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DUTIES OF COMPANY DIRECTORS

(Under the Companies Act 1993)

The Companies Act 1993 became effective for all companies from 1 July 1997. This bulletin reviews the general responsibilities of Directors in the light of this legislation.

Who Are Directors?

Directors' duties are imposed not only on the formally appointed directors, but also on a number of "de facto" directors. The Act's much wider definition of "director" will now include, for example, people to whom the board has delegated some of the powers or duties of directors, or who exercise such powers or duties with the consent of the board.

What Are Their Duties?

Directors are subject to a number of general duties listed in the Act. The Act also imposes many duties of an administrative nature, and additional duties may be imposed by the company's constitution, or by a specific contract with the director. The general duties of directors are:

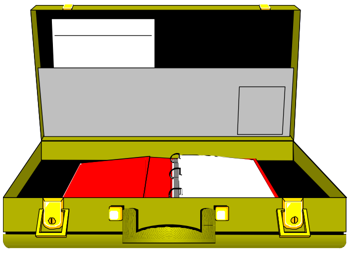
- **The duty to act in good faith and in the best interests of the company**. A director may be exposed to liability if placed in a position of conflict of interest. The director would be liable in damages for any resulting losses or to account for any profit.
- **Duty to exercise powers for a proper purpose**. A director may be liable if the power is used for something other than that for which it was intended. For example, if in the issuing of shares directors were to issue shares to themselves to affect the voting position of the company, or to defeat a takeover bid, it could be regarded as a breach of the duty to exercise powers for a proper purpose.
- **Compliance with the Act and constitution**. A director of the company must not act, or agree to the company acting, in a manner which contravenes the Companies Act or the constitution of the company.
- **Reckless trading**. A director must not cause a company to trade

recklessly in a manner which is likely to create a substantial risk of serious loss to the company's creditors. In addition, a director must not agree to the company incurring an obligation unless the director believes that, at the time and on reasonable grounds, the company will be able to perform the obligation when it is required to do so.

- **Duty of care**. A director must exercise care, diligence and skill, taking 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.

  It is acceptable for a director to rely on information and advice provided by others, if it is reasonable to do so. Thus, directors should document all decision making where reliance has been placed on any such advice, and incorporate that information in the company's records.

- **Duty to disclose**. Under the Act, where a director has an interest in a transaction, there is a duty to disclose that interest by entry in the "Interests Register" and by notice to the board.

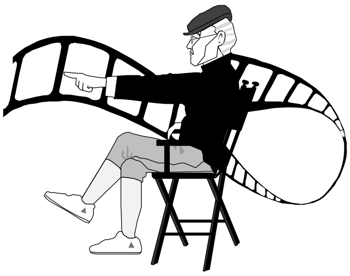


Board Certificates:

There are a number of specific provisions that require specific board certificates before the corporate acts can be undertaken. These circumstances include the following:

- Making a distribution.
- The issue of shares.
- Undertaking a share buy-back.
- Undertaking a redemption of shares.
- Giving financial assistance.
- Authorising certain remuneration or other benefits for directors.
- Effecting insurance for directors.
- Approving an amalgamation proposal.

Delegation:



Where a Board delegates a power (the third schedule of the Act details various powers which cannot be delegated) to a committee of directors, a director, an employee or any other person, the Board is responsible for the exercise of the power by the delegate as if the power had been exercised by the Board, unless the Board:

- believed on reasonable grounds at all times before the exercise of the power that the delegate would exercise the power in conformity with the duties imposed on directors of the company by the Companies Act and the company's constitution; and
- has monitored, by means of reasonable methods properly used, the exercise of the power by the delegate.

The requirement for monitoring is a requirement that should not be taken lightly.

Making Distributions - the Solvency Test:

Before the board may authorise a distribution to shareholders it must be satisfied the solvency test (sec 4 & 52) after payment of the dividend:

> ***To pass that test, a company must be able to pay its debts as they fall due in the normal course of business and the value of its assets must be greater than the value of its liabilities (including its contingent liabilities).***

Directors voting in favour of a distribution must sign a certificate stating their opinion that the company will satisfy the solvency test immediately after the distribution and the grounds for that opinion.

Major Transactions:

Under the new Act companies are prohibited from entering into a major transaction unless it is approved by a special resolution of shareholders (supported by 75% of shareholders entitled to vote).

> ***A major transaction involves buying or selling assets or a deal where the company incurs obligations or liabilities that are worth more than 50% of its assets.***

What Are The Consequences Of Directors Failure To Perform Their Duties?

If a company is liquidated a director found liable may be ordered to contribute an amount to the assets of the company by way of compensation, even though the director may be convicted of a criminal offence for the same act.

Also, in a liquidation, a court may if it thinks it proper declare any one or more of the directors personally responsible, without limitation of liability, for all or part of the debts or other liabilities of the company if proper accounting records have not been kept.

A director may be relieved from liability if the Court considers that he/she:

- took all reasonable steps to secure compliance; or
- had reasonable grounds to believe and did believe that a competent and reliable person was in charge of compliance.

Unless directors are mindful of their duties, it would be very easy for simple "lapses" to expose them to Personal liability and/or criminal conviction if an action were to be brought against a director by a shareholder, creditor or liquidator.

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Summary

What we have set out above is a very brief overview of Directors Duties under the 1993 Companies Act. Please contact Brian Bourke or Gerard Eastwood if you have any specific questions..