

AN OUTSIDER LOOKS AT THE PNG COMPANIES ACT -

WHAT IS DIFFERENT ?

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If the 'outsider' happens to be familiar with the company law of New Zealand, he or she will immediately feel at home, for the *Companies Act* 1997 (PNG) is modelled very closely on the New Zealand legislation.

It is an 'outsider' coming from Australia who will find some things in common (for both share the same legal heritage, and some of the modern reforms) but many differences in detail and some in principle. So it is to someone used to Australian company law that this article is addressed.

Constitutional documents

Among the familiar aspects, a common feature is the progressive substitution of the concept of contract between individuals by that of statutory codification. Once the corporate entity had its definition and its constitution in an association between individuals. This was recorded in an empowering Memorandum of Association and the relations between the individuals in Articles of Association - rules between individuals for association of individuals. In the name of simplicity, the legislators have now provided a generalised one-size-fits-all model which, when adopted, will produce the official stamp of approval and of separate identity. Under a different name - a constitution - some of the freedom to agree remains, but within prescribed limits.

Thus the statute is designed to act as a full and sufficient constitution for the company. No other constitutional document is required. A supplementary constitution is permitted, and there are some transactions which cannot be done without such a supplement. A detailed analysis of those transactions which cannot be done without a supplementary constitution appears in an article on this site: *Does My Company Need a Constitution? Things Which Cannot Be Done Without a Constitution*.

That article warrants attention, for there are some provisions of the 'statutory constitution' which may not suit the parties. Thus supplementary constitutions are common. There is considerable scope for 'short form' supplementary constitutions, but they are not common - yet.

Understandably, there are some provisions of the 'statutory constitution' (including the Regulations) which may not be amended.

The transfer to the new regime under the *Companies Act* 1997 was compulsory, not optional as in Australia. The Act came into effect on 2 March 1998 and all companies

which on 2 September 1998 had not yet voluntarily registered under the new *Companies Act* 1997 became on that day automatically registered under that Act with the statutory constitution alone. From that day, all Memorandum of Association and Articles of Association are automatically inapplicable and irrelevant. Occasionally one still meets such documents, but they are best removed as misleading. Unless and until a constitution is adopted by a company in terms of the *Companies Act* 1997, that Act and that Act alone (plus the Regulations under the Act) provides the constitutional documents.

Securities law

A point of difference between PNG and Australian statutes - and which, it has been said, shows singularly good judgement on the part of PNG - is that the legislation of PNG has followed the pattern set by the United Kingdom and New Zealand of separating company law from securities law. PNG has "joined other common law countries which have long recognised that securities regulation is distinct and separate from traditional company law concerns". The Australian legislation attempts to encompass both, thus creating a legislative monster and ensuring that corporate law is driven by the tiny fraction (less than one percent numerically) which are listed public companies, whilst the vast majority of Australian companies are, in the phraseology of L.C.B. Gower, 'incorporated partnerships'. In contrast, PNG has the *Companies Act* 1997 and the distinct *Securities Act* 1997, thus simplifying the legislation greatly.

Classification of companies

Further simplicity flows from limiting the types and classes of company. With only one variation, all companies have limited liability. All have shares and liability is limited by shares. The only exception is that, by appropriate provision in the constitution, a company may impose unlimited liability on its shareholders.

Thus there are no companies limited by guarantee, nor any limited by both shares and guarantee. Corporate entities which might have adopted one of those forms are either incorporated associations under the *Associations Incorporation Act* 1966, or are ordinary companies. Nor are there any no-liability companies.

Nor is there a separate class of proprietary companies. There is no distinction between public and private companies. The Act has been designed as a general statute for all, regardless of size or number of shareholders and it applies in the same way to all companies. It is this generalised nature of the statutory constitution that results in the common adoption of a supplementary constitution.

Mention will be made below, however, of simplified reporting and accounting requirements of certain companies, but this is a function of accounting and reporting only. The terms 'exempt companies', 'issuers' and 'reporting entities' are in use in this connection.

Overseas companies are subject to a special regime.

Division of powers

Another constitutional matter is a departure from the traditional division of powers between the board of directors and the members in general meeting. The Act provides that the business and affairs of the company must be managed by, or under the direction or supervision of, the Board, which has all necessary powers for this purpose (section 109).

However, in departure from the norm, the Board may not undertake a 'major transaction' without approval of the members (section 109). A major transactions is one which involves:

- the acquisition of assets with a value of more than half of the company's assets;
- the disposal of assets with a value of more than half of the company's assets; or
- the acquisition of rights or obligations with a value of more than half of the company's assets;

The required consent of members is that of a special resolution (75.%).

Abolition of the principle of preservation of corporate capital

The next point which an outsider will recognise is the adoption of a common recent reform, namely the abandonment of the principle of preservation of corporate capital. The economic view of corporate capital is that a shareholder in a large company, "although a member, is in economic reality but not in the eyes of the law, a mere lender of capital on which he hopes for a return but without any effective control over the borrower". In contrast, the historic legislative view has been determined largely by reactive response to the demand for investor and creditor protection following abuse, and we recognise the beginnings of this legislative view in the Bubble Act of 1720. Thereafter, there developed in the English company law tradition, as one of its "pillars", the doctrine of maintenance of capital. The essence of this was the 19th Century theory that a company's subscribed share capital should be maintained and used only in the company's business.

Many principles were developed in the law to apply this theory: the doctrine of *ultra vires* and its numerous applications; the requirement for authorised share capital in the memorandum; the requirement for par value of shares; the prohibition on use of capital for improper purposes; the prohibition on issue of shares at a discount to their par value; the prohibition on paying a person to take up shares; the prohibition on return of capital or reduction of capital except in controlled circumstances and often under Court supervision; the prohibition on a company purchasing its own shares or dealing in its own shares; the prohibition on providing finance for the purchase of shares in itself; the restrictions on source of funds for redemption of redeemable preference shares; and the requirement that dividends be paid only out of profits.

It is not necessary to document how those provisions failed to attain their objects and how both commercial and legal practices successfully circumvented the original object. Thus in recent decades, throughout jurisdictions of the English commercial law tradition, there have been progressive legislative moves away from the doctrine of maintenance of capital. Many of the other principles mentioned above remain nominally, but a vastly simpler procedure now preserves prohibition only in limited circumstances. Instead of the old theory, we now find different principles. The share capital rules are totally revised on the basis of three themes: solvency, fairness and disclosure. To these three are added three ancillary principles: reducing unnecessary procedural requirements, particularly for transactions which do not threaten the interests of the company shareholders or creditors; removing Court involvement from transactions which do not involve dispute; and by making available a right to seek compensation for those who have suffered a loss as a result of a contravention.

This is a significant change of direction from which many developments flow. Par value of shares is abolished. There is no longer an authorised or nominal share capital. The Memorandum of Association is now so emasculated of any purpose that, as noted, it is abolished. Acquisition of its own shares, redemption of shares and lending for the purpose of acquiring shares of the company may now be done simply. "Let the managers manage" is now the catch-cry.

Creditor protection is now to be achieved by forced disclosure in an interests register, by requiring certificates to be completed by directors who vote in favour of certain transactions, by requiring certificates of solvency for other transactions and by claw-back provisions. These open the way for - if not expressly stating - personal liability of directors in the event of company failure due to improper transactions. The managers are given more freedom to manage, but in return they are more accountable.

Disclosure

So the increased freedom of directors to act is complemented by the principle of openness and transparency as the surest way to good corporate governance.

Sunlight is said to be the best disinfectant; electric light the best policeman.
Louis D. Brandels, *Other People's Money*, 1912

This principle is common to both Australian and PNG jurisdictions, but the PNG legislation differs in being much more prescriptive of measures to force that openness and transparency. These requirements are legislated; they are therefore obligatory and there are substantial penalties prescribed for breach. They go far beyond those in Australian legislation and thus warrant careful attention.

First among them is the interests register. This is a very demanding requirement, not easily fulfilled, and without the benefit of detailed regulations or forms to aid in compliance. Part of the difficulty arises because the four types of occurrence or circumstance which must be recorded in the register are different in nature:

- transactions with the company in which the director has an interest (section 118);
- use of company information (section 123);
- dealings in shares or securities issued by the company (section 126); and
- remuneration and other benefits (section 139).

This register must be held at the company's registered office or, if not, its location must be advised to the Registrar (section 164). It must be available for inspection by shareholders (section 216). In the annual report to shareholders, particulars of entries during the year must be notified. It must be held for at least 7 years.

Not only is there a penalty for failure to comply, but - a feature foreign to Australian law - there is a statutory duty owed to *individual shareholders*, in addition to any duty owed to the company as a whole or the shareholders as a body, to maintain the Register.

A more detailed analysis of the interests register is on this site entitled *The Interests Register - Who Must Record, When and How?*

Another transparency measure in PNG law is that, for transactions of certain types, those directors who vote in favour of the relevant resolution must sign a certificate - having somewhat different requirements depending on the transaction - effectively declaring that in their opinion the interests of the company will not be adversely affected by the transaction, and giving reasons for that opinion!

Such certificates effectively become public property, as they must be held at the registered office for seven years and be available for inspection by shareholders.

These certificates are required to state, in the appropriate circumstance:

- when an allotment of shares is made - that the consideration is fair;

- when a distribution is made - that the company will be solvent afterwards, and give reasons;
- when any remuneration or benefit is given to directors - that the remuneration or benefit is fair, and give reasons;
- when directors & officers insurance is paid for by the company – that the cost is fair to the company;
- when an amalgamation is proposed - that it is fair and the outcome will be solvency;
- when a liquidator is appointed in certain cases – that the company will be solvent.

Failure to comply brings penalties. Financial difficulties resulting from the transaction may result in claw-back of the benefit on behalf of the company or, if unsuccessful, recovery from the directors.

A more detailed analysis of the certificates required is on this site entitled *Directors Have to Sign Certificates? Why? When? What?*

The declaration of solvency is a third instrument toward the same end, required:

- whenever a distribution is made (and 'distribution' is very widely defined);
- when an amalgamation is proposed; and
- in the annual return to the Registrar of Companies.

As with the other documents mentioned, such declarations must be retained for seven years, held at the registered office and be available for inspection by shareholders.

The annual report to shareholders is also important in disclosure. In addition to other information mentioned below, it must include particulars of entries made in the interests register during the year.

The annual return to the Registrar is also obligatory disclosure. The information required by the prescribed form is extensive. Because all companies must complete the same return, the information to be provided by small companies is far more detailed than that provided by proprietary companies in Australia. The return incorporates a declaration of solvency, made pursuant to a resolution by the board.

Solvency

That leads to the topic of solvency. In this legislation there is a definition of solvency that differs from that in Australian legislation in an important way. There is not just one test in the definition of solvency, there are two! Both must be satisfied. Section 4 of the *Companies Act 1997* provides that a company satisfies the solvency test where:

- the company is able to pay its debts as they become due in the ordinary course of business; and
- the value of the company's assets is greater than the value of its liabilities, including contingent liabilities.

In relation to the second of these tests, the directors:

- should have regard to the most recent financial statements;
- should have regard to all other circumstances that the directors know or ought to know;
- may rely on reasonable valuations of assets and estimates of liabilities; and
- in considering contingent liabilities, may take account of the likelihood of the contingency occurring and any reasonable counter-claim.

In section 50, which deals with distributions, there is further amplification of the terms "debts" and "liabilities".

So in addition to the 'flow test' or 'trading solvency test' used in Australia, there is also a 'position test' or 'balance sheet test' to be satisfied!

Directors are required to make a written declaration of solvency in the three situations mentioned above.

There is a more detailed analysis of the solvency issue and related provisions on this site entitled *Solvency – Why is this an important issue for me? What should I do?*

Duties of directors

What then of other duties of directors? The common law duties apply. Those in force in the United Kingdom at the date of independence, namely 16th September 1975, were introduced by the constitution of the Independent State of Papua New Guinea. The general statutory duties are provided for, the precise statutory wording of those duties being different in detail.

However there are some differences in principle also. Whilst the duties referred to above are duties owed to the company, there are three nominated duties which have the special characteristic of being owed to shareholders individually. Without necessarily denying to the company the opportunity to enforce them, the statute gives individual shareholders right of action against directors for breach. The three duties are:

- duty to maintain the share register (section 70);
- duty to disclose interests (section 118); and
- duty to disclose share dealings (section 126).

When addressing the topic of duties, the Act has confronted the difficult issue of nominee directors. In some other jurisdictions, the legal position ignores commercial reality. The difficulty is confronted directly in section 112 which sets out the situations in which a nominee director may act in what he or she considers to be the best interests of the nominator rather than the company itself, and in section 123 which sets out the circumstances in which company information may be disclosed to the nominator.

Director appointment and remuneration

The statutory constitution does not define the term for which a director is appointed on incorporation or for which he or she is elected subsequently, nor any maximum period for which he or she may hold office without the requirement of re-election. Once a director, he or she holds office until terminated in a manner set out in the constitution, if any, or in the Act.

The provisions mentioned above in relation to disclosure take the place of the 'related party transactions' provisions in Australia.

Furthermore, the statutory constitution vests the power to determine the remuneration of directors, in the absence of contrary provision in an adopted constitution, in the directors themselves.

Shareholder rights and duties

There is, in section 89, a statutory codification of the common law doctrine of informal assent (*re Duomatic Ltd* [1969] 2 Ch 365, *re Compaction Systems Pty Ltd* [1976] 2 NSWLR 477), namely that unanimous agreement of all shareholders validates an action, notwithstanding any provision in the constitution. The trade-off is that shareholders may be personally liable to the company if, as a result of such action, the company becomes insolvent.

Shareholders collectively do not enjoy the certainty of control over their directors that is afforded in other jurisdictions. Shareholders may remove a director or directors by ordinary resolution where appropriate notice is given, but to do so there must, of course, be a general meeting. Such a meeting may be called at any time by the board or by a person authorised by the constitution to do so, and must be called by the board on written request of shareholders with 5% of the vote. But if the board fails to do so, the remedy – found in other jurisdictions – of allowing the requisitioning members to call the meeting does not exist. The only remedy of the shareholders is to apply to the National Court for an order convening the meeting.

However it is in the area of individual rights that shareholders of PNG companies benefit.

A shareholder, or a person authorised by him or her, has the right to inspect the records of the company identified in section 164.

There is in section 219 a statutory right to require the company to provide information specifically requested. The only grounds on which the company can refuse to provide the information are:

- the shareholder fails to pay the fee reasonably requested; or
- the disclosure of the information would prejudice a commercial position; or
- the request is frivolous or vexatious.

A minority shareholder who is disaffected by the outcome of a special resolution that:

- varies the constitution of the company by imposing or removing a restriction;
- approves a major transaction; or
- approves amalgamation,

and who exercised his vote against the resolution, may require the company to purchase his or her shares. The price is determined, in the absence of agreement, by an arbitrator nominated by the court. However the court has power to exempt the company from the purchase in circumstances which threaten the company.

Record keeping

The records which the company must maintain for at least seven years and make available for inspection by shareholders are listed in section 164 and include the additional certificates and the interests register already noted. A shareholder may require that a copy of such record(s) be sent to him.

The records must be at the registered office, unless notice has been filed with the Registrar of another place for keeping and inspection.

These are in addition to the accounting records which must be kept and the financial statements which must be prepared

Accounting and reporting requirements

The financial year in PNG is the calendar year.

In addition to accounting records, the Act requires that the financial statements prepared by the company comply with Generally Accepted Accounting Practice. This is defined to include:

- applicable financial reporting standards; and
- where there is no applicable standard or rule of law, accounting policies that are appropriate to the circumstances of the company and have authoritative support within the accounting profession in PNG.

International Accounting Standards have been adopted by the Accounting Standards Board to this end.

If financial statements in accordance with GAAP do not give a true and fair view, the company is to give additional information and explanation.

Required financial statements are:

- balance sheet;
- in the case of a company trading for profit, a profit and loss statement, or in the case of a company not trading for profit, a statement of receipts and expenditure;
- a cash flow statement where required by applicable accounting standards. These do not require a cash flow statement in the case of an 'exempt' company.

If the accounting records are not held at the registered office, notice of other location must be given to the Registrar.

The deadline for the annual report to shareholders is not more than five months from balance date. In addition to the usual information, financial statements and audit report (if any - as to which see below) the report must include:

- particulars of entries in the interests register made during the period;
- the total remuneration and value of the benefits received by directors or former directors during the year; and
- the number of employees or former employees who received remuneration and other benefits in excess of K100,000, disclosed in K10,000 brackets.

The annual return is to be lodged within 14 days of the AGM or 14th July at the latest. Financial statements must be attached unless it is an 'exempt' company (see below). As previously noted, the information required is extensive, including disclosure of the values of assets and of liabilities at the balance date (relevant to the second test of solvency) and a declaration, made pursuant to a resolution by the Board, of solvency and of the other matters declared in Item 29 of the return.

Simplified accounting and reporting

Simplified accounting and reporting is available as follows:

- An audit is not required in the case of an exempt company (section 190).
- No annual report at all is needed in the case of an exempt company if every shareholder has given written notice waiving the right to an annual report (section 209).
- The annual report need not be sent to a shareholder who has given written notice waiving the right to receive a copy (section 210), but in this case a copy of the financial statements (and audit report, if any) must still be provided (section 211). A shareholder may in writing waive the right to receive any or all other documents from the company (section 213).

- An exempt company is not required to prepare a cash flow statement or comply with these accounting standards:
 - o IAS 7 cash flow statements
 - o IAS 12 accounting for tax on income
 - o IAS 27 consolidated financial statements and accounting for investments in subsidiaries
 - o IAS 32 financial instruments: disclosure and presentation.

The definition of an exempt company has three limbs. Firstly, the company is exempt if it has not, during the period, had:

- total assets exceeding K5 million; or
- more than 25 shareholders; or
- more than 100 employees.

Alternatively, it is exempt if every shareholder has agreed that an auditor should not be appointed and the company complies with one or two (but not all three) of those conditions.

Thirdly, a subsidiary of an exempt company is itself an exempt company.

Some companies cannot qualify as exempt, principally an 'issuer' (one that has issued securities pursuant to a prospectus) and an overseas company. A company cannot be exempt if it is a subsidiary of either an issuer or an overseas company or a subsidiary of a company that is not exempt.

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