares. What is important, however, is not the understanding of the plaintiff at the time, but the actual position. Realistically, with the spread of shareholding that existed at that time, a holding of between 47% and 50% of the shares would amount to effective control, even without the holdings of other directors.

By 1 April 1985 Mr Belton already had made an offer to the shareholders without limit to the number of shares he sought to acquire. The directors had advised shareholders against accepting that offer. Some transfers of shares in favour of Mr Belton had been signed and lodged with the company, but not registered. They covered some 6,000 shares. On 2 August 1985 Mr Watson matched an increased offer from Mr Belton and acquired 15,000 of the shares held by the mother of the company secretary. This purchase took the shareholding owned or controlled by Mr Watson above 50%. He advised shareholders and staff of this and of his intention not to sell his shareholding. He also stated in a circular dated 9 August 1985, "The philosophy, strategy and objectives will therefore been maintained".

By the time of a directors' meeting on 26 August 1985 the directors had reached an agreement with Mr Belton under which they were to approve transfers to him, or his nominees, of

shares up to 24.9% of the capital of the company. At the meeting on 26 August the directors recorded their approval of that agreement and also approved transfers to Mr Belton or his nominees of some 44,000 shares. It is not without significance that two consecutive items of business recorded in the minutes of that meeting were as follows -

> "428. General Manager's Service Contract
>
> The actual execution of the document has been deferred pending amendment of the wording of the Superannuation clause. Document effective 1 August 1985 is to be signed as soon as amended.
>
> 429. Share Transfers to SMS [Belton's nominee]
>
> The agreement enabling this group to purchase 49,999 Ordinary $1.00 shares out of the existing allotted 250,000 shares and permission to apply the Company Seal on the new certificates had been approved."

The plaintiff is recorded as having been in attendance at that meeting (although he was not a director) and I heard no evidence of any protest by him, at that time, with reference to his terms of employment. In fact, in evidence he acknowledged there were no events as at that date that would have caused him to exercise his rights under clause 11 of the agreement.

Between 26 August 1985 and the end of November of the same year Mr Belton himself, or through nominees, increased his shareholding to 27.89% of the allotted shares. I heard no specific evidence directed to the shareholding controlled by Mr Belton as at 18 October 1985 but, from the share transfers produced, it appears that he held just over 60,000 shares

which amounted to just under 25%.

On 6 December 1985 there was an extraordinary general meeting of the defendant company. The directors had proposed to that meeting a bonus issue of shares. Mr Belton had given notice of resolutions designed to secure an increase in the number of directors and a seat on the board.

On the morning of 6 December, prior to the meeting, the plaintiff was visited by Mr Belton. He was served with an injunction, obtained ex parte, restraining the company from deliberating upon the proposal for its bonus issue of shares and that was not proceeded with. The plaintiff's meeting with Mr Belton clearly was unpleasant. I was told that Mr Belton adopted an aggressive attitude and left the plaintiff in no doubt that he intended to continue his efforts to acquire control of the company and to obtain a seat on the board of directors. He made it clear to the plaintiff that, if he achieved his objective, there would be no future in the company for the plaintiff.

I also heard evidence of an attempt by Mr Belton to compromise the plaintiff in the course of those discussions but I was not given details.

At the general meeting of the company, held later in the day, the resolutions proposed by Mr Belton were defeated. It was shortly after that, on 23 December, that the plaintiff tendered his resignation. In the course of his evidence I

asked the plaintiff to articulate his concerns and the question and answers are as follows -

> "Just at the end of cross-examination by Mr Stewart, you said 'my real concern was when the full scenario became clear'. Now you say, I understand, that it was late in 1985 that the full scenario became clear?.....Yes.
>
> Would you, just very briefly, tell me what you mean by 'full scenario'?.....The ramifications of a change in shareholding, first Watson, secondly Belton and his interest and also the unwelcome approaches I received about that time from Belton.
>
> What do you say were ramifications of the Belton share acquisition?.....He had moved to a very significant level of shareholding, or had control over a significant level of shareholding, and pretty clearly stated it was his intention to keep up the price on his offers to existing shareholders until such time as he acquired a position of control.
>
> And what do you say were the ramifications of the Watson group acquisition?.....A fact an individual controlled more than half the shares of a company such as Fidelity which is a life insurance company and where there was at least the potential that one person could control the fate of the company and impact on everyone in the company including policy holders, shareholders, staff and everyone."

That extract from the notes of evidence provides a succinct summary of the grounds upon which the plaintiff considered the changes in shareholding were material.

So far as concerns the increase in the shareholding of Mr Watson, and those over which he exercised control, I am satisfied that while this may have resulted in ensuring his control of the company was absolute in real terms, it made little difference having regard to his extensive shareholding from before the commencement of the relevant period. Then the company was controlled by the four directors, who between them

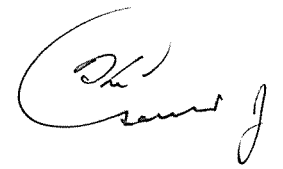
had over 60% of the shares. There had been only seven directors in the 16 year history of the company and there was no indication of any change of circumstances flowing from the acquisition of an additional parcel of shares by Mr Watson. He was, in effect, in control of the company; he had given assurances to the plaintiff and other executives of the company that there would be no change and there had been a very clear demonstration of this in the defeat of the proposals of Mr Belton at the extraordinary general meeting.

While Mr Belton had acquired 27.89% of the shares in the company, the circumstances in which he found himself were such that he was not able to exercise any significant influence over the affairs of the company. The plaintiff was concerned that the situation would change and that Mr Belton would be able to give effect to the intentions he had expressed in clear and strong terms. However there is a great difference between stated intentions and realisation of them, as proved to be the case with Mr Belton who was effectively locked in without any real power. Until such time as he was in a position to carry out his stated intentions it could not, in my view, be said that his acquisition of shares would have a material effect on the operation of the company. Whether the relevant period is taken from 1 August, 26 August or 18 October, the situation did not arise in which the plaintiff was presented with a situation of continuing "under another person, firm or company".

Accordingly, the change of shareholding upon the

acquisition of shares by Mr Belton and his nominees, in my view, did not amount to a material change as I have interpreted that phrase in clause 11 of the agreement.

There must be judgment for the defendant. The defendant is entitled to costs according to scale with disbursements as certified by the Registrar.



Solicitors: Olphert & Collins, Wellington for Plaintiff
Simpson Grierson Butler White, Auckland for Defendant