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Guide to Director's Obligations and Responsibilities

You're a company director, what does this mean?

This guide explains the role, obligations and responsibilities of company directors in New Zealand.

It outlines the liabilities directors can face if they fail to meet their responsibilities, and describes ways directors can reduce their risk of personal liability. A handy checklist is also included for directors to refer to.

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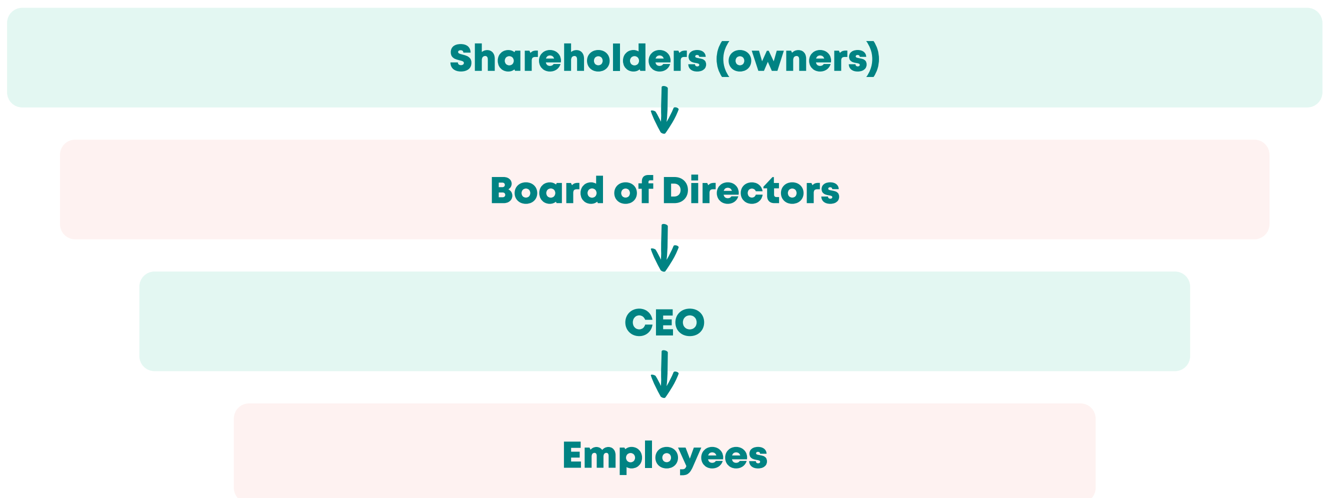
Company Structure and Governance

Think of a company as a series of layers – the shareholders create the company – they own it but don't have a part in its operations. The shareholders delegate the management and oversight (often referred to as 'governance') of the company to the directors. The employees (led by a CEO or general manager) operate the company in accordance with the directors' instructions and authority delegated to them by the directors.



In a small business, often one person is the director, shareholder and employee all at once! All these different roles have different responsibilities, and it is important to understand what these are. The legal obligations of a director do not change if the director is also the shareholder (or one of them) or is also an employee.

The Board of Directors is responsible for overall oversight and governance of the company. It will set the strategic aims and guide the company towards achieving them. One key role of the board is to identify risks and opportunities and plan accordingly. The board is responsible for keeping the company solvent and reporting to the shareholders. The board must put in place the right practices, policies and procedures to help guide the business in the right direction.

The CEO or Managing Director usually makes day-to-day decisions, and is responsible for the performance of the employees.

Shareholders do not have an active role in the operation of the company. They are entitled to receive regular information, and any 'major transaction' (a transaction involving selling or buying assets or liabilities worth more than 50% of the company's total assets, or incurring obligations or liabilities worth more than 50% of the company's total assets) requires 75% shareholder approval. A company's constitution or shareholders' agreement may give the shareholders additional voting rights regarding other key decisions.

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Who are directors, and how are they appointed?

Directors are people whom the shareholders appoint, but also include people who act in a director's role, even if they are not formally appointed as a director. Someone who directs the company's business, or whom other directors are accustomed to following, such as a shareholder who takes a very active interest and role in the company's business, may be deemed to be a director under the Companies Act 1993. These people are known as 'shadow directors' or 'deemed directors'. This has important consequences because that person, even if not formally appointed as a director, is still required to meet the legal obligations and responsibilities of directors.

A company must have at least one director. There is no restriction on the total (maximum) number of directors a company may have.

Under the Companies Act 1993, directors are appointed by a majority vote of the shareholders. However, a company's constitution or shareholders agreement may modify this so that certain shareholders have the right to appoint a certain number of directors, or some shareholders may not have the right to vote to appoint a director.

Directors who have resigned remain liable for their decisions when they were a director.

Director obligations and responsibilities apply equally to non-executive directors and executive directors (ie. directors who work in the business).

What obligations and responsibilities do directors have?

Directors have what is called in law a 'fiduciary relationship' with the company. Fiduciary relationships exist where one party places a very high degree of trust and confidence in the other party to act on their behalf. This fiduciary relationship means that directors must generally act in the best interests of the company (and not their own interests or the interests of any individual shareholder).

The Companies Act 1993 sets out several duties (known as directors' duties) with which directors must comply.

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Guide to Director's Responsibilities and Obligations in New Zealand

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This table below sets out the key directors' key duties under the Companies Act 1993.

Section	Director Duty	Comments
131	**A duty to act in good faith and in the best interests of the company**	The test is subjective (what the director honestly believed was right) but also objective, (how a reasonable director would be expected to act in the circumstances). Directors must consider the company as a whole, they can't ignore the interests of minority shareholders and must not act in the interest of only one shareholder or class of shareholders.
133	**A duty to exercise powers for a proper purpose**	Directors must not improperly use their position to gain an advantage for themselves or someone else, or harm the company. You can't use the information you've received in your capacity as a director to make a personal gain.
134	**A duty to comply with the Companies Act 1993 and the company's constitution (if it has one)**	Directors need to understand their obligations under the Act, such as maintaining a share register (see our Company Registers), keeping accurate and up-to-date records, preparing financial statements.
135	**A duty to avoid reckless trading**	In recent years, there has been increasing litigation on this section of the Act. A director must not agree to carry on business in a manner likely to create a substantial risk of serious loss to the company's creditors. The director's personal opinion is irrelevant – the Courts will assess whether there was something in the company's accounts which would have alerted an ordinary prudent director to the real possibility that continuing to carry on the business of the company would cause serious loss to the creditors.
136	**A duty not to agree to obligations that the director does not reasonably believe the company can fulfil**	This duty has also been a subject of litigation in recent years with directors being found liable for significant penalties and compensation.
	Sections 135 and 136 are supported by specific solvency test requirements.	Directors can only undertake certain transactions where they are satisfied the company is solvent. The test contains both a balance sheet and a liquidity/trading test. Directors need to be financially literate, as not only do they need to be comfortable to sign off a solvency certificate, but they (and not the accountants) are responsible for the company's financial statements and ongoing solvency. For more information and guidance, see the Institute of Directors New Zealand Solvency Checklist for Directors.
137	**A duty to act with the care, diligence, and skill a reasonable director would exhibit.**	The position of the director is compared with directors in similar circumstances, taking into account the nature of the company, the nature of the decision, the position of the director and the nature of the responsibilities undertaken by the director. A director can breach a duty by failing to do something, so it is important that directors have reasonable knowledge of what is happening within the company at all times.

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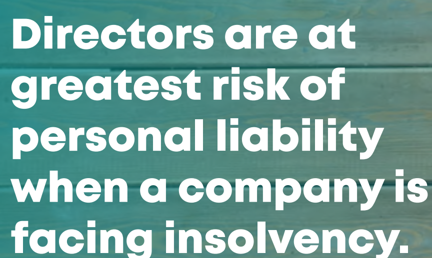
What liabilities do directors face if they fail to comply with their obligations?

Directors who breach their duties can be personally liable for significant civil and criminal penalties under the Companies Act 1993. Generally, directors owe their duties to the company, meaning the company can sue a director for a breach of duty. However, shareholders and creditors (such as the IRD) can take legal action against directors in certain circumstances. So, you shouldn't assume that because you run a small family business, you are immune from prosecution, there is still a risk of claims from creditors.

There are over 100 sections of the Companies Act 1993 of which a breach can constitute a criminal offence and therefore impose liability on directors. Penalties can be $5,000-10,000 depending on the offence. For dishonesty type offences, penalties can be up to $200,000 and 5 years imprisonment.

Also, under Section 138A of the Act, directors can be criminally liable for serious breaches of the duty to act in good faith where the director acts in bad faith, believing the conduct is not in the best interests of the company and knowing the conduct will cause serious loss to the company. Breaches of section 138A can attract the same penalties as a dishonesty offence.

Directors are also exposed to personal liability outside of the Companies Act, such as under the Resource Management Act 1991, Health and Safety at Work Act 2015 (eg unsafe work environment), Fair Trading Act (eg. for misleading and deceptive conduct), Commerce Act, Financial Reporting Act, Human Rights Act, Privacy Act and under tax legislation to ensure tax obligations are complied with. Directors could face claims from shareholders, creditors, suppliers, employees, regulators, liquidators, competitors, the general public or from the company itself.



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What can directors do to protect themselves from personal liability?

There are four key mechanisms directors can use to protect themselves from personal liability:

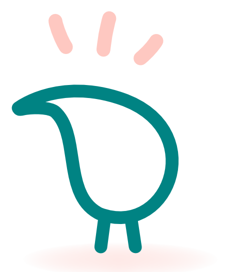
1. **Take professional advice:**
The Companies Act allows directors to rely on reports, statements and financial data, and professional advice given to them by an employee (reasonably believed by the director to be reliable and competent in the matters concerned) or a professional adviser/expert (on matters reasonably believed by the director to be within their expertise), provided the director acts in good faith, makes proper inquiry where the circumstances indicate a need for such inquiry, and have no knowledge that reliance is unwarranted.

2. **Indemnification:**
Require the company to indemnify you to the extent permitted under the Companies Act. An indemnity is essentially a promise to pay liabilities and costs incurred by a director in their role as a director. This must be permitted under the company's constitution, and there are certain liabilities the company cannot indemnify the director for. An indemnity is typically documented in a Deed of Indemnity. See our Director Indemnity Bundle and Constitution for more information.

3. **Insurance:**
Require the company to take out directors' and officers' insurance, to the extent permitted under the Companies Act. D&O insurance can provide additional protection in circumstances where the company's indemnity doesn't cover the liabilities incurred by the director. D&O insurance is complex, and there is huge variation in the terms and extent of cover amongst D&O insurance policies. It is important that directors understand the nature and extent of the protection provided and all the exclusions. We recommend discussing your needs with an insurance broker.

4. **Personal asset structuring:**
Directors can also undertake personal structuring of their own assets to avoid having any substantial assets in the director's own name in case they do face an action from shareholders or creditors. Talk to our asset protection law firm partner for more information.

Check out the handy checklist on the following page to ensure you're up to speed on your director's responsibilities!



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Checklist for directors

- [ ] Research the company before agreeing to be appointed – do you know the other directors? What is the company's current financial position? Is it in a heavily regulated or high-risk industry?
- [ ] Ensure you get regular financial reporting about the company's financial position from senior management – and ask questions if you don't understand. Make certain appropriate accounting policies and processes are in place.
- [ ] Hold regular board meetings and clearly document all board decisions by taking minutes or written resolutions – see our various company resolutions.
- [ ] Avoid conflicts of interest and disclose any conflicts that arise.
- [ ] Communicate regularly with your other directors.
- [ ] Prioritise the interests of the company over your own when making decisions.
- [ ] Ensure key employees have clearly documented delegated authorities (so they know what decisions they can make on behalf of the company) and regularly review these delegated authority levels and practice – see our Individual Employment Agreement.
- [ ] Adopt policies to manage employees – see our various employment policies.
- [ ] If you have any concerns about the financial solvency or stability of the company or whether you may have breached a duty, consult an accountant or lawyer (with insolvency expertise) as soon as possible.
- [ ] Take professional or expert advice on any controversial or complex issues, but ensure the advisor is properly qualified and the advice is plausible.
- [ ] If possible, resist giving personal guarantees to suppliers, banks or landlords.
- [ ] Require an indemnity from the company – see our Director Indemnity Bundle for more information.
- [ ] Ensure the company obtains D&O insurance with a reputable insurer.

If you need help understanding your obligations as a director, consider getting advice. On Your Terms' business law firm partner, is an expert in this field and would be happy to answer your questions.

To read more about legal issues relevant to SMEs in New Zealand, see our Knowledge Hub.

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