

# Director's Duties

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*PRESENTED BY:*

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# Outline

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1. Overview of duties company directors subject to:
  - Where are they are found?
  - Who they are owed to?
  - Who is caught by these duties?
  
2. What constitutes a breach of duty and what are the potential consequences in an insolvency situation?
  
3. Summary

# Director's duties – Where?

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- Companies Act 1993
  - Duties of an administrative nature (e.g. s 90 Directors' duty to supervise share register)
  - Fiduciary duties (previously common law duties now codified) – sections 131 – 149
  - Criminal provisions
- Constitution
- Contract

# Who are the duties owed to?

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- Company
  - The duty to act in good faith in the best interests of the company (s131)
  - Duty to exercise powers for proper purpose (s133)
  - Duty not to trade recklessly (s135)
  - Duty not to agree to incur certain obligations(s136)
  - Duty to exercise care, diligence and skill (s137)
  - Duties in relation to the use of company information (s145)

# Cont.

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- Shareholders and the Company jointly
  - Duty to supervise share register (s90)
  - Duty to disclose interests (s140)
  - Duty to disclose share dealings (s148)
- Duties (e.g. reckless trading) not owed to creditors of the Company

# Who can bring a civil claim?

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- Shareholders – for any duties owed personally
- The Company – for any duties owed to the company
- Issue - If the duties are predominantly owed to the Company, who can bring a claim for breach of duty?
  - Shareholders by way of a derivative action
  - Company (in liquidation):
    - Liquidators, potentially funded by a creditor
    - Creditors (section 301)

# Who is a director?

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## Companies Act, section 126:

- a person occupying the position of director of the company by whatever name called
- a person in accordance with whose directions or instructions a company director (or board) may be required or is accustomed to act
- a person who exercises or who is entitled to exercise or who controls or who is entitled to control the exercise of powers which, apart from the constitution of the company, would fall to be exercised by the board

# What constitutes a breach of duty?

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Section 131 - Duty to act in good faith and in best interests of company:

■ Three classic situations:

1. Acting for self-benefit or benefit of 3<sup>rd</sup> party
2. Failing to consider the interests of the company
3. Failing to take into account the interests of creditor



# Preferring own interests

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- The director must put his own interests (or the interests of a third party) ahead of the interests of the company for a breach to occur.
- Where an action benefits both the company and director (or a third party), that action may not amount to a breach of section 131

# Failure to act in best interests of the company

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- Key words – “what the director believes to be the best interests of the company”
- Subjective test – not subject to an objective assessment as to what is reasonable
- However:
  - A director may be in breach if he/she acted irrationally
  - *“There will be circumstances where the conduct is so clearly dishonest and detrimental to the interests of the company and its creditors, that one can discount the possibility that the director held a subjective belief that it was in the best interests of the company”*

*(Chris de Ruyter Painting Limited (in liq) v de Ruyter [2017] NZHC 1810 at [34])*

# Cont.

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- Required to turn mind to whether action is in best interests of individual company
- Using company to pursue personal agenda (e.g. in matrimonial disputes) = likely breach

# Failing to take into account the interests of creditors

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- Where a company is insolvent or nearing insolvency, the directors must consider the interests of creditors
- Assets transferred from distressed company to another company at undervalue, reducing the amount available to the creditors of the distressed company = breach
- Note - the duty under section 131 remains a duty to the company and not to creditors directly – not actionable by creditors until after liquidation (s301)

# What constitutes a breach of duty?

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## Section 135 – Reckless trading:

- Objective test applies – director’s subjective belief will not excuse a breach
- Focus - on the manner in which a company’s business is carried on, and whether that modus operandi creates a substantial risk of serious loss
- What is required when the company enters troubled financial waters is ... a “sober assessment” by the directors... as to the company’s likely future income and prospects (*Mason v Lewis*)
- If proper advice sought and relied on, a director may avoid liability

# What constitutes a breach of duty?

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## Duty not to agree to incur certain obligations (s136)

- Unless the director believes on reasonable grounds that the company will be able to perform the obligation when required
- Subjective/objective test – Reasonable prudent director
- Cannot claim ignorance of company affairs – it is not permissible to rely on another director to look after company finances

# What constitutes a breach of duty?

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## Duty of care (s137)

- Objective test based on what a reasonable director would do
- A failure to give any, or proper attention, to the interests of the company will amount to a failure to exercise care, diligence or skill : (*FAF Holdings Limited (in liq) v Bethune*)
- Reliance on proper advice may be sufficient to excuse a breach

# Consequence of formal insolvency

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- Personal recovery action against a director by a liquidator for breach of duty pursuant to section 301
- Practical issues:
  - Funding claim - the company will, inevitably have little to no assets
  - Can be funded by creditor/s
  - Recovery – does the director have any assets?
- Shareholder claim pursuant to section 301



# Consequence of formal insolvency

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- Creditor claim pursuant to section 301:
  - Ordinarily, the claim under s 301 for misapplication of company funds would result in restoration of those funds to company assets for distribution among all creditors
  - However, the section also provides the Court with a discretion on a creditor application to compensate the creditor directly
  - This order is generally held to be available when the liquidator takes no steps and the creditor begins proceedings at his or her own offence

# Compensation (s301)

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- Can claim on either a restitutionary or compensatory basis, but not both
- Compensatory loss is calculated based on the deterioration of its financial position between the date of the breach and the date of liquidation
- Onus on the director to prove that loss, or part of loss, would have occurred anyway

# Summary

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- Directors are subject to mandatory duties
- Duties cannot be ignored – to do so will amount to an actionable breach of duty
- A breach of duty opens a director up to personal liability for losses incurred as a result of breach, not just \$\$ received by the director
- Funding of claims against directors is a real issue