

Directors and Their Duties



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The duties of Directors have been codified in the 1993 Act are briefly discussed.

1. Definition of a Director

The statutory definition of a Director includes not only those persons expressly nominated as such, but also for the purposes of determining matters such as Directors duties, the statutory definition embraces other parties who have significant control or influence over the Companies affairs, giving rise to a "directorial capacity".

2. Qualification, Appointment, and Removal of Directors

i) Single Director Permitted

Under the 1993 Act a Company only requires one Director. (*Section 150*)

ii) Director's Qualifications

A Director must be a natural person. (*Section 151 [3]*)

To qualify for appointment as a Director, a natural person must not be disqualified by reason of:

- Age (must be over 18);
- An undischarged bankrupt;
- A prohibited person by virtue of the 1955 Act, or the 1993 Act;
- Any person not qualified under the Company's Constitution. (*Section 151 [2]*)

Even where a person is disqualified from being a Director but acts as a Director, for the purposes of the statutory provisions which impose duties or obligations on the Director, that person will be subject to these provisions. (*Section 152*)

iii) Appointment

Prior to appointment, a Director must consent to act in this capacity and certify that he or she is not disqualified from appointment. The consent to act must be given in the prescribed form – refer Form 10. (*Section 152*)

iv) Removal / Resignation

Subject to the Company's constitution, Directors may be removed from Office by way or an ordinary resolution passed at a meeting called for the purpose, or including this purpose. The notice of meeting must state that the purpose of the meeting (or one of the purposes) is the removal of the Director. (*Section 156*)

A Director will cease to hold office where he or she:

- Elects to resign in accordance with the statutory procedure; or
- Is removed from office in accordance with the statutory provisions or the Company's constitution; or
- Upon becoming disqualified; or
- Dies; or
- Otherwise vacated office in accordance with the Company's constitution. (*Section 157 [1]*)
- Where a Director voluntarily resigns, this is effected by giving a written notice of resignation, which must be delivered to the Company's address for service. The notice will take effect on the date received, or at a later date if specified in the notice. (*Section 157 [2]*)

v) Liability of Former Director

Notwithstanding their resignation, a former Director remains liable under the 1993 Act in relation to all matters, including acts or omissions and decisions made, whilst that person was a Director. (*Section 157 [3]*)

vi) Change in Directors

Where a change in Directors occurs, the following procedures must be observed:

- A notice must be given to the Registrar, in the prescribed Form 11;
- Any change in a Director's residential address must be provided to the Registrar in the prescribed form;
- The notice must specify the date of the change;
- The notice must include the full name and residential address of every Director in office following the date of the notice;
- Where a new Director is being appointed, a requisite form of consent and certificate from the incoming Director must be attached to the notice;
- The notice must be delivered to the Registrar within twenty working days of the change occurring or within twenty working days of the Company first becoming aware of the change where it occurs by virtue of a death or disqualification of a Director. (*Section 159*)

vii) Validity of Director's Acts

A Director's actions will be valid, and therefore binding upon the Company, even though the individual's appointment was defective or the individual was not qualified for appointment as a Director. (*Section 158*)

3. Remuneration of Directors

Subject to the Company's constitution, the Board is empowered to authorise the payment of remuneration (including ordinary Director's fees and other benefits, compensation for loss of office, loans, and other financial assistance) to a Director, for services as a Director or in any other capacity. Prior to authorising any remuneration, the Board must be satisfied that the arrangement is "fair" to the Company. *(Section 161 [1])*

Any remuneration arrangements pertaining to Directors must have the relevant details entered in the "Interests Register". *(Section 161 [2])*

Those Directors voting in favour of the remuneration arrangements are required to sign a certificate stating that, in their opinion, the making of the payment or the provision of the other remuneration benefits is fair to the Company, and the grounds for that opinion must be expressly stated. *(Section 161 [4])*

Remedial actions exist which are available to the Company where a payment of benefit is provided to a Director and reasonable grounds did not exist for the opinion set out in the certificate as to the fairness of the arrangement. For example, any loan made to a Director becomes immediately repayable notwithstanding any agreement to the contrary, if it can be shown that the statutory procedures have not been complied with, or reasonable grounds did not exist for believing that the arrangement was "fair" to the Company, unless the recipient Director can prove that the loan was in fact fair to the Company at the time it was given. *(Section 161 [5] and [6])*

4. Director's Indemnity and Insurance

The 1993 Act permits, within defined circumstances, a Company to indemnify or insure its Directors or employees in respect of certain liabilities which may arise as a consequence of their role on behalf of the Company.

Specifically, a Company may indemnify its Directors or employees in respect of costs incurred in any proceeding relating to any alleged liability for any act or omission occurring in their capacity as a Director or employee, however such action must be expressly authorised in the Company's constitution and the judgement must be given in favour of the Director or employee. *(Section 162 [3])*

Indemnity may also be given, if expressly authorised by the constitution, for, in the case of a Director, a breach of the duty to act in good faith and in the best interests of the Company, and in the case of an employee, a breach of any fiduciary duty to the Company, so long as these breaches do not result in criminal liability. *(Section 162 [4])*

Insurance may also be provided, if expressly authorised by the constitution and with the prior knowledge of the Board, in respect of the following matters:

- Liability, not being criminal, for any act or omission when acting in the capacity of a Director or employee; or
- Costs incurred in defending any claim; or
- Costs incurred in defending any criminal proceeding in which the Director or employee is acquitted. *(Section 162 [5])*

Directors voting in favour of authorising insurance must sign a certificate stating that, in their opinion, the cost of effecting the insurance is fair to the Company. *(Section 162 [6])*

The particulars of any indemnity or insurance given must be recorded in the Interests Register. *(Section 162 [7])*

5. Director's Duties

Whilst the decision to codify the duties of Directors presents a departure from the 1955 Act, the reality in terms of the practical obligations of Directors has remained largely unchanged from the previous law, founded largely in common-law and some statutory provisions that existed in the 1955 Act.

Set out below is a brief summary of the statutory duties imposed on Directors under the 1993 Act.

i) Duty to Act in Good Faith

Director must, when exercising powers or performing duties, act in good faith. *(Section 131)*

This is an objective test, and largely focuses on the Director's state of mind, which will generally be inferred from surrounding items of evidence, including oral and written communication, other documentation, and of course the Director's own actions.

ii) Duty to Act in the Best Interests of the Company

There is a general duty upon Directors to act in what the Director believes to be the best interests of the Company. *(Section 131)*

Note that this is a subjective test, and that the standard is the Director's belief as to what comprises "best interests", rather than an objective test on this point.

iii) Directors' Powers Must be Exercised for a Proper Purpose

Directors must exercise their powers or functions, whether provided under the 1993 Act or the Company's constitution for a proper purpose. *(Section 133)*

iv) Directors' Duty to Comply With the 1993 Act and the Company's Constitution

Director must not act, or allow the Company to act, in any manner which contravenes the 1993 Act or the Company's own constitution. (*Section 134*)

v) Duty Not to Allow Reckless Trading

Director must not:

- Agree to the Company's business being conducted in a manner likely to create a substantial risk of serious loss to the Company's creditors. (*Section 135*)
- This duty involves various elements. First, the Director must not agree, cause, or allow to continue, the "reckless trading". Reckless trading (the term used in the 1955 Act) is now defined as carrying on business in a manner likely to create a "substantial risk" of "serious loss" to the Company's creditors. The key elements which must be present to establish reckless trading are:
 - A causal link so that the conduct is *likely* to create loss; and
 - Substantial risk; and
 - Potential for serious loss.

In other words, reckless trading will only exist where there is a causal relationship between the Director's conduct and the risk of loss to creditors. The risk be substantial, and not merely a remote possibility, but it need not be probable either. The extent of potential loss must be serious, rather than minor.

vi) Duty Not to Incur Obligations Unless they can be Performed

This duty is also an amended version of a similar requirement which previously existed in the 1955 Act. A Director must not agree to a Company incurring an obligation unless that Director believes, when the obligation is entered into, on reasonable grounds, that the Company will be able to perform the obligation when it is required to do so. (*Section 136*)

vii) Director's Duty of Care

Directors have always owed a duty of care when undertaking their role, however, this has been tightened by referencing the standard of care of what would be expected of other Directors, rather than by judging their conduct against the standard "ordinary person" test.

The key features of this duty are that the level of care, diligence, and skill is judged by reference to what a reasonable Director would do, and moreover, the test must be assessed in the light of the particular circumstances, taking account of the Company's position, the specific decision involved, and the Director's own position and responsibilities.

6. Director's Reliance on Information

Directors, for the purpose of carrying out their duties or exercising powers in relation to a Company, are entitled to rely on the following information:

- Reports, statements, financial data, and other information prepared by an employee of the Company.
- Professional or expert advice supplied by an appropriately qualified professional advisor or expert in relation to matters.
- Information provided by any other Director or committee of Directors.

Note however, that the Director is only entitled to rely on such information when the Director is acting in good faith, undertaking proper enquiry's that are warranted by the circumstances, and the Director has no knowledge that reliance on the information is unwarranted (for example if the concerned was in fact incompetent).

7. Use of Company Information

Any Director (or employee) who possesses information that would not otherwise be available except by virtue of that person's capacity as a Director (or employee) must not disclose the information or use the information except for the Company's purposes, or as required by law, or in accordance with limited statutory exception. (*Section 145*)

A Director is also permitted to disclose and utilise Company information providing that particulars of the disclosure and use of information have been entered in the Interests Register, and the Director has been authorised to use this information by the Board, and disclosure and use of the information is unlikely to prejudice the Company's position. (*Section 145 [3]*)

8. Transactions Involving Self-Interest

A Company Director will be treated as having an interest in a transaction to which the Company is party if the Director:

- Is party to, will, or may derive a material financial benefit from the transaction; or
- Has a material financial interest in another party to the transaction; or
- Is a Director, Office, or Trustee of another party with a material involvement in the transaction, other than the Company's parent (where the Company is a wholly-owned subsidiary), or a wholly-owned subsidiary of the Company, or a sister Company that is wholly-owned by the Company's parent or;
- Is a close relative (parent, child, or spouse) of another party with a material financial interest in the transaction; or
- Is otherwise directly or indirectly materially interested in the transaction. (*Section 139[1]*)

A Director will not be regarded as being interested in a transaction which comprises only the provision of security by the Company to a third party in relation to a debt obligation of the Company's which has been personally guaranteed by that Director. (*Section 139 (2)*)

It is apparent that the statutory definition of "interested" is extremely wide, and essentially catches any situation where a Director has a material interest, either as an owner, director, or by way of the derivation of a financial benefit, whether actual or contingent, which has some connection with the transaction or the parties to the transaction. There is a materiality threshold and a Director will only be regarded as being "interested" where the Director's interest is of a material nature, however, what amounts to material will need to be assessed in any given situation.

Director's are under a statutory obligation to disclose details of any interest in a transaction or proposed transaction in the Company's "Interests Register" as soon as they become aware that they are interested. (*Section 140 [1]*)

Where there is more than one Director, then the interested Director must also disclose the monetary value of their interest (if capable of quantification) as well as the nature of their interest.

It is possible for Directors to make general disclosures as to their interest in other parties, by way of having these noted in the Interests Register and disclosed to the Board. This form of notification will provide sufficient disclosure of interest in relation to any further transaction involving that named party in which the Director is interested. (*Section 140 [2]*)

Failure by a Director to comply with the disclosure provisions where they are interested in a transaction does not impair the validity of the transaction per se. (*Section 140 [3]*)

Unless a Company's constitution provides otherwise, a Director who is interested in a transaction is entitled to vote on the matter, and attend meetings of Directors where the matter is discussed, and may execute documentation relating to the transaction or attend to any other matters in relation to the transaction, as if they were not interested. (*Section 144*)

9. Share Dealings By Directors

A Director who purchases or sells a "relevant interest" in shares issued by the Company must, immediately after the purchase or sale, provide the following disclosures to the Board and ensure that the same particulars are entered in the Interests Register:

- The number and class of shares in which the relevant interest has been acquired or sold;
- The nature of the relevant interest;
- The consideration paid or received;
- The date of acquisition or disposal.

Where a Company presently registered under the 1955 Act re-registers under the 1993 Act, a Director with a relevant interest in any shares on issue at the time of re-registration must, immediately after re-registration, disclose to the Board the number and class of shares in which they hold a relevant interest, the nature of their relevant interest and ensure that these details are recorded on the Interests Register. *(Section 148)*

The 1993 Act contains a detailed definition of what comprises a “relevant interest” for the purposes of the provisions relating to dealings and shares by Directors. A Director will be regarded as having a relevant interest in share if the Director:

- Is a beneficial owner of the shares;
- Has an ability to exercise the voting rights attaching to the shares;
- Can control the exercise of voting rights attaching to the shares;
- Has the power to acquire or dispose of the shares;
- Has power to control the acquisition or disposal of the shares;
- Has an ability to enjoy any of the above by virtue of any trust, agreement, or arrangement etc. *(Section 146 [1])*

There is also tracing provisions to ensure that any indirect interests are attributed back to a Director as a “relevant interest”. *(Section 146 [2])*

Relevant interests that arise solely by virtue of ordinary business dealings, such as the lending of money and taking of security over shares, or the business of share broking, or by virtue of a proxy arrangement solely instituted for a particular shareholders’ meeting, are excluded from the definition of “relevant interests”.

10. Restrictions on Directors’ Share Dealings

Where a Director has information received in his/her capacity as a Director which would not otherwise be available, and this information is material to an assessment as to the value of shares, then a Director may only acquire or dispose of shares if:

- In the case of an acquisition, the consideration is not less than the fair value of the shares;
 - In the case of a disposition, the consideration is not more than the fair value.
- (Section 149 [1])*

Fair value of shares is to be determined on the basis of all information known to the Director or publicly available, at the time of the transaction. *(Section 149 [2])*

Where a Director purchases shares in contravention of these provisions, the Director will be liable to the Vendor for any shortfall between the actual consideration and the fair value. Conversely, where a Director sells shares in contravention of these provisions, the Director will be liable to the purchaser to repay the amount by which the consideration received exceeded the fair value of the shares. *(Section 149 [4] and [5])*

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