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Chapter 1

DIRECTORS: DEFINITION AND ROLE

A director is an essential component of corporate governance. Each director is placed at the apex of the structure of direction and management of a company. . . . The role of a director is significant as their actions may have a profound effect on the community, and not just shareholders, employees and creditors.[1]

¶101 Introduction

It is trite that a company is in law a person in its own right. But a company can operate only through its agents. Of these, as Middleton J noted in *Australian Securities and Investments Commission v Healey* above, the directors of the company are among the most visible and the most important.

The role of directors and our perception of them have changed markedly since the mid-nineteenth century, when the legislation permitting companies as we now know them was first introduced. To the Victorians, the director was an agent or trustee of the company.[2]

Traditionally, the link between shareholders and directors was direct and significant. The director was beholden to the shareholders for appointment to office, could readily be dismissed and was even obliged to follow the shareholders' directions in the management of the company.

By contrast, a feature of the large modern company is the schism between management (the directors) and ownership (the shareholders). Since the 1990s shareholders have lost, in practical terms, a significant portion of control. This loss of control is because there are either too many of them to act in unison, or because the institutional investors, such as the pension funds and insurance companies, have tended in general to take a non-interventionist role. However, in the wake of high profile collapses such as HIH Insurance, Worldcom, Enron, and Lehman Brothers, shareholders (particularly institutional shareholders) have become more active in pursuing their rights.

It is also no longer appropriate to think of directors simply as trustees. One reason is that directors are engaged to make decisions that frequently involve a high degree of risk. A trustee, on the other hand, must avoid placing trust funds at risk.

1. *Australian Securities and Investments Commission v Healey* [2011] FCA 717 at [14].
2. *The Bell Group Ltd (in liq) v Westpac Banking Corporation (No.9)* [2008] WASC 239 at [4371].

¶102 What law applies?

Company law is a complex mixture of rules derived partly from statutes and partly from case law as it has developed through decisions by the courts.

The Companies Act 1993

The statute that most directly affects directors is the Companies Act 1993 (Companies Act).

By the mid-1980s it had become apparent that the Companies Act 1955 was outdated and that company law in New Zealand was due for reform. In September 1986 the Minister of Justice asked the New Zealand Law Commission "to examine and review the law relating to bodies incorporated under the Companies Act 1955, and to report on the form and content of a new Companies Act". The Law Commission responded with the publication in June 1989 of a report entitled "Company Law: Reform and Restatement" to which was appended a draft Companies Act. The draft Companies Act was reshaped and expanded as it passed through the parliamentary process. Ultimately it was enacted as the Companies Act 1993 on 28 September 1993 and came into force on 1 July 1994.

All companies, whether incorporated before or after 1 July 1994, are governed by the Companies Act.

Other statutes

A number of other statutes relate to directors. The most significant of these are the Financial Reporting Act 2013 (formerly the Financial Reporting Act 1993, which continues to apply to some companies under transitional provisions) and the Financial Markets Conduct Act 2013 (replacing the Securities Act 1978 and the Securities Markets Act 1988 over a transitional period ending on 30 November 2016). The Secret Commissions Act 1910 also applies directly to directors. It prohibits advisers or agents from receiving rewards, gifts or commissions from third parties or having pecuniary interests in contracts, unless disclosed to the advisers' or agents' principal.

There are a number of statutes for specific types of companies, for example, the Co-operative Companies Act 1996 and the Port Companies Act 1988. These statutes are not discussed in detail in this book.

Case law

Statutory provisions are amplified by judgments that interpret and apply the statutory provisions to specific factual situations. The Companies Act contains comprehensive provisions relating to directors which were not contained in the Companies Act 1955. Nonetheless, interpretation of some of these provisions is difficult, and will become clear only after decisions of the courts give guidance as to their meaning.

Extralegal sources

Constraints on the way directors may act or on the appointment of directors are also found in extralegal sources. The most important of these for listed companies is NZX Limited's Main Board/Debt Market Listing Rules and the NXT Market Rules, replacing the NZX Alternative Market Listing Rules, which set out certain requirements that must be met if a company is to obtain and retain a listing on those stock exchanges. Listed companies are contractually bound by the stock exchange's listing rules (*New Zealand Stock Exchange v Listed Companies Association Inc and NZ Forest Products Ltd* (1984) 2 NZCLC 99,159 (also reported as *New Zealand Stock Exchange v Listed Companies Association Inc* [1984] 1 NZLR 699 (CA))).

¶103 Types of companies

The Companies Act 1955 distinguished between public and private companies. This was important for companies governed by the Companies Act 1955 because certain provisions of that statute were modified or excluded in the case of private companies.

The dichotomy between public and private companies is not found in the Companies Act. The Companies Act allows the creation of only one kind of company, although a large measure of flexibility (particularly for closely held companies) can be achieved by a particular company through careful drafting of its constitution.

¶104 The company's constitution

A company incorporated under the Companies Act is not required to have a constitution (s 26). Rather, the Companies Act itself has been devised to operate as a constitution. The Companies Act provides that if a company does not have a constitution, the company, the board, each director and each shareholder of the company has the rights, powers, duties and obligations set out in the Companies Act (s 28). Usually a company is best advised to incorporate with a constitution to achieve a corporate form that is closest to its own particular needs.

Not all companies have complete autonomy in devising their constitutions. The NZX Main Board/Debt Market Listing Rules prescribe, amongst other things, the contents of the constitution for listed companies.

Law: Companies Act 1993, ss 26, 28.

¶105 Incorporation

Section 10 of the Companies Act prescribes the following essential requirements for a company registered under the Companies Act:

- a name
- one or more shares

- one or more shareholders, and
- one or more directors, of whom at least one must:
  - ☐ live in New Zealand; or
  - ☐ live in an enforcement country and be a director of a company that is registered (except as the equivalent of an overseas company) in that enforcement country.

At the time of writing, the only enforcement country is the Commonwealth of Australia. These resident director requirements only came into force on 1 May 2015 and apply to companies incorporated on or after this date. Companies incorporated before the 1 May 2015 have an additional 180 days after 1 May 2015 (until 28 October 2015) to comply with these requirements.

The process of incorporation is now entirely electronic and begins with an application to the Registrar for reservation of a name for the company on the Companies Office website.[3]

Once the Registrar has approved the name, an application may be made for registration of the company. The application may be made by any person, although the applicant will usually be a shareholder or director. The application is made online and the details required in the prescribed form are submitted through the website.[4]

Details of the applicant(s), ultimate holding company, the director(s) and the shareholder(s) must be filled out. The details required include the class and number of shares taken by each shareholder. Directors of the proposed company will need to provide details of their date and place (town and country) of birth. This information will be kept confidential and not be made available to the public. Directors will also need to advise the Registrar if they are a director of any Australian incorporated companies and advise the name, ACN and address of the registered office of one of those companies.

Details of the new company's ultimate holding company must be provided:

a. the name of the ultimate holding company

b. the ultimate holding company's country of registration

c. the ultimate holding company's registration number or code (if any)

d. the registered office of the ultimate holding company.

3. www.business.govt.nz/companies/.
4. The Registrar has powers under s 360(4) to decide how to keep the register of companies. On 26 April 2002, the Registrar of Companies announced, in the *Gazette*, the change to electronic filing: Registrar of Companies, "Electronic Register of Companies", Notice 2808 (26 April, 2002) <www.dia.govt.nz/>.

An ultimate holding company is a body corporate that is a holding company (as defined in the Companies Act) and is not itself a subsidiary.

The following documents must accompany the application for registration (s 12(1)):[5]

- signed consents by all the directors to act as such and certificates stating that they are not disqualified from acting (Form 2)
- consents by shareholders to take the stated number of shares, signed by the shareholders or by their agents in writing. If the latter, an instrument authorising the agent to sign the form must be submitted (Form 3)
- the notice from the Registrar reserving the company's name (electronically stored by the Companies Office website), and
- if the company has a constitution, a copy of the constitution certified as such by an applicant for registration (electronically submitted).

If a proposed company will have directors or shareholders who are resident outside of New Zealand, the Companies Office has the discretion to ask for further information from such directors or shareholders such as proof of their residential address or a certified copy of their passport, in order to confirm their identity. As soon as the Registrar receives a properly completed application for registration, the Registrar must register the application and issue a certificate of incorporation (s 13). The company is then incorporated on and from the date of incorporation stated in the certificate (s 14(b)).

Law: Companies Act 1993, ss 10, 12(1), 13, 14(b).

¶106 Who is a director?

The definition of "director" is contained in s 126 of the Companies Act. For all purposes a director includes a person occupying the position of director of the company by whatever name called (s 126(1)(a)). In this way the Companies Act defines what the term director includes, not what it means.[6]

Sometimes, the definition of director is expanded, but for the purposes of certain provisions of the Companies Act only. In these cases, "director" includes:

- a shadow director (s 126(1)(b))[7]
- a delegate of the board (s 126(1)(c))

5. Submitted electronically.
6. *HLH Equity Trading Ltd v White* [2010] NZHC 1107, 24 May 2010, Lang J at [60]–[61].
7. For the purposes of this chapter "shadow director" is used to refer to all deemed directors under s 126(1)(b). See *Krtolica v Westpac Banking Corporation* [2008] NZCCLR 24 at [182]–[185] for definitions coming out of the case law.

- the controller of a person occupying a position of director of a company, a shadow director or delegate (for convenience referred to in this discussion as an "ultimate controller") (s 126(1)(d)), and
- a shareholder in certain circumstances (s 126(2) and (3)).

The rationale of the expanded definition of "director" is to apply key provisions of the Companies Act to those persons who effectively control the company and make them subject to the statutory duties of good faith and honesty, and they may be liable if those duties are breached.

Law: Companies Act 1993, s 126.

¶107 Person occupying position of director — de facto director

The hallmark of a de facto director is the willing assumption of the status and functions of a director.

The concept of de facto director at common law comes up in different contexts. Therefore, just what makes a person a de facto director has varied and the courts, rightly, have refused to define the term exhaustively. This makes sense in that the concept of de facto directorship is a "stop gap" of sorts for when de jure directorship is absent or defective and must therefore remain malleable. That being said the hallmark quality noted above must always be present. Directorship carries with it heavy burdens and liabilities and there is no satisfactory justification for the imposition of liability on a putative de facto director unless it is a consequence that is accepted by the voluntary assumption of office.

In *Revenue and Customs Commissioners v Holland* Lord Collins examined the history of the de facto director cases. His Lordship found that historically de facto director cases arose in the context of the validity of acts of persons who were not de jure directors. These persons were appointed as a director, but their appointment was defective in some way or had simply come to an end and they continued to act as a director.[8] However, starting in the 1980s cases in the context of director disqualification and "wrongful trading" looked to persons who were never appointed as directors, but rather were held to be part of the corporate governance of the company by their actions (ie persons who assumed functions/duties that were the sole responsibility of a director or the board of directors).[9] This his Lordship referred to as the modern law. Gradually, case law built up and elaborated on what this meant (discussed below). But Lord Collins stressed that the voluntary

8. *Revenue and Customs Commissioners v Holland* [2010] 1 WLR 2793 at [54], [64] and [72] regarding usurpation of office in absence of appointment.
9. Ibid and at [91].

assumption of office and its liabilities[10] must guide an inquiry into whether a person is a de facto director: otherwise there is no strong justification for the imposition on him or her of the particular duty, liability or disqualification. As his Lordship put it:

> . . . the assumption of office [is] a mark of a de facto director.

In the author's view, comparing the "historic" and "modern" cases is a little like comparing apples to oranges. As his Lordship pointed out, each arose in different contexts and that there is a defect in appointment in one and, potentially, an absence of appointment in the other is of little moment because the context differs and the legal issues differ.[11] It cannot be forgotten that finding a person to be a de facto director is not an end in itself; it is in aid of some other legal query. In the historic cases, that query was essentially the validity of putative de facto director's acts. In the modern cases, that query was what liability should follow from the putative de facto director's acts in binding the company to a transaction. It is not clear then why what a de facto director is has to be the same in each situation. Moreover, focussing on defective or absent appointment is likely to distract from the central query into the voluntary assumption of directorial office, whether by defective appointment or action absent appointment.

Nonetheless, to understand the New Zealand position on de facto directors, it is first necessary to briefly explain the development of the modern English cases. The cases often associated with the start of the modern approach are *In re Lo-Line Electric Motors Ltd*[12] and *Re Hydrodam (Corby) Ltd.*[13] In *Lo-Line* Sir Nicolas Browne-Wilkinson V-C, in the context of director disqualification proceedings,[14] held that the term "director" as used in the director disqualification provisions of the Companies Act 1985 (United Kingdom) included persons who were never appointed a director at all and simply acted as a director. This was on the basis that the section could not fulfil its purpose of public protection if merely by being a de facto director a person could avoid disqualification proceedings. In Hydrodam, Millett J held that a de facto director could be liable for wrongful trading.[15] Millett J said:

10. His Lordship also noted that it does not follow that "de facto director" must be given the same meaning in all of the different contexts in which a "director" may be liable ([2010] 1 WLR 2793 at [93]).
11. It is also not clear why a distinction between defective appointment and an absence of actual appointment should be determinative of the issue other than as an indicator of the voluntary assumption of office.
12. [1988] Ch 477.
13. [1994] 2 BCLC 180.
14. Under s 300 of the Companies Act 1985 (United Kingdom) (now s 6 of the Company Directors Disqualification Act 1986 (United Kingdom)), a person can be banned from being concerned in the management of a company, on the basis of their conduct as director of a company now in liquidation. The comparable Companies Act provision is s 385 (see also s 383).
15. Under s 214 of the Insolvency Act 1986 (United Kingdom), a director can be liable for such contribution as the court determines to the assets of the company in insolvent liquidation, where the director knew or ought to have known that there was no reasonable prospect that the company could avoid insolvent liquidation. The Companies Act equivalent would be s 301.

> Liability for wrongful trading is imposed by the [Insolvency Act 1986] on those persons who are responsible for it, that is to say, who were in a position to prevent damage to creditors by taking proper steps to protect their interests. Liability cannot sensibly depend upon the validity of the defendant's appointment. Those who assume to act as directors and who thereby exercise the powers and discharge the functions of a director, whether validly appointed or not, must accept the responsibilities which are attached to the office.
>
> A de facto director is a person who assumes to act as a director. He is held out as a director by the company, and claims and purports to be a director, although never actually or validly appointed as such. To establish that a person was a de facto director of a company it is necessary to plead and prove that he undertook functions in relation to the company which could properly be discharged only by a director. It is not sufficient to show that he was concerned in the management of the company's affairs or undertook tasks in relation to its business which can properly be performed by a manager below board level. A de facto director, I repeat, is one who claims to act and purports to act as a director, although not validly appointed as such.

Justice Millett also noted that de facto directors and shadow directors are alternatives and in most and perhaps all cases are mutually exclusive.

In the years following the judgment, numerous cases arose, usually in the director disqualification or wrongful trading area. In *Revenue and Customs Commissioners v Holland*, itself a case under the Insolvency Act 1986, Lord Collins discussed the history of the development of the case law. His Lordship noted that although Millett J used expressions such as "held out as a director" and "claims and purports to be a director" in expressing what a de facto director was, these were subsequently held to be relevant factors (ie evidentiary matters) and not necessary factors.[16]

Once the concept of de facto directorship was divorced from the unlawful holding of office the courts were left to the difficult task of identifying what functions were, in essence, the sole responsibility of a director or a board of directors. This question has often been recast by asking whether, taking into account all the circumstances of the case, the person was part of the company's corporate governing structure. "Corporate governance" meaning the system by which the company is directed and controlled.

Numerous evidentiary indicators have been suggested in the case law, but it has been emphasised that there is no single "test" by which a de facto director can be defined. In all cases, it will be a matter of fact and degree.[17] The factors and guidelines coming out of the English case law have been summarised below:

16. *Revenue and Customs Commissioners v Holland* [2010] 1 WLR 2793 at [89]–[90].
17. *Secretary of State for Trade and Industry v Tjolle* [1998] 1 BCLC 333, *Smithton Ltd v Naggar* [2014] BCC 482, *Revenue and Customs Commissioners v Holland* [2010] 1 WLR 2793, *Dairy Containers Ltd v NZI Bank Ltd; Dairy Containers Ltd v Auditor-General* (1995) 7 NZCLC 260,783; [1995] 2 NZLR 30.

- Was the person the sole person directing the affairs of the company (or acting with others all equally lacking in a valid appointment) or if there were others who were true directors, was the person acting on an equal footing with the others in directing the affairs of the company and not in a subordinate role?[18]
- Was there a holding out by the company of the person as a director, and whether the individual used the title? This is not necessary, but may support the finding that the person assumed the role of director.[19]
- Even if there was holding out, it is not sufficient. What matters is not what he called himself, but what he did![20]
- The perceptions of those dealing with the company can be of evidentiary significance, especially if independently formed, reasonable in the circumstances and support the appearance that the person was acting under the colour of office. Third party perceptions, though, cannot change the reality of the true character of the position in which the person acts.[21]
- Did the person have proper information (eg management accounts) on which to base decisions?[22]
- Was there an agreement, such as a joint venture agreement or shareholders agreement, recording the powers and/or expectations of the putative de facto director?[23]
- The court must look at the cumulative effect of the activities relied on. The court should look at all the circumstances "in the round". Nonetheless, it is also important to look at each act in its context. A single act may lead to liability in an exceptional case.[24]
- The fact that a person is consulted about directorial decisions or their approval does not in general make them a director because they are not making the decision.[25]

18. *Re Richborough Furniture Ltd* [1996] 1 BCLC 507 at 524; applied in *Revenue and Customs Commissioners v Holland* [2010] 1 WLR 2793 at [91].
19. *Secretary of State for Trade and Industry v Tjolle* [1998] 1 BCLC 333; applied in *Revenue and Customs Commissioners v Holland* [2010] 1 WLR 2793 at [91]. See chapter 5 as to the agency law implications of there being a holding out of a putative de facto director by the company.
20. *Gemma Ltd (in Liq) v Davies* [2008] BCC 812 at [40].
21. *Grimaldi v Chameleon Mining NL (No 2)* [2012] FCAFC 6 at [75], citing *Re Richborough Furniture Ltd* [1996] 1 BCLC 507 at 524 and 526.
22. *Secretary of State for Trade and Industry v Tjolle* [1998] 1 BCLC 333 at 343–344.
23. See generally *Smithton Ltd v Naggar* [2014] BCC 482 and see also *Delegat v Norman* [2012] NZHC 2358.
24. *Smithton Ltd v Naggar* [2014] BCC 482 at [40]–[41], but see generally [33]–[45].
25. Ibid at [43].

- Acts outside the period when he is said to have been a de facto director may throw light on whether he was a de facto director in the relevant period.[26]
- If it is unclear whether the acts of the person in question are referable to an assumed directorship, or to some other capacity such as shareholder or consultant, the person in question must be entitled to the benefit of the doubt.[27]

As a general point, the Full Court of the Federal Court of Australia, in *Grimaldi v Chameleon Mining NL (No 2)* noted that the central question (was the person acting as a director) had the capacity to mislead the inquirer. Namely, the question suggests that the duties and functions that can only be performed by de jure directors are capable of being set out in advance of inquiry. While this may be possible for functions set out in the constitution or the Companies Act, it is not so with respect to the board's most fundamental of functions: the management of the business of the company.[28] While this may vary in fact from company to company, the role of the board cannot be forgotten. The board must guide and monitor the affairs of the company with the knowledge they ought to have of the company's affairs. In this regard, there is a significant difference between a board assigning responsibility for day to day running of certain activities and formally delegating collective responsibility for decision making in those areas. The inquiry could be put as looking for the difference between making decisions that guide the affairs of the company and merely executing those decisions. It is on the decision makers that the legislation places liability. Justice Millett's comments in *Hydrodam*, that it is insufficient for a putative de facto director to be concerned in the management of the company's affairs should be understood in that light.

Finally, it is worth remembering Jacob J's guidance in *Secretary of State for Trade and Industry v Tjolle*:

> Taking all these factors into account, one asks "was this individual part of the corporate governing structure", answering it as a kind of jury question. In deciding this, one bears very much in mind why one is asking the question. That is why I think the passage I quoted from Millett J is important. There would be no justification for the law making a person liable to misfeasance or disqualification proceedings unless they were truly in a position to exercise the powers and discharge the functions of a director. Otherwise they would be made liable for events over which they had no real control, either in fact or law.
>
> [The plaintiff] says there are no different rules for de facto directors as opposed to de jure directors. I think that must be right, but I think it follows that someone who has no, or only peripheral knowledge of matters of vital company concern (e.g. financial state) and has no right, legal or de facto, to access to such matters is not to be regarded by the law as in substance a director.

26. Ibid at [44].
27. *Re Richborough Furniture Ltd* [1996] 1 BCLC 507 at 524, *Gemma Ltd (in Liq) v Davies* [2008] BCC 812 at [40], *Elsworth Ethanol Co Ltd v Hartley* [2014] EWHC 99 at [54].
28. *Grimaldi v Chameleon Mining NL (No 2)* [2012] FCAFC 6 at [70].

The New Zealand position

The High Court, in *Delegat v Norman*, noted that s 126 distinguishes between de facto directors and shadow directors.[29] Justice Woolford noted that s 126(1)(a) describes a de facto director who occupies the position of a director notwithstanding that he or she has not been validly appointed as such. A de facto director is one who is held out by the company and purports to act as a director.

This should not be taken as a conclusive judicial statement that s 126(1)(a) incorporates within the term "director" de facto directors for all purposes under the Companies Act. Section 126(1)(a) defines, albeit inclusively, what a director is for all purposes under the Companies Act. It, therefore, goes beyond cases of liability in corporate insolvency and director disqualification, being the areas where it can be concluded that the legislature intended de facto directors (in the sense of Lord Collins' modern understanding of that term) to be liable.[30] In this respect, it is important, that the case was brought under s 301 of the Companies Act (under which "directors" can be made liable for the outstanding liabilities of a company where it is in liquidation). So the case is better understood as standing for the proposition that s 126(1)(a) includes de facto directors, where liability under s 301 is being considered (or simply that s 301 applies to de facto directors).[31] To extend the position beyond this, without some context, would result in undesirable outcomes (eg sections relating to quorum of directors) and would leave some provisions of the Companies Act redundant (eg s 158). In aid of this view, it is worth noting that the judgment did not analyse, nor did it need to analyse, case law which in some circumstances includes de facto directors in s 126(1)(a)[32] and case law suggesting that s 126(1)(a) as drafted was intended to deal with nomenclature and preferring instead to consider the relevant duty or liability provision.[33]

In the author's view, it is consistent with authority that de facto directors can be included in s 126(1)(a). As s 126(1)(a) applies for all purposes, a "de facto" director

29. See ¶108 below on shadow directors.
30. *In re Lo-Line Electric Motors Ltd* [1988] Ch 477, *Re Hydrodam (Corby) Ltd* [1994] 2 BCLC 180, *Revenue and Customs Commissioners v Holland* [2010] 1 WLR 2793.
31. It is clear from s 126(1)(b) and s 126(1)(c) that the legislature intended persons other than de jure director to be caught by s 301. Further, the purpose of 301 would be frustrated if persons who were responsible for liquidation in that they were in a position to prevent it, could escape liability simply by lacking valid or actual appointment.
32. *Clark v Libra Developments Ltd* [2007] 2 NZLR 709. On the facts of the case, the Court of Appeal concluded that irrespective of a person's disqualification by bankruptcy, that person could still occupy the position of a director as there was no one else who could. See also *HLH Equity Trading Ltd v White* [2010] NZHC 1107, Lang J at [58]–[65]. Note that Lang J was considering the Securities Act 1978. See too *Bobs Cove Developments Ltd v Strategic Nominees Ltd* [2010] NZHC 640, Associate Judge Gendall, at [20] and *Ng v Harkness* [2014] NZHC 1667 at [15].
33. *In re Lo-Line Electric Motors Ltd* [1988] Ch 477. Here the Court held that the definition of director can vary depending upon the context in which it is found and in the context of the disqualification provisions in s 300 of the Companies Act 1985, the term director included "de facto" directors.

should be a person who voluntarily assumes the office of director (ie a de facto director in the modern sense). It would not make sense to impose the duties and liabilities of directorship on someone who did not accept them. However, for this to be workable within the scheme of the Companies Act, in any given situation it should (i) be shown that the legislative intent was to impose directors' duties and liabilities on a person other than a de jure director and (ii) s 126(1)(a) be read so as to apply only to the section(s) imposing those duties and liabilities on the de facto director. Alternatively, this could be simplified so as to only consider the provision imposing the relevant duty or liability. It is submitted that this approach is consistent with the approach in *Hydrodam, Lo-Line, Tjolle, Clark v Libra and Holland*.[34]

In the context of the Companies Act, the need to resort to the above analysis is likely to be limited. As will be explained further on in the chapter, s 126(1)(b)(iii) and 126(1)(c) are broad and will capture most types of de facto director. Indeed, in some respects, those sections would encompass more individuals than the modern de facto director concept.[35] However, in circumstances where this is not the case, it may be important to have the option of using s 126(1)(a) in the way mentioned above.[36]

Turning now to the definition of de facto director suggested in *Delegat v Norman*. The definition used largely follows from *Hydrodam* and *Re Richborough Furniture Ltd* (the latter case though was not cited in the judgment):[37]

> [31] . . . the central question is whether [the defendant] had assumed the status and functions of a director even though he was *not actually appointed* as such. The concept of de facto director *is confined* to those who willingly or voluntarily take upon themselves the role, either by usurping the office or by continuing to act once their formal role has ceased. It does not extend to a person who does not willingly adopt the role of director.
>
> [32] . . . in order to establish that a person is a de facto director of a company, it is necessary to plead and prove that:
>
> - he or she undertook functions in relation to the company that could properly be discharged only by a director. There needs to be clear evidence that the person was either the sole person directing the affairs of the company or if there were others who were true directors that he or she was acting on an equal footing with the others in directing the affairs of the company.
> - If it is unclear whether the acts of the person are referable to an assumed directorship or to some other capacity, such as shareholder or consultant, the person must be entitled to the benefit of the doubt.
>
> [Emphasis added and format changed slightly.]

Four observations can be made.

First, in contrast to the introductory remarks noted at the start of this section, paragraph 31 refers to a lack of actual appointment as opposed to mere lack of valid appointment. As noted above, this is what Lord Collins would refer to as the distinction between the historic and the modern cases. Given the present case focuses on liability, the distinction is of no moment.

Secondly, although the introductory classification refers to a de facto director as "one who is held out and purports to act as a director", this does not feature in the test above. This is consistent with the modern English position, where being held out or purporting to act as a director is not necessary and is an evidentiary matter to the central question.[38] In this context of determining the liability on de facto directors, it is submitted that this is correct.

Thirdly, the test looks to the person's intentions; their actions are evidentiary indications of that intent, not a substitute for it. The evidence suggested as showing that intent comes from guidance offered by the English courts (see above as to other factors that may be relevant). In the author's view, the "clear evidence" to be sought is not intended to be exhaustive and indeed courts in New Zealand, Australia and the United Kingdom have cautioned against this.[39]

34. Note also Lord Collins' observation in *Revenue and Customs Commissioners v Holland* [2010] 1 WLR 2793 at [93] that the term "de facto director" need not be given the same meaning in all the different contexts in which a "director" may be liable.
35. As Professor Watts notes, the broad scope of s 126(1)(c) means compliance with the "strictures" in *Re Hydrodam (Corby) Ltd* [1994] 2 BCLC 180 is unnecessary: Peter Watts *Directors' Powers and Duties* (2nd Edition, LexisNexis NZ Ltd, 2015), at 13.
36. This is particularly important given that s 126(1)(b)(iii) is limited to only directorial powers that are given to individuals by way of the constitution: see *Fatupaito v Bates* (2001) 9 NZCLC 262,583; [2001] 3 NZLR 386 and *Arcadia Homes Ltd (in liq) v More to this Life Ltd* [2013] NZCA 286 at [41]. An alternative interpretation may have been that this provision was intending to capture common law de facto directors. This could follow by arguing that the proviso's purpose was to ensure that, irrespective of how it may be varied by the constitution (under ss 128(3) and 109(3)), any person who exercises powers that by default belong to directors under s 128 of the Companies Act is a deemed director for liability purposes. In this sense, the proviso would not be read as an empowering provision (ie by powers granted by the constitution) but rather as a measure preventing the reduction in the scope of the board's powers for the purposes of the section. Indeed in *Fatupaito v Bates*, O'Regan J noted that the definition of a de facto director *Re Hydrodam (Corby) Ltd* [1994] 2 BCLC 180 was broadly similar to the wording of s 126(1)(b)(iii). This interpretation would also lend support to the argument that s 126(1)(a) should only apply to de jure directors.
37. *Delegat v Norman* [2012] NZHC 2358 at [31]–[32].
38. *Revenue and Customs Commissioners v Holland* [2010] 1 WLR 2793, *Gemma Ltd (in Liq) v Davies* [2008] BCC 812.
39. *Gemma Ltd (in Liq) v Davies* [2008] BCC 812, *Re Richborough Furniture Ltd* [1996] 1 BCLC 507 at 524.

Fourthly, paragraph 31 states correctly, in the author's view, that the concept of de facto directorship is confined to those who willingly take on the role.[40] While this characteristic of de facto directorship must always be present, the extract does not set out the circumstances in which a de facto director at common law is a director under s 126(1)(a). That is, by including an inclusive definition within an inclusive definition, its bounds are not set out. Consequently, for the reasons noted earlier, it should not follow that just because a person is a de facto director in the modern sense, that he/she should be a director for all purposes under s 126(1)(a) of the Companies Act as the dicta in paragraph 32 might imply. Rather the case should stand for the proposition that s 126(1)(a) includes de facto directors, where liability under s 301 is being determined. Given the reasoning for imposing liability on de facto directors in such cases, it is suggested the test adopted is correct.

¶108 Shadow director

The concept of a shadow director is included in s 126(1)(b). This extends the definition of director for the purposes of ss 131–141, 145–149, 298, 299, 301, 318(1)(bb), 383, 385, 385AA, 386A–386F and cl 3(4)(b) of sch 7 of the Companies Act. In this context, a director includes:

- a person in accordance with whose directions or instructions a person occupying the position of director may be required or is accustomed to act (s 126(1)(b)(i))
- a person in accordance with whose directions or instructions the board of the company may be required or is accustomed to act (s 126(1)(b)(ii)), and
- 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 (s 126(1)(b)(iii)).

A person who falls within any of these categories is not deemed to be a director to the extent that he or she is acting only in a professional capacity (s 126(4)).

In *Delegat v Norman*, Woolford J observed that s 126(1)(b)(i) and (ii) describe a shadow director who directs or instructs or has the power to direct or instruct the actions of an appointed director or the board of directors. A shadow director does not claim or purport to act as a director.

This statement was made in distinguishing de facto directors[41] from shadow directors. It was also based on the classification made by Millett J in *Hydrodam*. In

40. See *Revenue and Customs Commissioners v Holland* [2010] 1 WLR 2793, *Grimaldi v Chameleon Mining NL (No 2)* [2012] FCAFC 6; *Buzzle Operations Pty Ltd (in liq) v Apple Computer Australia Pty Ltd* [2011] NSWCA 109. See also Peter Watts *Directors' Powers and Duties* (2nd Edition, LexisNexis NZ Ltd, 2015) at 8.
41. See ¶107 above on de facto directors.

that case, Millett J expressly stated that de facto directors and shadow directors are alternatives and will in most and perhaps all cases be mutually exclusive. Subsequent cases have, however, found that such a rigid classification cannot be maintained. In *Holland* it was noted that this was a consequence of divorcing the concept of de facto directorship from the unlawful holding of office (if ever such a thing was required). This must be correct because a shadow director is a person that exercises directorial powers through conduits (ie de jure/de facto directors). It follows then that a shadow director could be a de facto director as through their actions they could be taken to voluntarily assume the office of director.

On an evidentiary level, this means looking at the putative deemed director's real influence in the affairs of the company as a measure of the actual role he/she had in it.[42] The greater the influence and the role of the person in the affairs of the company, the more likely it is that that person will have voluntarily assumed the office of director and, therefore, become a de facto director. At the same time where that influence or role is exercised through de jure and/or de facto directors, that person can become a shadow director. Therefore, a person can be a de facto director and a shadow director concurrently.[43]

In *Fatupaito v Bates*, O'Regan J held that s 126(1)(b)(iii) encompasses only those persons who by a provision of the company's constitution, are given powers that would otherwise have been exercised by directors. This reading appears to have been adopted by the Court of Appeal in *Arcadia Homes Ltd (in liq) v More to this Life Ltd*. The Court noted that s 126(1)(b)(iii) caught those people who are not directors but who have director's powers conferred on them by the company constitution.[44] It seems that while such a person may act as a shadow director (and therefore be caught under s 126(1)(b)(i)–(ii) as well), it is clear that this may capture common law de facto directors.

As a general point, it should be noted that in *Arcadia* the Court also noted that s 126(1)(b), and presumably the remaining parts of the section relating to deemed directors, is not an empowering provision. Its purpose is not to cut across the provisions of the Companies Act relating to appointment of de jure directors. The purpose, rather, is to hold persons acting in that manner accountable under the liability provisions of the Companies Act.

What falls for consideration next is the meaning of "direction or instruction", "accustomed to act" and "may be required". A brief treatment of directors of corporate deemed directors and third parties is also given.

42. See also *Grimaldi v Chameleon Mining NL (No 2)* [2012] FCAFC 6 at [69].
43. See also *Smithton Ltd v Naggar* [2014] BCC 482 at [32].
44. *Arcadia Homes Ltd (in liq) v More to this Life Ltd* [2013] NZCA 286 at [41]. However, the contrasting view of Gendall AJ in *Managh v Britton Built Ltd* [2012] NZHC 2949 was noted.

and inconvenient, and the case was not technically difficult. In *C of IR v DT Australia Ltd* [2013] NZHC 3387, the Court allowed the sole shareholder and director to appear for the company, given the simple nature of the proceedings in question, the legal training of the director (although he had never applied for a practicing certificate, he had a legal background) and as the director had sworn an affidavit in relation to the proceedings, no cross-examination of the director would be required.

But the Court refused permission in *Gold Medal Hortech Ltd v Edwards & Williams Greenhouses Ltd* (2001) 9 NZCLC 262,421. In that case, the managing director of the plaintiff company sought leave of the Court to represent the company, arguing that as a structural engineer he would be best placed to understand the technical issues arising in the case and that the company could not afford legal representation. The Court refused to grant leave holding that the case was complicated and that the Court would require assistance on legal issues that the director could not provide. Other reasons were that, in that case, it was essential to keep a clear distinction between evidence and argument, which the director would have found difficult, and that giving leave to the director to represent the company would have the effect of prolonging the case with cost to the other side.[29]

29. For further examples of where leave to appear sought by directors has been refused: *962149 Ltd v Hansen* [2014] NZHC 1884, *Chesterfields Preschools Ltd v C of IR (No 6)* (2012) 25 NZTC ¶20-147, *Wells v Verisure Investigations Ltd* [2012] NZHC 936.

Chapter 6

DUTIES

Responsibility, and thus liability, must lie with some human agency and it is over the entrances to boardrooms that [the Companies Act] has rightly painted:

"The buck stops here".[1]

¶601 Introduction

The comment above, from Owen J in *The Bell Group Ltd (in liq) v Westpac Banking Corporation (No 9)*, made as part of a general discussion of corporate governance and directors' duties, illustrates the gravity of accepting an appointment to the board of a company. A director must understand the scope of his or her duties and comply with them.

A commonly held view amongst professional directors is that the most important function of a board of directors is to appoint the right CEO, monitor and remove her or him if required. However, the role is much more extensive than that. The courts have pointed out that a director is not an ornament.[2] A modern director has, amongst other duties, extensive positive duties to familiarise himself or herself with and monitor the performance of the company. Further, a director cannot leave the running of the company to management without applying his or her mind to the information provided by management, and ensuring that he or she understands the information, particularly in relation to matters that require disclosure by law.

In the wake of the global financial crisis, the Financial Markets Authority (FMA) has taken a more assertive enforcement approach in relation to directors' duties and disclosures and prosecuting infringements more aggressively. Legislative reforms have also given the FMA broader enforcement powers, for example, the FMA has the power to exercise the right of another person to take action against a third party, such as action against a director on behalf of a company. Also, amendments to the Companies Act 1993 (Companies Act) in 2014 introduced two new criminal offences relating to serious breaches of the best interests duty (see ¶604 below) and dishonestly incurring company debt (see ¶614 below). Directors would be wise to

1. *The Bell Group Ltd (in liq) v Westpac Banking Corporation (No 9)* [2008] WASC 239 at [4368] citing *Directors' Duties* (1983) *The Australian Accountant* 417. This case will be referred to later in this chapter and it is important to note that it considered general law duties and not statutory ones. However, there is a great deal of overlap and the guidance provided is therefore helpful.
2. *Daniels v Anderson* (1995) 16 ACSR 607 at 667 and *Australian Securities and Investments Commission v Healey* [2011] FCA 717 at [19].

consider not just the law as interpreted by the courts but also publications such as *Corporate Governance in New Zealand – Principles and Guidelines* published by the FMA in 2014.[3]

It is important not to lose sight of the fact that, notwithstanding the greater focus on directors' duties in recent times, the standards expected of directors are unchanged compared to those before the global financial crisis.

What the case law of the last five years or so does draw out, particularly in the context of the duty of care and skill, is that directors come to grief (outside cases of intentional wrongdoing) not when they are diligent and simply make a mistake, but when they omit to exercise the care and attention that the job requires. The purpose of directors' duties is to foster integrity and competence, not to stifle the taking of educated risks that naturally come with any business venture.

The FMA recognises that risk is an essential feature of business and that one of the roles of directors is to form the strategies that, hopefully, increase the value of the business. However, the risks of the business must be understood and managed by, or under the ultimate supervision of, directors. In this way the risks taken can be assessed to be appropriate in light of the environment in which the business operates at that time.

¶602 To whom are directors' duties owed?

Directors' duties at common law were traditionally divided into the categories of fiduciary duties of good faith and the duty of care and skill. Broadly speaking, these relate in the first case to the *integrity* of a director's decisions and actions, and in the second case to the *standard* required of a director's performance. However, the complexity of the law relating to directors' duties led the New Zealand Law Commission in 1989 to describe the law in this context as inaccessible, unclear and extremely difficult to enforce. According to the Commission, reform of the law was a matter of urgency. The Companies Act subsequently set out the duties of directors expressly, although it is generally considered, without removing their common law duties. The basic principles are carried over from the common law into the legislation with some significant modifications. This Companies Act does not codify all directors' duties, rather the Act restates the basic duties, in order to "promote accessibility to the law".[4]

At common law, directors' duties were generally accepted to be owed to the company and not to the shareholders individually. Under the Companies Act, the following duties are *owed to the company* and not to shareholders (s 169(3)(d)–(i)):

3. See <https://www.fma.govt.nz/assets/Reports/_versions/5431/141201-FMA-Corporate-Governance-Handbook-Principles-and-Guidelines2014.1.pdf> (accessed 11 October 2015).
4. *Internet Traders Ltd v Williams* [2014] NZHC 3407 at [20].

- duty to act in good faith and in the best interests of the company (s 131)
- duty to exercise powers for a proper purpose (s 133)
- duty to avoid reckless trading (s 135)
- duty not to agree to a company incurring certain obligations (s 136)
- duty of care (s 137), and
- duty not to disclose, make use of or act on company information (s 145).

However, the Companies Act specifies that the following duties are owed to shareholders, although the Companies Act does not exclude the possibility that these duties may also be *owed to the company* (s 169(3)(a)–(c)):

- duty to supervise the share register (s 90)
- duty to disclose interests (s 140), and
- duty to disclose share dealings (s 148).

A shareholder or a former shareholder may bring a personal action against a director for a breach of a duty owed to him or her as a shareholder (s 169(1); ¶1104).

Conversely, a shareholder may not personally sue a director for breach of a duty owed to the company. Personal actions by shareholders against directors and the company are discussed in more detail at ¶1104.

Liability to third parties

In the context of takeover offers, it can occur that a successful bidder discovers that the prize is worth less than first thought. Directors are potentially liable for negligent misstatement where they have put forward misleading information on which the bidder relies.

In *Jagwar Holdings Ltd v Julian*,[5] Jagwar bought shares in Fullers Corporation Ltd, a new company created by the merger of the Fullers Tourist business and the Julian family business. As part of the float of the company, prospective shareholders were sent a Corporate and Financial Profile. The Financial Profile contained forecasts of future profits and net asset positions. The forecasts did not eventuate and the shares subsequently proved to be valueless.[6] The directors were found not to have a special relationship with Jagwar, as the profile information was relied on for a different purpose from which it was provided.

5. (1992) 6 NZCLC 68,040.
6. See also *Houghton v Saunders* [2009] NZCCLR 13 at [70].

In *Morgan Crucible Co plc v Hill Samuel & Co Ltd*,[7] the bidder made an initial bid and subsequently a revised bid for greater consideration. In between the two bids, the company released a number of statements including a profit forecast. The forecast was incorrect and the bidder lost £50m. Hoffmann J held that a director cannot be liable for a negligent misstatement in the company's financial statements or other documents where the documents were intended to inform shareholders as to the acceptability of the bid but were not intended for the guidance of the bidder itself.[8] This statement was made in the context of the broader question of whether, *in general terms*, the directors of a target company owe a duty of care to safeguard the interests of a potential bidder in their conduct of a contested takeover, to which the answer was "no".

The English Court of Appeal reversed Hoffmann J's decision. The Court of Appeal held that where directors intended that documents should be relied on by the bidder in deciding whether or not to increase their bid and the bidder does rely on them accordingly, a duty of care arises. The Court of Appeal added that no duty arose before the initial bid was made.[9] Therefore, the decision was made on a much narrower point of law than the broad issue considered by Hoffmann J.

Where a prospectus issued by a company is intended to inform prospective subscribers of a new issue of shares, the directors cannot be liable if an existing shareholder purchases shares in the company through the stock market on the basis of the information contained in the prospectus, which turns out to be incorrect (*Al-Nakib Investments (Jersey) Ltd v Longcroft* [1990] BCC 517).[10]

In the context of misleading and deceptive conduct in takeovers, directors should also be mindful of:

- the fair dealing regime under the Financial Markets Conduct Act 2013 (FMCA) (see ¶1007 for further discussion), and
- the prohibitions on conduct that is misleading or deceptive or likely to mislead or deceive relating to transactions involving the Takeovers Code.[11]

Law: Companies Act 1993, s 169(1), (3).

7. [1990] BCC 686.
8. Ibid at 692.
9. Ibid at 87 and 92.
10. *Houghton v Saunders* [2009] NZCCLR 13 at [72].
11. Rule 64 of the Takeovers Code Approval Order 2000 and see also the Takeovers Panel's guidance note on the topic: http://www.takeovers.govt.nz/assets/Assets-2/Guidance-Notes/Guidance-Note-on-Rule-64-September-2015-consolidation.pdf (last accessed 11 October 2015).

¶603 Duty of care and skill

Common law

Historically, the courts permitted directors a considerable degree of latitude in relation to whether their duty of care and skill had been breached. The common law obligations of directors' duty of care and skill developed in the late nineteenth century and reflected a then prevailing view of directors as benign and indolent amateurs. In the case of a director, the courts declared that mere negligence did not of itself constitute a breach of the duty of care and skill: it had to be shown that the director had acted with gross negligence (*Lagunas Nitrate Co v Lagunas Syndicate* [1899] 2 Ch 392 (CA) at 435, *Re National Bank of Wales Ltd* [1899] 2 Ch 629 (CA) at 672, *Grayburn v Laing* (1990) 5 NZCLC 66,813; [1991] 1 NZLR 482).[12] It seems that this was intended to protect a director from liability, unless he or she had acted culpably or was otherwise blameworthy.

Furthermore, a number of rules were developed at common law which were favourable to directors regarding special skills, intermittent attention and reliance on others. These are discussed in more detail below.

No special skills

It was held that a director need show no greater skill than may reasonably be expected from a person of his or her knowledge and experience (*Re City Equitable Fire Insurance Co Ltd* [1925] 1 Ch 407 at 428). In other words, a director who did not hold out that he or she had any particular skills could not be held liable for any loss to the company arising from the director's lack of expertise (*Re Brazilian Rubber Plantations and Estates Ltd* [1911] 1 Ch 425). If the company appointed a director who was not competent, that was the fault of the company (*Turquand v Marshall* (1869) LR 4 Ch App 376 at 386).[13]

In *Re Denham & Co*,[14] Crook was one of four directors of a company in the business of operating a quarry and trading as stone merchants. Incorporated in 1873, the company was dominantly managed by Crook's brother-in-law, Denham. Crook himself was content to leave the running of the company entirely in Denham's hands, so much so that Crook himself did not attend a board meeting until 1878. Nor did Crook see or ask to see any documents relating to the company accounts, except the printed balance sheets, until 1879 when, at the prompting of the shareholders, he did look into the books for the first time. So far as he could judge, everything was in order. This was in fact far from the case, and on the liquidation of the company the directors were sued for the amount of dividends which for four

12. See also *Paape v Fahey* (2005) 9 NZCLC 263,813 at [91].
13. See also *Daniels v Anderson* (1995) 16 ACSR 607 at 658–659.
14. (1884) LR 25 Ch D 752.

years had been paid out of capital. One of the arguments against Crook was that the fraud should have been uncovered by an investigation of the books. The judge accepted that Crook had acted negligently in some respects, but considered that the result would have been no different had Crook been more diligent. Crook was a country gentleman and not a skilled accountant, and could not be expected to interpret accounts.

Intermittent attention

Unless the articles or contract of employment (in the case of an executive director) provided otherwise, a director was not bound to give continuous attention to the affairs of the company (*Re City Equitable Fire Insurance Co Ltd* [1925] 1 Ch 407 at 429). Accordingly, a director could not be held responsible for decisions taken at board meetings which that director did not attend (*Re Cardiff Savings Bank* [1892] 2 Ch 100).

Reliance on others

A director had no duty to supervise the actual running of the company or to become acquainted with all the details of managing it (*Huckerby v Elliot* [1970] 1 All ER 189 at 194). Therefore, it was perfectly proper for a director to leave such business to the officers or managers of the company, and the director was entitled to assume that they would perform their duties competently and honestly (*Re City Equitable Fire Insurance Co Ltd* [1925] 1 Ch 407 at 429). If directors were not able to entrust the details of management to subordinates, business could not be carried on (*Dovey v Cory* [1901] AC 477 (HL) at 486).

In *Re Denham & Co*, the accounts of the company appeared to have been audited, and the auditors appeared to be accountants of skill and integrity. Crook was, therefore, entitled to trust them and there was nothing about the way they performed their duties to arouse his suspicions (*Re Denham & Co* (1884) 25 Ch D 752).

Companies Act 1993

Section 137 is the statutory expression of the directors' duty of care and skill. However, in considering s 137, reference should be made to s 128. Under s 128(1), the business and affairs of the company must be managed by, or under the supervision of, the board of the company. This statutory requirement surpasses the requirements of the common law cited above. Indeed in *Dairy Containers Ltd v NZI Bank Ltd; Dairy Containers Ltd v Auditor-General*,[15] Thomas J held that although power must be delegated to allow the business to be managed effectively, the primary responsibility to manage and monitor performance and direction of the

15. [1995] 2 NZLR 30 at 79.

company remains firmly with the directors. The New Zealand Court of Appeal held that the "days of sleeping directors . . . are long gone".[16] Section 137 provides that a director, when exercising powers or performing duties as a director, must exercise the care, diligence and skill that a reasonable director would exercise in the same circumstances. In judging the care, diligence and skill which a reasonable director would show, the following factors must be taken into account:

- the nature of the company
- the nature of the decision, and
- the position of the director and the nature of the responsibilities undertaken by him or her.

The standard is, therefore, now one of ordinary negligence, measured against the standard of the reasonably competent director. However, the Companies Act recognises that circumstances differ widely from company to company.

The Companies Act does not impose a higher standard of skill on directors who hold relevant professional qualifications. However, as set out in s 137(c), a court will take account of the director's position in the company and the nature of his or her responsibilities.[17] If a director is appointed to undertake a particular task, the director may be liable if he or she does not bring the requisite skills to the task.[18]

In *Davidson v Registrar of Companies*,[19] Miller J reiterated that the nature of the company must be considered. Accordingly, although the defendant in that case was an experienced commercial lawyer and not an accountant, Miller J considered that he, like all the directors,[20] must understand the fundamentals of the business,

16. *Mason and Meltzer as liquidators of Global Print Strategies Ltd (in liq) v Lewis* (2006) 9 NZCLC 264,024 at [83].

17. See *Vercauteren v B-Guided Media Ltd* [2011] NZCCLR 9, White J, at [57]. See also P Watts *Directors' Powers and Duties* (2nd Ed, LexisNexis, Wellington, 2015) at 237 and *Morley v Australian Securities and Investments Commission* [2010] NSWCA 331 at [819].

18. Note that in *Asic v Adler and 4 Ors* [2002] NSWSC 171 at [372(5)], the Court, citing *Permanent Building Society v Wheeler* (1994) 14 ACSR 109, noted that in an employment contract there will an implied term that an executive director promised that he or she has the skills of a reasonably competent person in his or her category of employment.

19. [2011] 1 NZLR 542 at [121].

20. Note the lack of distinction between executive and non-executive directors. This is consistent with Venning J's comment in *FXHT Fund Managers Ltd (in liq) v Oberholster* (2009) 10 NZCLC 264,562 at [98]: ". . . even as a non-executive director there are certain basic requirements that [a director] is unable to avoid responsibility for . . ." (insert added). See also *R v Moses* [2011] NZHC 646, Heath J at [80]–[85], [397], [398] and [401], *Australian Securities and Investments Commission v Healey* [2011] FCA 717 at [16] and [18], *Australian Securities and Investments Commission v Adler* [2002] NSWSC 171 at [372], at point (9) regarding matters outside of a director's area of expertise and monitoring, *Daniels v Anderson* (1995) 16 ACSR 607 at 664 and *R v Petricevic* [2012] NZHC 665; [2012] NZCCLR 7 at [388].

monitor performance[21] and review financial statements regularly. That case involved a finance company and accordingly all its directors needed a degree of financial literacy in order to understand and contribute to the running of the company.[22] Often, a breach of the duty of care in s 137 will be found in parallel with a breach of s 135, the duty in relation to reckless trading, discussed later in this chapter.[23]

More generally, all directors, whether executive or non-executive, must guide and monitor the performance of the company.[24] As expressed in *R v Moses* (also known as the *Nathans Finance* case),[25] what changes is the specific form that this monitoring must take: this is always a fact-specific inquiry to be undertaken without the benefit of hindsight. This is the tenor of s 137. However, a director cannot ordinarily be expected to have specialised skills (cf *Norman v Theodore Goddard* [1991] BCLC 1028).[26]

The chairperson of a company may have particular responsibilities that an ordinary director does not. In the *Nathans Finance* case, Heath J said at 399 that the chairman is not a figurehead and that his role involves leadership:

> A chairman has the primary obligation of ensuring that the agenda for a meeting is properly formulated, guiding discussion and ensuring that the meeting is conducted efficiently and effectively.

Heath J also cited the Institute of Directors' Code of Practice for Directors:

> . . . the chairman's role involves ensuring that all directors receive sufficient and timely information to enable them to be effective as board members.[27]

21. Venning J affirmed the responsibility of directors to monitor the actions of persons in day-to-day control of the company in *FXHT Fund Managers Ltd (in liq) v Oberholster* (2009) 10 NZCLC 264,562 at [104] (citing *Dairy Containers Ltd v NZI Bank Ltd; Dairy Containers Ltd v Auditor-General* [1995] 2 NZLR 30). As to the financial status/capacity of the company see *R v Moses* [2011] NZHC 646 at [87] and in particular footnote 111 of the case which cites *Francis v United Jersey Bank* 432 A 2d 814 (NJ 1981) at 821–823. See generally *Mason and Meltzer as liquidators of Global Print Strategies Ltd (in liq) v Lewis* (2006) 9 NZCLC 264,024 and *Felter* (infra) at [53] citing *Adler and Commonwealth Bank v Friedrich* (1991) 5 ACSR 115 at 125–126.

22. See generally, *Daniels v Anderson* (1995) 16 ACSR 607 at 661–668.

23. See *Richard Geewiz Gee Consultants Ltd (in liq) v Gee* [2014] NZHC 1483 at [106], *FXHT Fund Managers Ltd (in liq) v Oberholster* (2009) 10 NZCLC 264,562 at [95] and *Grant v Johnston* [2015] NZHC 611, where at [129] Brown J stated:

"The degree of overlap between ss 137 and 135 is accentuated in a case such as the present where essentially the same allegations are made in support of both claims".

24. *Davidson v Registrar of Companies* [2011] 1 NZLR 542 at [121], and *R v Moses* [2011] NZHC 646, Heath J at [85], footnote 109 and [397].

25. Ibid at [73], [78], [80]–[85], [397] and [398].

26. See also *Australian Securities and Investments Commission v Macdonald (No 11)* [2009] NSWSC 287 at [236]. Also see *R v Moses* (supra), where it is suggested that, in the case of finance companies, the standard of financial literacy required of directors is higher than that of other companies. See also *R v Petricevic* [2012] NZHC 665; [2012] NZCCLR 7 at [388].

27. *R v Moses* [2011] NZHC 646 at [399] and [400]; see also *Australian Securities and Investments Commission v Rich* [2003] NSWSC 85 at [67] and [70].

Reliance on others

The Companies Act recognises the dependency of the board on management (s 138). It provides that a director, when exercising powers or performing duties as a director, may rely on reports, statements, financial data and other information, and professional or expert advice obtained from certain persons, being:

- an employee of the company whom the director believes on reasonable grounds to be reliable and competent in relation to the matters concerned
- a professional adviser or expert in relation to matters which the director believes on reasonable grounds to be within the person's professional or expert competence, and
- any other director or committee of directors on which the director did not serve in relation to matters within the director's or committee's designated authority.

A director is entitled to rely on third-party information and advice only where the director acts in good faith, makes proper inquiry (where need for inquiry is indicated by the circumstances), and has no knowledge that to rely on such advice or information is unwarranted.

In *Ministry of Economic Development v Feeney*,[28] (treated more fully below) Judge Doogue said:

> . . . directors must exercise intelligent oversight of the company's affairs. They must pay attention and give appropriate consideration to material placed before them. They are entitled to impose trust in others so long as they take reasonable steps to ensure that such trust is warranted and are not alerted to reasons why the trust may be misplaced.

The decisions in *Mason v Lewis*,[29] *FXHT Fund Managers* and *Davidson* echo the need for intelligent oversight – that is, familiarity with and monitoring of the status of the company and acting accordingly.[30]

In *FXHT Fund Managers*, Venning J noted that directors have a responsibility to monitor the actions of persons in day to day control of the company.[31] In this regard, his Honour said that a director cannot rely on oral or informal advice. Section 138 contemplates proper and probably written documentation, not general and unsubstantiated advice.

28. (2010) 10 NZCLC 264,715 at 264,727.

29. (2006) 9 NZCLC 264,024.

30. Recently, in *R v Sullivan* [2014] NZHC 2501 at [83], the Court observed that subject to adequate monitoring of management by the directors or anything that may put a director on notice of the need for further inquiry, reliance on information provided by management in their delegated areas of authority will generally be appropriate.

31. (2009) 10 NZCLC 264,562 at [104].

The Australian case law has emphasised the same expectation that directors should consider seriously those matters brought before them, and cannot rely on others without critical and detailed attention.[32] Moreover, even with expert advice, directors must still exercise their own judgment, and must not blindly accept advice or suspend their own judgment if the advice is contrary to their experience or knowledge.[33]

A director who does make inquiries and is properly satisfied as to the competence of management cannot then rest on his or her laurels, but must continue to monitor the position.[34]

Monitoring does not mean that a director is responsible for gathering and verifying the necessary information. Directors of large companies must necessarily, albeit reasonably, rely on others for information and advice.[35]

The position was summarised by Ormiston J in *Statewide Tobacco Services Ltd v Morley* (1990) 8 ACLC 827 at 847 as follows:

> Directors are entitled to delegate to others the preparation of books and accounts and the carrying on of the day-to-day affairs of the company. What each director is expected to do is to take an intelligent interest in the information either available to him or which he might with fairness demand from the executives or other employees and agents of the company.

In the James Hardie Industries Ltd (JHIL) asbestos cases,[36] JHIL manufactured and sold asbestos products and over time was sued by former employees for asbestos exposure. To deal with these claims, JHIL set up a foundation to manage and pay the claims of asbestos victims (as part of a broader restructuring of the JHIL group of companies), and released an announcement on the ASX concerning the creation of the foundation.

The Australian Securities and Investments Commission (ASIC) alleged that the announcement misleadingly conveyed that the foundation was fully funded to meet all present and future asbestos claims. It was subsequently shown that the fund was not large enough to satisfy all claims and ASIC brought proceedings against the directors for failing to comply with their statutory duty of care[37] in approving the ASX announcement.

32. *Australian Securities and Investments Commission v Healey* [2011] FCA 717 at [174] and [581].
33. *The Duke Group Ltd (in liq) v Pilmer* (1999) 17 ACLC 1,329.
34. *The Duke Group Ltd (in liq) v Pilmer* (1999) 17 ACLC 1,329. See also *FXHT*, at [95]–[101], where the defendant non-executive director failed to implement "systems and processes within the company to minimise the risk of misappropriation".
35. Note also *Daniels v Anderson* (1995) 16 ACSR 607 at 665–666.
36. *Morley v Australian Securities and Investments Commission* [2010] NSWCA 331, *Australian Securities and Investments Commission v Macdonald (No 11)* [2009] NSWSC 287, *Australian Securities and Investments Commission v Macdonald (No 12)* [2009] NSWSC 714.
37. Section 180(1) of the Australian Corporations Act 2001 (Cth).

The Supreme Court of New South Wales said consideration of the draft ASX announcement was not a matter in which a director was entitled to rely upon his co-directors who were more concerned with communications strategy than he was. The ASX announcement was a key statement in relation to a highly significant restructure of the JHIL group. Management brought the matter to the board, and no director was entitled to abdicate responsibility by delegating his or her duty to a fellow director.[38] The New South Wales Court of Appeal said that this was a matter that called for the directors to apply their minds.[39]

Reliance and financial statements

This section is included to draw the reader's attention to the central importance of a company's financial statements and the level of scrutiny required by directors. This importance is heightened in the case of an FMC Reporting Entity[40] whose financial statements must be audited and publicly filed because they serve as a guide on the status of the company for its shareholders and their advisers. It is on FMC Reporting Entities that this section will focus, in particular companies making or having made offers of financial products to the public (whether under the repealed Securities Act 1978 or the FMCA).

Under the FMCA, an FMC Reporting Entity has an obligation to ensure that financial statements are prepared (in accordance with generally accepted accounting practice (GAAP)), audited and registered with the Registrar of Companies.[41] Further, the FMCA imposes criminal liability on directors who know the above obligations have been breached[42] and, in the case of unknowing breach, civil liability is imposed.[43] With respect to civil liability, a director has a defence if he or she proves that they took all reasonable and proper steps to ensure that the

38. *Australian Securities and Investments Commission v Macdonald (No 11)* [2009] NSWSC 287 at [260].
39. *Morley v Australian Securities and Investments Commission* [2010] NSWCA 331 at [821].
40. An FMC Reporting Entity includes, for the most part, entities that were issuers under the Financial Reporting Act 1993 (the predecessor financial reporting legislation to the FMCA) but is in many respects broader (see s 451 of the FMCA). Certain other companies, which are not FMC Reporting Entities, will also need to have their financial statements audited and filed, see ss 206 and 207D of the Companies Act 1993.
41. Financial Markets Conduct Act, ss 460–461B, 461D and 461H.
42. Being, on conviction, a fine of up to $500,000 and/or a term of imprisonment of up to 5 years, see s 461I.
43. Including a pecuniary penalty of up to $1,000,000, see s 461M and s 534(1)(ca), which treats directors as having contravened the financial reporting obligations on the FMC reporting entity where the court is satisfied those obligations were, in fact, breached by the FMC reporting entity.

FMC reporting entity complied with the above obligations (s 501).[44] Where directors have complied with s 138, it is difficult to see how they would not avail themselves of this defence in the context of financial reporting obligations.[45]

As seen earlier in this section, the case law has made it clear that directors, whether executive or non-executive, need to monitor and guide the performance of the company and this includes an obligation to maintain familiarity with the financial status of the company, and necessarily read, the financial statements. This requires at least a rudimentary understanding of accounting principles. This oversight will form the basis of the knowledge that a director is expected to have in discharging his or her duties.

An earlier case that dealt with this issue in New Zealand is a District Court decision, *Ministry of Economic Development v Feeney* (also known as the *Feltex* case). While this case was decided under the now repealed Financial Reporting Act 1993, for the reasons noted earlier, it is submitted that the principles in this case are still relevant to financial reporting obligations under the Companies Act and the FMCA.[46] The case centred on errors in Feltex Carpets Ltd's interim financial statements resulting in failure to comply with applicable reporting standards by failing to disclose breaches, of which the directors were aware, of certain financial covenants contained in an ANZ Bank Facility agreement, and failure to classify the ANZ liability as a current liability. At the time of the failures, Feltex was making the transition to reporting under IFRS. Judge Doogue, after citing *Jagwar Holdings Ltd v Julian*[47] and *Australian Securities and Investments Commission v Adler*[48] noted the need for intelligent oversight and the need for directors to give appropriate consideration to material placed before them.[49]

The decisions in *Mason v Lewis*, *FXHT Fund Managers* and *Davidson* similarly highlight the need for intelligent oversight – that is, familiarity with and

44. New Zealand incorporated companies which are not FMC reporting entities may have obligations to ensure that financial statements are prepared (in accordance with GAAP), audited and registered with the Registrar of Companies depending on the financial size of the company and its shareholder base (ss 200, 206 and 207D of the Companies Act). If the company breaches these obligations, directors commit an offence punishable, on conviction, by a fine of up to $50,000. However, they have a defence similar to that in s 501 of the FMCA and, formerly, s 40 of the Financial Reporting Act 1993 (see s 376(2) of the Companies Act).
45. See (2010) 10 NZCLC 264,715 at [40] in the context of litigation under the predecessor financial reporting legislation to the FMCA under s 40 of the Financial Reporting Act 1993, which is broadly similar to the defence in s 501.
46. (2010) 10 NZCLC 264,715 (DC).
47. (1992) 6 NZCLC 68,040 at 68,072–68,086, in particular see 68,076 and 68,085. This case was decided in 1992 when directors' duties in Australasia were yet to be conclusively determined as requiring reasonable familiarity with the financial status of the company. Nonetheless, it is submitted that Thorp J's conclusions on the facts, particularly at 68,076, are sensible: a director made inquires as to inadequacies in the relevant financial forecasts, and action was taken with apparent approval of external professionals.
48. [2002] NSWSC 171 at [372]: see pts 8, 10 and 11.
49. *Ministry of Economic Development v Feeney* (2010) 10 NZCLC 264,715 at [54].

monitoring of the status of the company and acting accordingly. In *Feltex*, Judge Doogue held that directors do not need to be personally expert in accounting – otherwise what is the point of s 138?[50] Nonetheless, what passes the test is a highly fact-specific inquiry to be evaluated without the benefit of hindsight. In *FXHT Fund Managers* the relevant director failed to implement monitoring systems and lacked the basis to test the answers to questions he did ask, making his reliance unreasonable. In *Feltex*, by contrast, Judge Doogue recognised that the directors had:[51]

- placed reliance on a qualified, competent and well-resourced financial management team
- established a comprehensive transition process to IFRS
- engaged a highly reputable accounting firm (Ernst & Young) to prepare an IFRS assessment report, identifying key areas and issues that needed to be addressed in the transition to the new IFRS standard so as to ensure compliance
- created and established a steering committee comprising Feltex's own financial management and supervised by Ernst & Young who would actively advise, educate, assist and participate in the review of all the IFRS standards applicable to Feltex and to take measures to ensure compliance
- engaged Ernst & Young to undertake a review of half year accounts with a particular emphasis on compliance with the new IFRS accounting standards[52]
- obtained declarations by the CEO and the CFO in relation to Feltex's compliance with the Financial Reporting Act 1993, which certified that the company's internal financial controls were adequate and effective
- used an appropriately constituted audit committee whose responsibilities extended to overseeing the integrity of the financial reporting and control process, and
- in respect of the directors, Thomas and Feeney, neither of whom were members of the audit committee, relied on the recommendation made to the board by the audit committee that the interim half year accounts were accurate and fully compliant with IFRS standards before taking the decision to approve and issue the accounts.

In addition to these points, the Judge emphasised that the standards were very complex and detailed calling them "an arcane set of prescriptions".[53] Further, there are fundamental changes under IFRS but the directors were still applying the old

50. (2010) 10 NZCLC 264,715 at [141]–[143].
51. Ibid at [77].
52. Ibid at [125].
53. Ibid at [158] and [164].

standards, having received incorrect expert advice on this point.[54] Accordingly, *Feltex* is a case where, on the facts, there was nothing more the directors could reasonably be expected to do.

On similar facts, a different outcome was reached in Australia in *Australian Securities and Investments Commission v Healey*.[55] In this case, Centro Properties Group (CNP) and Centro Retail Group (CER) failed to disclose significant matters in their annual reports (*Feltex* considered interim annual reports). CNP's reports failed to disclose $1.5 billion of short-term liabilities by incorrectly classifying them as "non-current liabilities", and the reports also failed to disclose US$1.75 billion in guarantees of short-term liabilities of an associated company after the balance date. CER failed to disclose some $500m of short-term liabilities that had been classified as non-current. PricewaterhouseCoopers was the auditor. The extreme and obvious nature of the errors is a key feature of this case. It is also one that would set it apart from other scenarios where the errors are less apparent and of lesser monetary value.

In his capsule summary, Middleton J held that:

> ... Directors are entitled to delegate to others the preparation of books and accounts and the carrying on of the day-to-day affairs of the company. What each director is expected to do is to take a diligent and intelligent interest in the information available to him or her, to understand that information, and apply an enquiring mind to the responsibilities placed upon him or her.[56]

In applying his or her enquiring mind, the director should bring the information known or available to him or her in the normal discharge of the director's responsibilities to the task of, in this case, focussing upon the financial statements. The normal discharge of a director's duties involves taking all reasonable steps to be in a position to guide and monitor the company.[57] It is to this level of understanding of the company's affairs that a director should then compare what is presented in the company's financial statements. Relevantly, his Honour said that the basic concepts and financial literacy required to be in a position to properly question the apparent errors in the financial statements were not complicated.[58] Specifically, his Honour said that:[59]

> ... the objective duty of competence requires that the directors have the ability to read and understand the financial statements, including the understanding that financial statements classify assets and liabilities as current and non-current, and what those concepts mean.

54. Ibid at [65]–[67] and [138].
55. [2011] FCA 717.
56. *Australian Securities and Investments Commission v Healey* [2011] FCA 717 at [20].
57. Ibid at [16] and [22]. See also *Daniels v Anderson* (1995) 16 ACSR 607 at 664, *Australian Securities and Investments Commission v Adler* [2002] NSWSC 171 at [372], at point (8).
58. [2011] FCA 717 at [23].
59. Ibid at [124].

Middleton J considered the *Feltex* decision at some length and distinguished it because of the different standards that were contended for by the relevant regulator. In *Feltex* the regulator, in the words of Judge Doogue, argued that the directors should themselves have engaged in the study of accounting standards.[60] In *Healey*, Middleton J said that ASIC argued the directors required only a routine knowledge of and basic application of the test for classification of liabilities in order to discharge their duties. A working knowledge of all accounting standards is not required.[61] In carrying out his duties a "director armed with the information available to him was expected to focus on matters brought before him and to seriously consider such matters and take appropriate action. This task demands critical and detailed attention, and not just 'going through the motions' or sole reliance on others, no matter how competent or trustworthy they may appear to be".[62]

Importantly, Middleton J noted that "information overload" was not an excuse; information is provided to directors for a reason and a board can control the information it receives.[63]

In *Healey*, Middleton J found that the directors:

- knew or ought to have known of the relevant accounting standard and its "plain English" meaning regarding classification of liabilities, expressed as note 1(w) in the financial statements of a related company[64]
- knew or ought to have known of CNP's and CER's *substantial* short-term liabilities[65]
- were aware of the need to disclose post-balance date events and failed to turn their minds to the omission of the guarantees from the financial statements relying instead *solely* on advice[66]
- never placed reliance on incorrect accounting policy manuals,[67] and
- were unaffected in their thinking by the lack of clarity on the relevant accounting standard with their accountants, and the complexity of facilities and the status of negotiations regarding refinancing or extension was irrelevant. [68]

60. (2010) 10 NZCLC 264,715 at [141], compare with [2011] FCA 717 at [162].
61. [2011] FCA 717 at [288], [211], [206] and [23].
62. Ibid at [174] and [581].
63. Ibid at [229] and [298].
64. Ibid at [221], [272] and [389]. This is also an important difference to *Feltex*.
65. Ibid at [317].
66. Ibid at [504] and [505].
67. Ibid at [380].
68. Ibid at [388] and [392] contrast the last three points with *Feltex* where the directors applied the wrong standard.

Therefore, combining the simple knowledge of the accounting standards required[69] together with the conspicuous nature of the short-term liabilities and guarantees involved, each director failed to properly apply his or her mind to reading the financial statements and, as a result, failed to ask the right questions or raise the relevant concerns about the financial statements which, if done, would have meant all reasonable steps were taken.[70]

An important point made in *Healey* is that both the relevant, though simplified,[71] knowledge of accounting standards and the nature of the facilities and guarantees comes from the knowledge a director is meant to take away from his or her intelligent oversight of the company.[72]

From a New Zealand point of view, the High Court decision in *R v Moses*[73] provides some further guidance on directors and financial statements,[74] even though it relates to breaches of the Securities Act 1978 rather than the Financial Reporting Act 1993. Citing, with approval, Miller J in *Davidson*, Heath J held that as directors of a finance company, all the directors needed to have more than a basic understanding of accounting:[75]

> It is axiomatic that a director of a finance company will be assumed to have the ability to read and understand financial statements and the way in which assets and liabilities are classified. For example, a director of a finance company should be expected to know that a "current asset" is one expected to be realised within one year.

An elaboration on the knowledge of accounting and, therefore, extent of reliance a director can have was made:[76]

> While it was fair for the directors to rely on the auditors to check aspects of the company's financial statements and to ensure that technical standards were fully met in relation to accounting policies, the accounts remained those of the directors and they had their own obligation to be satisfied of their content when signed.

It can be argued that the comments of the High Court in *R v Moses* are consistent with *Feltex* and should not be construed in a way that requires directors to be personally expert in accounting and, therefore, to diminish the purpose of s 138.[77] However, they do indicate that, at least for certain types of company, that is, finance companies, directors are expected to have a sound basic knowledge of accounting going further than the rudimentary understanding of directors of other

69. Ibid at [54(c)], [393], [437], [567] and [579].
70. Ibid at [8], [576] and [583].
71. Ibid.
72. Ibid [22]–[23]. See [210] for a useful list of Australian "usual practices".
73. [2011] NZHC 646.
74. This case primarily concerns directors' liability for misleading advertisements and prospectuses, see below.
75. *R v Moses* [2011] NZHC 646 at [80], [83], [223], [402] and [422].
76. Ibid at [422].
77. Ibid at [82] and [84].

companies. With this financial understanding and their knowledge of the company (gained through proper monitoring and guidance) directors must be able to query management and external advisers in respect of material before them where there are areas of concern and must also understand and assess the answers they are given. In this way the duty on the director will be discharged.

In *R v Graham*,[78] the Court rejected the argument that the approach adopted by *R v Moses* unduly restricted the entitlement of directors to rely on information provided by others, in that it required directors to carry out detailed analysis more appropriately left to managers. The Court in *R v Graham* observed that:[79]

> Neither section [2B Securities Act 1978 or s 138 Companies Act] can be read in a way that would relieve a director of the obligation to check on the competence of a delegate, in any circumstances where a signal occurs that would put a reasonable director on notice of the need to do so. It is not helpful to attempt a definition in abstract of the circumstances in which a director should not rely on information provided by management, in terms any more precise than those I have just attributed to the Crown's position.
>
> To the extent that [counsel for the Defendant] proposes that directors can rely on the judgement of managers until the directors are on notice that something of substance has gone wrong, then that puts permissible reliance too highly. Directors are appointed to exercise judgement and that extends to testing the competence of management within areas in which managers are relied upon. Each circumstance of reliance on management needs to be assessed within its own context.

Further, both *Feltex* and *Healey* make it clear that reliance, where appropriate, is necessary in modern corporate life but it is not a complete defence. Both decisions also require directors to have intelligent oversight over the company's affairs and familiarity with its financial status. Neither requires directors to be experts in accounting. And, finally, both decisions say that the question to be answered is a highly fact-specific inquiry to be assessed without the benefit of hindsight.

As with other areas of the law there will be a continuum of possibilities. Intelligent oversight is just that – "intelligent" and "oversight". It is necessary, especially in relation to large companies, for many tasks of management to be delegated by the directors to employees and advisers. That is why reasonable grounds are required by the case law and in s 138. The further one moves from documents such as financial statements, prospectuses, target company statements or larger projects[80] and goes into day-to-day activities, the more it can be said that the requirement of reasonable grounds will be satisfied where a task is left to a properly appointed delegate over whose activities less review time is spent, especially on an individual basis, so long as the delegate is regarded as competent and honest.

78. [2012] NZHC 265.
79. Ibid, [34] and [35].
80. Ibid at [335]–[343].

¶730 Overseas companies

Part 18 of the Companies Act applies to foreign companies that carry on business in New Zealand. Although the Companies Act does not impose direct obligations on the directors of an overseas company, contravention of certain provisions by the company constitutes an offence by each director. A director commits an offence and is liable on conviction to a fine not exceeding $10,000 where an overseas company carries on business in New Zealand without having first reserved its name (s 333(5)), carries on business in New Zealand without registering by application to the Registrar within 10 working days of commencement of carrying on business (s 334(6)), does not notify the Registrar of certain changes relating to the company (s 339(2)), or fails to submit an annual return in accordance with s 340 (s 340(6)). In addition, where a large overseas company fails to prepare, audit and register (group) financial statements, as required, the directors commit an offence and are liable on conviction to a fine not exceeding $50,000 (ss 207G and 374(3)).

Law: Companies Act 1993, ss 207G, 333(5), 334(6), 339(2), 340(6), 374(3).

Chapter 8

DIRECTORS' MEETINGS

In order for there to be a valid meeting of directors, it is not necessary that the directors be simultaneously present in one room [. . .]. What is essential is that there be, in the phrase so often used, a genuine "meeting of minds" of the directors, so that they have in reality met, considered, and decided.[1]

¶801 Introduction

Directors must act together, as a board of directors whenever they exercise powers conferred on them (as a board). With some exceptions, these powers may be delegated, and invariably this occurs where a managing director is appointed (¶506). Directors may also assume individual responsibility without involving the board as a whole. However, the general premise remains true: statute vests the responsibility for managing the business and affairs of the company (and other functions) in the board as a whole (s 128 of the Companies Act 1993 (the Companies Act)) and it is, therefore, essential that the board meet regularly to discharge these responsibilities.

Under the Companies Act, proceedings of the board are governed by the provisions set out in sch 3 to the Companies Act (s 160). This rule is subject to the provisions of the constitution, which may accordingly vary or wholly supplant the rules set out in sch 3.

Law: Companies Act 1993, ss 128, 160, sch 3.

¶802 Right to participate

Every director is entitled to participate in the formulation of decisions concerning the affairs of the company, even if that person has no right to vote (*Trounce and Wakefield v NCF Kaiapoi Ltd* (1985) 2 NZCLC 99,422). If wrongfully excluded from board meetings, the director may bring an action for relief by way of declaration or injunction against the company and the other directors (*Pulbrook v Richmond Consolidated Mining Co* (1878) 9 Ch D 610, *Hayes v Bristol Plant Hire Ltd* [1957] 1 WLR 499). Moreover, a director is entitled to all information relevant to the decision before the board (*Novick v Comair Holdings Ltd* 1979 (2) SA 116 (W) at 128).

1. *The Bell Group Ltd (in liq) v Westpac Banking Corporation (No 9)* [2008] WASC 239 at [5586]–[5587].

The converse of the right to participate is the rule that a director who neglects to attend a meeting of the board may be liable for breach of the director's duty of care and skill (see ¶603).

Under the Companies Act, a director (or employee if requested by a director) may convene a meeting of the board by giving the requisite notice (sch 3 cl 2(1)).

Law: Companies Act 1993, sch 3 cl 2(1).

¶803 Formalities

It is not necessary, for a directors' meeting, that the directors meet physically in one place. Schedule 3 of the Companies Act makes specific provision for holding directors' meetings by audio or audio-visual communication. A meeting of directors may be held either by the requisite quorum of directors assembling physically at the appointed time and place, or by audio or audio-visual communication of a quorum of directors by which means all directors participating can simultaneously hear each other throughout the meeting (cl 3). If a company's constitution does not have such a clause, Santow J stated, in obiter, in *Hans Wagner & Anor v International Health Promotions Pty Ltd (admin aaptd)* (1994) 15 ACSR 419 that the words "'meet together' was a meeting of minds made possible by modern technology and not of bodies". Therefore teleconferencing by directors without a supporting article would be acceptable. In *Re GIGA Investments Pty Ltd (in admin)* (1995) 13 ACLC 1047, the articles required two directors to "meet together" and when they met via telephone they were considered to have met properly. In *Re GIGA* the term "meet together" did not necessarily mean a physical gathering but was taken to mean a meeting of minds. For example, a two-director company with both directors on the telephone and intending to conduct a director's meeting, this does not require a facilitating constitution, as had been the requirement prior to *Re GIGA Investments Pty Ltd (in admin)*.

Conversely, the mere fact that the directors do physically meet does not turn the occasion into a meeting of the board. A casual meeting between the directors cannot be treated as a board meeting if one of them does not consent to it. For instance, in *Poliwka v Heven Holdings Pty Ltd* (1992) 10 ACLC 641, a meeting took place between directors in a café over lunch. It was held that this did not constitute a directors' meeting because there was no common intention that it be a business meeting of the company. The parties had no intention of acting in their capacity as directors of the company.

This was similarly the case in *Barron v Potter* [1914] 1 Ch 895 where the only two directors of a company had been involved in a long-standing dispute. The articles of the company gave the chairperson, Potter, a casting vote at a board meeting in the event of a deadlock.

However, this power was defeated by the refusal of the other director, Barron, to attend meetings proposed by Potter. Eventually Barron did appear at the offices of the company in order to attend an extraordinary general meeting called by himself, but with no intention of attending a board meeting. As Barron entered the room, Potter proposed a resolution for the election of additional directors and purported to carry the resolution by his casting vote. It was held that no board meeting had occurred, since Barron had no intention of attending one.

Law: Companies Act 1993, sch 3 cl 3.

¶804 Unanimous resolution

Where the directors are in agreement, it is not necessary for them to meet. Clause 7(1) of sch 3 of the Companies Act provides that a resolution in writing, signed or assented to by all the directors entitled to receive notice of a board meeting is as valid and effective as if it had been passed at a meeting duly convened and held. This is really only a restatement of the rule developed in cases such as *Re Bonelli's Telegraph Co* (1871) LR 12 Eq 246 and *Cromwell Corp Ltd v Sofrana Immobilier (NZ) Ltd* (1992) 6 NZCLC 67,997 (CA) at 68,004 that informal unanimous agreement by the directors without actually meeting will be considered a substitute for a formal resolution.

Moreover, it is not necessary that all the directors sign or assent to the very same form; the resolution may consist of several documents in like form (eg faxed or emailed copies of the resolution) each signed or assented to by one or more directors (cl 7(2)). Nor is it necessary that each director *signs* the resolution or a copy of the resolution: it is enough that he or she assents to it. So, for example, a director may in an email record having read the resolution and confirm that he or she agrees to it.

A copy of the resolution must be entered in the minute book of the board (cl 7(3)).

Law: Companies Act 1993, sch 3 cl 7.

¶805 Notice

Schedule 3 of the Companies Act stipulates that not less than two days' notice of a meeting of the board must be sent to every director who is in New Zealand (cl 2(2)). The fact that a director has to be in New Zealand to receive notice is likely a relic of a pre-digital world. Companies should consider amending this requirement so as to require notice to be sent to directors outside New Zealand but by electronic means where the relevant director has left such contact details. Note that this is not two *working days'* notice. The notice of meeting must include the date, time and place of the meeting and the matters to be discussed. An irregularity in the notice of a meeting is waived if all the directors entitled to receive notice attend the meeting without protest or agree to the waiver (cl 2(3)).

Schedule 3 does not spell out the effect of a meeting that is held without proper notice if the irregularity in notice is not waived as envisaged by cl 2(3). Some authorities treat a resolution passed at the meeting as void (*Re Homer District Consolidated Gold Mines, ex p Smith* (1888) 39 Ch D 546, *Ryan v Kings Cross RSL Club* (1971–1973) CLC ¶40-043; [1972] 2 NSWLR 79). In *Gibson v Moorhouse* (1988) 4 NZCLC 64,114, a New Zealand Court held that a directors' meeting for which notice had not been given to all directors was invalid and any resolution passed at the meeting was likewise invalid.

However, other cases have treated the resolution as voidable only in the sense that a director without proper notice may require a further meeting to reconsider the resolution, with the proviso that this right may be lost if the director procrastinates in objecting (*Browne v La Trinidad* (1887) 37 Ch D 1 (CA), *Bentley-Stevens v Jones* [1974] 1 WLR 638).

Law: Companies Act 1993, sch 3 cl 2.

¶806 Quorum

Under sch 3 of the Companies Act, a quorum for a meeting of the board is a majority of the directors, and no business may be transacted at a meeting of the board unless a quorum is present (cl 4).

Although cl 4 of sch 3 says that no business may be transacted at a board meeting unless a quorum is present (see, too, *Merchants of the Staple of England v Bank of England* (1887) 21 QBD 160), it does not expressly require that a quorum be present throughout the meeting. It seems that a resolution is valid, provided that at the time it was passed there was a sufficient quorum, and it does not matter that at other times the meeting was inquorate (cf *Re Hartley Baird Ltd* [1955] Ch 143). However, if the constitution provides that there must be a continuing quorum, the requisite number of directors, or a majority of them, depending on the constitution, must be present throughout the meeting (*Henderson v Louttit* (1894) 21 R (Ct of Sess) 674).

A director who has an interest in a company transaction is not disbarred from forming the quorum unless the constitution expressly excludes him or her from doing so. Section 144 of the Companies Act says that an interested director may (amongst other things):

- vote on the matter, and
- attend a board meeting at which a matter relating to the transaction arises and be included among the directors present for purposes of a quorum.

If the constitution does require a disinterested quorum, that requirement cannot be circumvented by the artificial splitting of resolutions that relate to a single transaction. For example, in *Re North Eastern Insurance Co Ltd* [1919] 1 Ch 198, a

company had four directors and a quorum of three was required for directors' meetings. The constitution provided that no director should be disqualified from contracting with the company, but that no director should vote in respect of any such contract. At a board meeting, which all directors attended, resolutions were passed for the issue of two debentures, one each to Young and Dobbie, who were both directors, each abstaining from voting only in respect of the resolution which concerned them. It was held that there was not a quorum and the resolutions were therefore invalid. The issue of each debenture was not truly a separate transaction; rather, the debentures formed part of the same transaction in which Young and Dobbie were jointly interested and on which neither could vote at all.

Similarly, in *Ireland Alloys Ltd v Dingwall* (1999) SLT 267, three directors convened and voted in favour of changing a pension plan, entitling each of them to enhanced benefits under the plan. A quorum of two was required and the articles expressly provided for a disinterested quorum. While it was argued that each director was considered separately, it was held that changing the plan was a single business decision and each of the three directors addressed himself to the single matter of the inclusion of all three (including himself) as named directors under the beneficial pension plan. As a result, their votes had to be held invalid and the resolution void.

Where a director wilfully refuses to attend a board meeting to consider a resolution for the approval of a transfer of shares, with the result that no quorum is possible, the court may set aside quorum requirements and order that the share register be rectified as if the transfer had been approved (*Re Copal Varnish Co Ltd* [1917] 2 Ch 349).

In some circumstances, the court may exercise its powers to call a shareholders' meeting to appoint additional directors so that a quorum is present. Further, in more extreme cases where the refusal to attend meetings involves oppressive conduct, the court may make an order under s 174 regulating the future conduct of the company affairs (see *Re Sticky Fingers Restaurant Ltd* (1992) 10 ACLC 3,011; [1992] BCLC 84).

Law: Companies Act 1993, s 144, sch 3 cl 2.

¶807 Procedure

Chairperson

The directors may elect one of themselves to be the chairperson of the board (sch 3 cl 1(1), Companies Act). The person elected holds office until he or she dies or resigns or the directors elect another chairperson in his or her place (cl 1(2)). If no chairperson is elected, or if the chairperson has not arrived at a board meeting within five minutes of the scheduled time for the meeting to begin, the directors who are present may choose one of themselves to be chairperson of the meeting (cl 1(3)).

In *Kelly v Wolstenholme* (1991) 9 ACLC 785, the two directors of the company met informally with the company secretary. W, who controlled the majority of the votes, simply asserted that he was the chairperson and purported to pass a resolution removing K as manager of the company, relying on the chairperson's casting vote to do so. It was held that the resolution was of no effect. W could not be regarded as chairperson without having exercised procedural control over the meeting by, amongst other things, nominating who was to speak, dealing with the order of business, putting questions to the meeting, declaring resolutions carried or not carried, in due course asking for general business and declaring the meeting closed. This he had not done. In any event, the meeting could not be said to have chosen W as chairperson, since K had not acquiesced in W's assertion that he was the chairperson. See also *Northwest Capital Management v Westate Capital Limited* [2012] WASC 121 at [29] where it was held that a chairperson must actually have control over the meeting and behave in a manner to show this actual procedural control.

Voting

Under sch 3, every director has one vote and the chairperson has no casting vote (cl 5(1), 5(2)). A resolution is passed if all directors present agree or if a majority of votes are cast in favour of the resolution (cl 5(3)).

A director present at a meeting is presumed to have agreed or voted in favour of a resolution unless he or she expressly dissents from or votes against that resolution (cl 5(4)). In order to dissent, it is not sufficient that a director merely abstains from voting on a particular resolution. As appears from ¶726, directors are subject to obligations to give certificates following certain board resolutions. Typically, the Companies Act requires a director who votes in favour of a particular resolution to certify that the matters set out in the resolution are correct. Under sch 3, a director is presumed to have voted in favour of a resolution, and must therefore sign a certificate, unless he or she has expressly voted against the resolution.

Law: Companies Act 1993, sch 3 cl 5.

¶808 Committees

With some exceptions, the board may delegate its powers to a committee of directors, subject to any restrictions in the constitution (s 130(1) of the Companies Act). For example, listed companies must have an audit committee, and are suggested to have a nomination committee and a remuneration committee. Non-listed companies, may, depending on size, appoint committees to handle such matters but also matters of importance for the company, for example, a mining company may have a health and safety committee.

Membership of a board committee may have implications for the liability of a director. If the director is a member of a key committee, such as a finance and audit committee, and has or ought to have more detailed financial information than other members of the board, that director may be liable for a breach of the duty of care and skill in relation to the financial affairs of the company whereas other directors who are not members of the committee might escape liability (see chapter 6 – ¶603).

Law: Companies Act 1993, s 130(1).

¶809 Minutes

The board must ensure that minutes are kept at all meetings of the board (Companies Act, sch 3 cl 6). The minutes form part of the records of the company and must be kept at the company's registered office (s 189(1)(d)). They must be available to directors for inspection but shareholders have no right of access to them (see ¶716 and ¶720).

The minutes are evidence that a particular resolution has been passed, but the validity of a resolution is not affected by the failure to record the resolution in the minutes, even if the minutes have been confirmed (*Saunders v The Liquidator of Woodware Products Ltd (in liq)* (1982) 1 NZCLC 98,341 at 98,346; cf *HL Bolton (Engineering) Co Ltd v TJ Graham & Sons Ltd* [1957] 1 QB 159 (CA) at 171). The validity and force of a resolution depends on it being the decision of the majority of the directors present at a duly convened meeting of the board (*Toole v Flexihire Pty Ltd* (1992) 10 ACLC 190), whether it is subsequently confirmed or not.

A director who is not present at a meeting at which a breach of trust is committed by the board does not become liable for that breach merely because he or she attends a subsequent meeting at which the minutes are read and confirmed (*Re Lands Allotment Co* [1894] 1 Ch 616 (CA)). Acquiescence in the breach must be shown by some positive conduct on the director's part, such as publicly affirming the action of the board at a general meeting.

Law: Companies Act 1993, s 189(1)(d), sch 3 cl 6.

¶810 Validity of directors' acts

Section 158 of the Companies Act provides that, generally, a person's acts as a director are not invalidated by a defect in appointment or a lack of qualification for the office of director (See ¶216 for further commentary on defects in appointment).

Law: Companies Act 1993, s 158.

Chapter 9

DISCLOSURE

Regulatory authorities are not going to go away and they are not going to be brow-beaten. Commerce in this country simply must learn to live with them, and to meet their disclosure requirements authorised by law.[1]

¶901 Introduction

Disclosure is the foundation upon which the regulation of companies is built. The necessity to disclose is a major deterrent to wrongdoing on the part of the company's controllers.

Under the Companies Act 1993 (the Companies Act), disclosure by directors takes two forms: individual disclosure and collective disclosure. Individual disclosure by directors is centred on the "interests register" that every company must keep. Collective disclosure of the knowledge that the board possesses about the company's affairs is put into effect through the board's responsibility to keep records, to make the requisite statutory returns and to disseminate information to shareholders by way of the annual report and disclosure documents.

In respect of listed issuers, the Financial Markets Conduct Act 2013 (the FMCA) provides that the directors and senior managers of all listed issuers must disclose relevant interests in quoted financial products of the listed issuer (or a related body corporate) and certain specified derivatives to the listed issuer and to the relevant licensed market operator to ensure that information about such interests is available to participants in New Zealand's financial products markets. The FMCA also imposes continuous disclosure requirements on listed issuers to provide appropriate continuous disclosure of material information that is not generally available to the market, for which directors of listed issuers can be liable. Disclosure requirements on directors are also found in the Takeovers Code Approval Order 2000 (Takeovers Code).

¶902 Particulars of directors

The Companies Act does not require a company to maintain a register of directors as such. However, the company must identify the directors at several points. First, the company must keep a document listing the full names and addresses of the current directors (s 189(1)(f)). This document can be inspected by the public, including a shareholder, upon written notice of the intention to inspect being

1. *Securities Commission v Gulf Resources and Chemical Corp* (1990) 5 NZCLC 66,324 at 66,336.

served on the company. Secondly, most companies have an obligation to prepare an annual report under s 208.[2]

The annual report must state the names of the persons holding office as directors as at the end of the accounting period and the names of any persons who ceased to hold office as directors during the same period (s 211(1)(i)). Thirdly, the annual return must state the full names, dates and places (town and country) of birth (though this is kept confidential) and residential addresses of the directors (s 214(1), read with sch 4(g)). Finally, the board must ensure that electronic notice is given to the Registrar of Companies through the Companies Office website of a change in the directors of a company or a change in the name or the residential address of a director within 20 working days of the change occurring (s 159(1)).

Where a new director is appointed, the Registrar must be provided with, in addition to the director's name and residential address, their place (town and country) and date of birth. Further, if the director is resident in Australia, they must advise the Registrar whether they are a director of any Australian incorporated companies and provide the name, ACN and address of the registered office of one of those companies. For information required to be disclosed about directors on incorporation, see ¶105.

Law: Companies Act 1993, ss 159(1) and (2), 189(1)(f), 211(1)(i), 214(1), sch 4.

¶903 Interests register

Companies Act 1993

Every company must keep an interests register at its registered office (s 189(1)(c)). Generally, a director's personal interest in transactions relating to the company must be recorded in the interests register. A shareholder is entitled to inspect the interests register on giving written notice to the company (s 216(1)(d)). Particulars of changes in the interests register in the relevant accounting period must be disclosed in the annual report which is received by every shareholder (s 211(1)(e)). Under the Companies Act, an entry in the interests register must be made in the following circumstances:

- disclosure of an interest in a company transaction (s 140(1))
- use or disclosure of company information (s 145(2), (3))

2. The board of a company that is not an FMC reporting entity (which includes listed issuers and other entities, see s 451 of the FMCA) or a public entity and which has fewer than 10 shareholders and is not "large" (as defined in s 45 of the Financial Reporting Act 2013) is not required to prepare an annual report. However, a shareholder or shareholders who hold 5% or more of the voting shares in the company may give written notice to the company within the opting period requiring the company to prepare an annual report (see ss 207H to 207K of the Companies Act and ¶722).

- disclosure of share dealing (s 148(1), (2))
- remuneration (s 161(2)), and
- particulars of indemnity or insurance (s 162(7)).

Financial Markets Conduct Act 2013

Under the FMCA, a director or senior manager of a listed issuer must disclose any relevant interest and any dealings with a relevant interest in the quoted financial products of the listed issuer or a related body corporate (s 297). Similar obligations exist with respect to certain specified derivatives (s 298). These disclosure obligations are discussed at ¶906. The disclosure must be made to the licensed market operator with which the listed issuer is listed and in the interests register of the listed issuer kept in accordance with the FMCA (s 299(1)). The FMCA requires a listed issuer to keep an interests register for disclosures by directors and senior managers (s 304(1)), which may be the same as the interests register kept for the purposes of the Companies Act (s 304(4)). The interests register must be kept at (s 304(2)):

- the listed issuer's registered office, or
- any other place in New Zealand, provided that written notice is given to the Financial Markets Authority (FMA) within 10 days of it being at that place.

Law: Companies Act 1993, ss 189(1)(c), 211(1)(e), 216(1)(d).
Financial Markets Conduct Act 2013, ss 297–299, 304.

¶904 Disclosure of interests in financial products

The Companies Act and the FMCA both contain provisions requiring disclosure by directors of interests in, respectively, the shares and quoted financial products of the company. The FMCA extends disclosure obligations on directors to certain specified derivatives of which the company is not necessarily the issuer (see ¶906).

A financial product is defined in the FMCA as an equity security, a debt security, a managed investment product or a derivative (s 7 – see also s 8, which elaborates on these terms). To be "quoted", a financial product must be one that is approved for trading on a licensed market.

The above disclosure obligations have a twofold purpose. First, a director has the advantage of access to information about the affairs of the company, which is not generally available, and may be tempted to use that knowledge to his or her advantage in dealing in the shares of the company. The FMCA regulates insider trading and market manipulation, and the obligation on directors of listed issuers to disclose an interest in quoted financial products helps to ensure that trading by a director can be detected. Particularly, the interests register of a listed issuer must be

kept open for inspection by any person (s 305). Any person may request a copy of, or extract from, an interests register for payment of the prescribed fee to the listed issuer (s 306). Secondly, it is important that the identity of the actual controllers of the company should be known. Disclosure of relevant interests in quoted financial products ensures that a director cannot disguise his or her control of a company through the use of nominees.

¶905 Disclosure of interests in shares: Companies Act 1993

Continuing disclosure

The Companies Act imposes a continuing obligation on a director to disclose particulars of a relevant interest in shares issued by the company (s 148(2)). More specifically, there is a separate obligation to disclose the particulars of any acquisition or disposition of such an interest. In other words, the Companies Act scrutinises any change in a director's position in relation to an interest in the shares of the company. It is important to note that while this obligation overlaps with the disclosure obligations under the FMCA discussed in ¶906, it is different in that: (i) it applies only to shares of the company (and not any other kind of financial product), and (ii) it does not matter whether the shares are quoted or not.

The following particulars must be disclosed to the board:

- the number and class of shares in which the relevant interest was acquired or disposed of, as the case may be
- the nature of the relevant interest
- the consideration paid or received, and
- the date of the acquisition or disposition.

In addition, the director must ensure that these particulars are entered in the interests register (s 148(2)(b)). Although there is no direct sanction under s 148 for non-compliance, s 169(1) and 169(3)(c) treat the obligations under s 148 as a duty owed to shareholders. Accordingly, a shareholder can bring a personal action against a director for breach. Similarly, under s 170 of the Companies Act, a shareholder can apply for orders from the High Court requiring a director to take action required to be taken by directors under the Companies Act. Further, as elaborated on in ¶204, s 383(1)(c)(i) of the Companies Act provides that a director may be disqualified by the High Court for persistent failure to comply with the Companies Act. Finally, s 134 of the Companies Act requires directors to comply with the Companies Act and the company's constitution.

Meaning of "relevant interest"

A director must disclose particulars of the acquisition or disposition of a *relevant interest* in the shares of the company. This term is defined very widely in s 146(1) of the Companies Act. Section 146(3) to (5) in particular contain various anti-avoidance provisions. A relevant interest in shares arises in the following circumstances (s 146(1)):

- beneficial ownership of a share
- the power (or potential power, by virtue of any trust, agreement, arrangement or understanding relating to the shares) to exercise or control the exercise of the votes attached to the shares
- the power (or potential power by virtue of any trust, agreement, arrangement or understanding) to acquire or dispose of the shares, and
- the power (or potential power by virtue of any trust, agreement, arrangement or understanding) to control the acquisition or disposition of the shares by another person.

Even where a director has no relevant interest according to the criteria set out in s 146(1), a director is deemed to have such an interest where he or she is closely associated with a person who does have a relevant interest (the interested person). An association giving rise to an indirect interest on the part of a director must be disclosed if it is one of the following (s 146(2)):

- the interested person or its directors (if it is a company) are accustomed or obliged to act, whether under a legally enforceable obligation or not, in accordance with the directions, instructions or wishes of the director in relation to the exercise or control of voting rights, the acquisition or disposition of shares in the company or the control of such acquisition or disposition, and
- in the case of an interested person which is a company, the director has the power to exercise or control the exercise of 20% or more of the votes attached to the shares in the interested person or the power to acquire or dispose of, or control the acquisition or disposition of 20% or more of the shares in the interested person.

Certain interests in shares are not considered relevant interests for the purpose of disclosure under s 148. These are set out in s 147. The most significant from the point of view of the individual director is contained in s 147(1)(e). That section provides that no account shall be taken of a director's interest in shares of a company if the director has the interest by reason only that the director is a bare trustee of a trust to which the shares are subject.

Law: Companies Act 1993, ss 146–148.

¶906 Disclosure of interests in financial products: Financial Markets Conduct Act 2013

Background

The FMCA replaced the suite of securities laws that had been in place in New Zealand, and had been amended on an ad hoc basis, for many years. The FMCA, together with the Financial Markets (Repeals and Amendments) Act 2013 and the Financial Markets Conduct Regulations 2014 (Financial Market Conduct Regulations), replace a number of pieces of legislation, including the Securities Act 1978 and the Securities Markets Act 1988.

The FMCA is the result of a comprehensive review of financial markets legislation and takes into account the work of the Capital Markets Development Taskforce, the effects of the global financial crisis and the failure of numerous finance companies in the wake of the crisis. While the FMCA significantly revised the financial products offering regime by comparison to the Securities Act 1978, the regime covering the disclosure of directors' and "officers'" (now "senior managers") relevant interests in financial products remains, with a few noteworthy exceptions, the same.

What must be disclosed?

Section 235 of the FMCA sets out the basic rule for determining whether a person has a *relevant interest* in a financial product.

A person has a relevant interest in a financial product if they are the registered holder or beneficial owner of the product, or have the power to exercise or control the exercise of a right to vote attached to the product, or to exercise or control the exercise of the acquisition or disposal of the product (s 235(1)). Significantly, it is irrelevant to the creation of a relevant interest whether the power is: express or implied, direct or indirect, legally enforceable or not, relates to particular financial products or not, exercisable presently or in the future, exercisable jointly or alone. It is also irrelevant whether the power is conditional or subject to a restriction (s 235(2) and (3)).

Sections 236 and 237 extend the basic rules above to cover relevant interests arising because of breaches of trust or agreements as well as persons acting jointly or in concert or who are deemed to be under the control of another person. For example, a person who owns 20% of the shares of company A, which in turn holds shares in company B, has a relevant interest in the shares held by company A.

Section 238 covers the situations not giving rise to a relevant interest. Broadly, the section deals with situations that do not give "true" control of the financial product to the person who would otherwise have a relevant interest. For example, proxy

holders at particular shareholders' meetings of the listed issuer, bare trustees, a director of a body corporate where that body corporate has a relevant interest in the relevant financial product, persons undertaking trading activities in the ordinary course of their business on a licensed market on behalf of others, etc.

Subject to applicable exemptions, a director or senior manager of a listed issuer must disclose all relevant interests in a quoted financial product of the listed issuer or a related body corporate on appointment or the listed issuer's listing (whichever is sooner) and any subsequent acquisition or disposition of a relevant interest (s 297 (1) and (2)).

Where the listed issuer is the issuer of a quoted derivative (which is not a specified derivative), the director or senior manager would disclose his or her relevant interest therein under s 297. However, disclosure obligations also apply to certain specified derivatives of which the listed issuer is not necessarily the issuer but where the "underlying" or one of the "underlyings" of those derivatives is a financial product of that listed issuer (s 298). An "underlying" is anything by which the amount of consideration provided under a derivative or the value of the derivative is ultimately determined, derived or varies by reference to (s 6).

A director or senior manager of a listed issuer must disclose all relevant interests:

- in any quoted derivatives where the "underlying" is, or includes, a financial product of that listed issuer or a related body corporate (s 298(3)(a)), and
- in any unquoted derivative which has a quoted financial product of the listed issuer (of which the person is a director or senior manager) as one of or the "underlying" (s 298(3)(b)).

"Senior manager" means a person who is not a director but occupies a position that allows that person to exercise significant influence over the management or administration of the listed issuer. Section 6 of the FMCA gives the chief executive and chief financial officer as examples of senior managers.

Senior manager replaces the term "officer" used under the Securities Markets Act. An officer was defined as any person, however designated, who is concerned with, or takes part in, the management of the public issuer's business. The scope of this definition was reduced by regulation to apply only to persons who report directly to the board or to a person who reports to a person who then reports to the board.[3] Despite the former Securities Commission reminding market participants that even if a person was within two degrees of separation from the board, they still had to meet the base definition of officer, the conservative practice that developed was for

3. See the Securities Markets (Disclosure of Relevant Interests by Directors and Officers) Regulations 2003.