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GENERAL DUTIES OF DIRECTORS
THE DUTY OF CARE

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ABSTRACT

This paper is an analysis on section 137 and related sections of the Companies Act 1993. The paper applies the duty of care provisions of the Act on a transactional basis to the facts of Re City Equitable Fire Insurance [1924] 1Ch407.It examines the care required of the board of directors as a joint liability, and the individual liabilities of directors with regard to their own actions and actions of their delegates.

Word Length

The text of this paper comprises approximately 13100 words.

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I INTRODUCTION

The Companies Act - 1993 which came into force on 1 July 1994 has introduced a sense of statutory duty to directors and officers which until now has been left to the principles of common law. The commencement of this Act states as one of its objectives,

> *To encourage efficient and responsible Management of Companies by allowing directors a wide discretion in matters of business judgement while at the same time providing protection from shareholders and creditors against the abuse of management power.*

This paper examines the general duties of a director under the Companies Act 1993 devoting special attention to the duty of care provisions of the Act in sections 137 and 138 in association with section 130. It attempts a comparison between the common law as it has been developed through the years since the landmark decision of **Romer J in Re City Equitable Fire Insurance Company Ltd [1924]** and analyses if a more or less stringent regime of care is owed by a director under the Companies Act 1993.

There has been much controversy about section 137 and the quantum of care required of directors. Some commentators believe nothing has changed and that the Act only reinforces the common law. Others believe there is a significant increase in the standard of care. This paper is intended to analyse on a transactional basis what the outcome would be under the Act.

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II BACKGROUND AND ORIGINS OF DUTY OF CARE PROVISIONS

One of the prime reasons which spurred the Law Commission to make recommendations for a new Act was the subject of directors' duties. The Companies Act 1955 was silent on this topic and duties of directors could only be determined by reference to previous decisions of the courts. This was found to be unsatisfactory in terms of defining the law.

Prior to the enactment of the Act the Bill as it was first introduced to Parliament[1] consisted of the provision that the director was not only required to exercise the care, diligence and skill of the reasonable director, but also the requirement in the case of a director in a profession or occupation or possessing specialist skills or knowledge that he or she exercises the care diligence and skill that a reasonable director in that profession or occupation or possessing those special skills or knowledge would exercise in the same circumstances[2].

Upon introduction of this provision the Parliamentary Select Committee met with opposition from the professions themselves arguing that professionals

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1 Companies Bill as reported from the Justice and Law Reform Committee December 1992.

2 Above n1, Section 115 (2).

would shy away from company directorships if such a requirement were to be legislated. The select committee heeded to these submissions, hence the introduction of the current section 137 replacing the stricter provisions of the earlier Bill. What was introduced in replacement is commonly known as the Awa qualifications which requires the director to exercise the care, diligence and skill that a reasonable director would exercise in the same circumstances taking into consideration such things as the nature of the company, nature of the decision, the position of the director and the nature of the responsibilities undertaken by him or her[3]. The move away from the higher standard of care introduced in the original Bill although not diluting the serious nature of the responsibilities owed to the company by a director, certainly makes a difference in the standard of care required of the professional director. However there is much debate about whether the section 137 requirement is more onerous on the director than the standards set by the common law since **Re City Equitable**[4] and applied in every instance where directors duties have been examined in New Zealand.

The select committee also recognised the need for directors to rely on information, opinions and reports prepared by officers, experts or committees of the board. The law commission draft followed the North American model in introducing section 138 which provides for such reliance provided the

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[3] Companies Act 1993 Section 137.

[4] (1924) 1Ch 407.

directors act in good faith, and make inquiry when the need for inquiry is indicated and had no knowledge that such reliance is unwarranted.

III INTERPRETATION OF SECTION 137 GENERALLY

Section 137 of the Companies Act 1993 provides that

> *A director of a company, 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 taking into account, but without limitation.*
>
> *(a) The nature of the company; and*
> *(b) The nature of the decision; and*
> *(c) The position of the director and the nature of the responsibilities undertaken by him or her.*

The words "reasonable director" appear to set a distant and objective standard for the person described in the section. Yet further on in the section it talks of the person in the "same circumstances" and goes on further to say that the circumstances of the person's position, nature of responsibilities undertaken by the person in relation to the nature of the company and the nature of the decision should be taken account of.

The words "same circumstances" brings in a subjective element to the section and dilutes the objective standard set by the words "reasonable director". To say the least this is very ambiguous and leaves the section up in the air with no conclusive standard in sight. The section also requires taking into consideration the following:

(a) *The nature of the company and*

(b) *The nature of the decision and*

(c) *The position of the director and nature of responsibilities:*[5]

Again the subjective element is being manifested in these three qualifying circumstances which further exacerbates the ambiguities of the section.

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5 These are known as the Awa qualifications referring to the judgement of Rogers C J in Awa V Deloite Haskins and Sells.

IV RE CITY EQUITABLE FIRE INSURANCE COMPANY LTD [1924] 1 CHANCERY DIVISION 407- 532

The examination of directors duties have been frequently the task before the Courts and the decision of Romer J in **Re City Equitable Fire Insurance Company Ltd**[6] stands out as the foremost authority on this subject. In these proceedings Romer J delivered his judgment on the issue of whether the directors were properly discharging their duties that they owed to the company's shareholders during the misfeasance of the chief executive. The official receiver alleged that they were not. Whilst admitting that they had acted honestly throughout he maintained they were still guilty of such negligence, as to render themselves liable to the company in damages. The allegations against the directors were claims in negligence, breach of trust and breach of duty. In Romer J's judgement directors duties are often summarised by commentators as being

- A Director must act honestly
- A Director must exercise reasonable care an ordinary man might be expected to take on his own behalf
- A Director must give attention to a company's affairs although such attention may be intermittent and he or she is not obliged to attend all meetings.[7]

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[6] Above n4.

[7] See J Hodder "Corporate Management and Directors' Duties" Coopers and Lybrand and Chapman Tripp Sheffield Young joint seminar paper.

This is often viewed as a lenient standard. It is submitted that while the different interpretations of Romer J's decision have always conveyed his judgement as being a relaxed standard expected of a director as opposed to the standard of care required under the Common law of Negligence, Romer J did make some higher standard of care rulings which he only put aside due to the existence of Article 150 in the City Equitable Company's Articles of Association. He said at the conclusion of his judgement:[8]

> .... *But for the 150th of the articles of association, I should in my judgement have to hold the respondent directors liable in varying degrees for the loss to the company that might have been prevented.*

Article 150 of the City Equitable Company's articles of association provided:[9]

> *No Directors, Auditors, Secretary or other officers for the time being should be answerable for the acts, receipts, neglects, or defaults of the others or other of them, or for any bankers or other persons with whom any moneys or effects belonging to the company should be placed out or invested or for any other loss, misfortune or damage which might happen in the execution of their respective offices or trusts, or in relation thereto, unless the same should happen by or through their own wilful neglect or default respectively.*

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8 Above n4, 474.

9 Above n4, 413.

Romer J in his analysis of the words "Wilful Neglect"[10], said that an act or an omission to do an act is wilful where the person knows what he is doing and intends to do what he is doing. But if that act or omission amounts to a breach of his duty and therefore to negligence is the person guilty of negligence? Romer J said unless the person knows he is committing and intends to commit a breach of his duty it could not amount to wilful negligence.

It is submitted that in the City Equitable judgement, Romer J is influenced to great an extent by the Article 150 which is derived from the UK Companies Legislation[11] of the time when the action came before the Courts. An equivalent of this article was not provided for in the New Zealand Companies Act 1955 or its predecessors. Hence the Directors in City Equitable could well have been in breach of their duties to the shareholders of the company under New Zealand law, as Romer J only found them to be not "wilfully negligent". The City Equitable judgement will be dealt with on a transactional basis in the discussion following, forming the basis for the decision if directors duties specified in section 137 in association with section 138 and section 130 of the Companies Act 1993 require a different standard of care than what the common law has required up to now.

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[10] Above n4, 434.

[11] Companies Consolidation Act, 1908 8 Edw, 7. C. 69.

V THE LAW AS APPLIED IN CITY EQUITABLE

In laying down the principles of law applicable to directors duties Romer J alluded to the fact that directors have sometime been considered to be in a fiduciary relationship to a company. However he was sympathetic to the fact that different directors would have different standards of care applicable such as an insurance company director would have different obligations to a director of a bank; A director of a small company may have different responsibilities in attending to most of the activities himself as opposed to a director of a larger company where certain matters are dealt with by the management and staff. Romer J said that in order to ascertain the duties of a director it was necessary to consider:[12]

> *Not only the nature of the company's business, but also the manner in which the work of the company is distributed between the directors and the other officials of the company, provided always that this distribution is a reasonable one in the circumstances, and is not inconsistent with any express provisions of the articles of association. In discharging the duties of his position thus ascertained, a director must of course act honestly.*

Romer J went on to analyse the law saying that although it has been said in the past that as long as a director acts honestly he cannot be made

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[12] Above n4,427.

responsible in damages unless guilty of gross or culpable negligence, he felt that one could not say whether a person had been guilty of negligence, gross or otherwise unless the extent of the duty itself can be determined. One had to know the extent of the duty that has been neglected.[13] Romer J was referring to Neville J's analysis in **Re Brazilian Rubber Plantations and Estates.**[14]

Romer J also compared the difference between ordinary negligence and gross negligence in determining what standard of care was required from the director. He said if a Director has to be proved to be grossly negligent a director did not owe a duty to the company to give all possible care. He referred to what Neville J had quoted in re Brazilian Rubber Plantations in saying a director owes to a company "reasonable care" to be measured by the care an ordinary man might be expected to take on his own behalf. He went on to conclude that directors could not be liable for mere errors of judgment.

This summary of the law in general by Romer J has been accepted as the law applicable in the assessment of directors duties ever since Re City Equitable. Romer J applied these principles to the facts of the City Equitable transactions which will be discussed in the ensuing pages.

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13 Above n11.

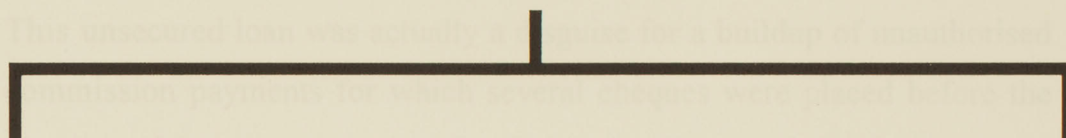
14 [1911] 1 Ch425,437.

VI STANDARDS OF CARE - A COMPARISON

The weight of the burden of care in the City Equitable context would need to be examined as against section 137.

The standards would be:

DIRECTORS STANDARD OF CARE



COMMON LAW CITY EQUITABLE	COMPANIES ACT - 1993 SECTION 137
(1) To exercise reasonable care an ordinary man might exercise on his own behalf.	To exercise the care of a reasonable director in the same circumstances taking into consideration
(2) Not bound to give continuous attention to the affairs of the company.	(1) The nature of the company (2) The nature of the decision
(3) In the absence of suspicion may trust an official to perform his duties honestly.	(3) The position and responsibilities undertaken by the director.

VII CITY EQUITABLE TRANSACTION A - OVERPAYMENT OF COMMISSION

A Facts

The general manager of the City Equitable Fire Insurance Company had a large sum of money advanced to him by the company, which sum was unsecured and never paid back as at date of the company's liquidation.[15] This unsecured loan was actually a disguise for a buildup of unauthorised commission payments for which several cheques were placed before the directors of the company at regular meetings which were all signed without question by the directors. In the three year period in question in Re City Equitable 154 cheques were signed by the directors amounting to £110,000 in payments to the general manager.

The usual procedure in the company where a note accompanying each cheque would be prepared stating the amount and purpose of the cheque with a statement such as "authorised for payment at board meeting of (date)," had not been followed. Normally a list would also be prepared of all cheques stating the names of payees, amount of cheques and purpose of each cheque which would be ratified at each board meeting. This practice had suddenly ceased, the list would only state each amount of the cheque without payee names or purpose of requirement. The list itself was gradually omitted for

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[15] Above n4, 448.

presentation at the board meetings but merely went to the company secretary's department and got transcribed as a whole amount for which cheques were required into the agenda book. At the meeting the board would resolve that cheques be drawn to the amount stated in the agenda book and each cheque was signed by any two directors that were present. None of these unauthorised amended procedures were questioned by the directors at the regular board meetings.

B Findings

Romer J in considering these facts said that as regards the cheque amounts a director must of necessity trust to the officials of the company to perform honestly and properly the duties allocated to them. He said that no single cheque amount exceeded what a director might reasonably consider to be properly payable to the employee on account of or in anticipation of commission. As regards the duties owed to the company by one of the directors who was also a member of the finance sub committee, Romer J said although the frequency of the cheques did raise some difficulty, he was prepared to excuse him on the ground that there was no ostensible reason for this director to have kept a list of all the cheques he signed, as this would have been far outside the duty owed by a director to a company and quite impractical. Hence Romer J concluded that a director only undertakes to bring to the service of the company a memory of a normally imperfect nature implying the prudence of an ordinary man.

In the foregoing set of facts Romer J found that directors could quite rightly rely on company officials with regard to preparation of cheques. However despite this finding he went on further to consider the directors responsibilities with regard to the unauthorised amendment of procedures by the company officials for cheque payments which not one of the directors had questioned.

The alteration in procedures was where the normal list which would be prepared containing names of payees and amounts of each cheque was not being produced at board meetings anymore, but the total amount of payments for which cheques were required would be transcribed in the agenda book. Romer J held that although the directors could be freed from liability for their individual signing of the cheques in the circumstances, a major procedural lapse had occurred, in that he found that a board resolution should have authorised each cheque payment by way of a total list of all cheques. He said such authority from the board was necessary and although some precaution was being exercised in this case, all cheque amounts were lumped together as an aggregate amount on which the board resolved at each meeting. This rendered the precaution useless. Romer J went on to say that if a proper list of cheques were read out at each meeting and subsequently transcribed into the minutes of the meeting which would have been circulated prior to board meetings all the overpayment of commission cheques would have come to light and the frequency of the payments to the general manager would have been detected.

Romer J concluded with a finding of near negligence in the words:[16]

> .... *Whether the omission of the respondent directors to follow the proper practice in giving authority for the signing of cheques constituted negligence on their part may be a question of some difficulty. But if it was negligence it was not wilful negligence..........*

It is again significant that Romer J was restricted to a certain degree by Article 150 of the company's articles.

Romer J also questioned the representations of the overpayments lumped together as "loans at call or short notice" in the balance sheet for the years in question. He held that any director whose duty it was to inquire as to loans owing to this company would have discovered, or be deemed to have discovered the existence of the loans to the general manager.

It is therefore submitted that the City Equitable standard of care as decided by Romer J in relation to the transaction of overpayment of commissions went beyond the common interpretation given to the City Equitable facts i.e. the ordinary man standard. Romer J's decision expounds the fact that the directors needed to act more responsibly regarding the unauthorised amendment of company procedures in relation to approving cheque payments in general.

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16 Above n4, 460.

VIII APPLICATION OF SECTION 137 TO TRANSACTION A - CITY EQUITABLE

The findings of Romer J on the facts related above with regard to the overpayments to the general manager could be summed up as

1. Directors cannot be expected to keep note of each and every cheque signed by each of them as this would be outside the prudence of an ordinary human being

2. Directors should take responsibility to resolve at each board meeting their approval to the list of cheques being signed each time.

3. Directors should satisfy themselves as to the reported figures in the balance sheets of the company.

An application of section 137 to the above facts in Re City Equitable may on the face of it appear to convey that directors would be required to show a much higher standard of care than what has been the usual interpretation of Romer J's findings ie that City Equitable required the directors to only bring

the memory of a normal human being[17] to the boardroom whereas section 137 would require the director to have acted as a "reasonable director".

However as submitted previously City Equitable goes beyond the ordinary man standard in requiring the directors to pay heed to boardroom procedures and give closer attention to figures reported in the annual accounts and only relieved the directors of liability due to the existence of Article 150.[18] Would the outcome be any different under section 137?

Under section 137 a Director is required to exercise the care, diligence and skill of a reasonable Director in the same circumstances taking into consideration

1. The nature of the company
2. The nature of the decision
3. The position and nature of responsibilities undertaken by the Director.

Dealing first with the nature of the company in a large company such as City Equitable which was a thriving fire and general business with a progressive

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17 Above n4,458 "Nor can I think that a director fails in his duty by reason of lapses of memory that are in the circumstances reasonably excusable. He only undertakes to bring to the service of the company a memory of the normally imperfect nature, and Mr Grenside's memory would appear to have been of this order" Romer J.

18 See above pp7,8.

trading profit and increasing premium income in the years in question it would be easily justified that the nature of the company required the directors of the company to delegate the day to day running of the business to the officials of the company. Also that the directors could rely on them for efficient management of the company without too many oversight obligations from directors.

As regards the second qualifier (nature of the decision) firstly in relation to the decision of cheque amounts it was not a decision that could have put the directors on inquiry. It was not a decision that normally requires closer scrutiny and it would be usual to treat such a decision as a routine matter. The section 137 outcome could well be similar to Romer J's findings.

However, the decision in regard to altered practices in presenting cheques for signature to the board, would require more attention under section 137. The decision would be a more serious one to which under section 137 the board will be required to pay more attention. Again Romer J's conclusion was similar.

As for the nature and responsibilities undertaken by the directors in the City Equitable context, Romer J tended to treat the directors of the main board less severely than the directors represented on the finance sub committee. Section 137 together with section 138 permits directors to place reliance on

employees and committees of directors etc[19] provided the director acts in good faith and has no knowledge that such reliance is unwarranted and makes proper inquiry when the need for inquiry is indicated by the circumstances. Hence it is possible that the application of sections 137 and 138 would coincide with Romer J's treatment of more severity to directors of the board who were also on the finance committee rather than all board members.

Romer J in discussing the involvement of the directors said they were not all involved to the extent that each director would have attended every board meeting. Each director was involved in varying degrees:

Lord March -	Due to serious illness could only attend two meetings in the three year period under question and had offered to resign his directorship but was persuaded by his colleagues to remain.
Mr Milligan -	Carried on business in Aberdeen and could only attend few Board Meetings.

Haig Thomas and Henry Grenside were businessmen of repute and were members of the finance sub committee as well as the main board. Additionally Grenside was a solicitor with a vast business clientele. They

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19 New Zealand Companies Legislation, Chapman Tripp Sheffield Young, pp313 004,313151.

were both appointed to the finance committee together with the chairman and chief executive.

Section 137 on the other hand may not provide a defence to a director who lives in Aberdeen and cannot attend board meetings regularly. Yet liability that attached to such a director could differ from the liability attaching to the directors in the finance sub committee who undertake ostensible responsibility for the investments of the company generally.

The words "position and nature of responsibilities undertaken by the director" is very wide terminology which leaves the discretion as to the duties undertaken to the director himself, rather than stating something similar to the words "duties and responsibilities imposed on the directors". Hence section 137 appears to fix the duty of care corresponding to the duties undertaken by the director at the director's discretion, almost on a contractual basis. This again introduces a subjective element which offsets the distant standard of the "reasonable director" in the same section. Even if a "reasonable director" in normal parlance would point to someone more astute (i.e. an experienced professional director) than an ordinary man as applied by Romer J the "reasonable director" is being given some comfort in the qualifying circumstances provided by the Companies Act 1993 which standard appears to coincide to a large extent with the ordinary man standard applied in this transaction A in Re City Equitable.

David O Jones in his account on director's duties[20] suggests that the requirements in relation to the director's duty of care under the Companies Act 1993 is not that of a reasonably "careful" director but the care of a reasonable director who he infers as satisfying the requirements of an "ordinary man as applied by Romer J in City Equitable.

> *Use of the expression "same circumstances" is of some significance for it introduces a subjective approach to consideration of the standard expected of directors. The circumstances which must be considered are exactly those facing the director under scrutiny and not circumstances which distance the decision making from the director. This offsets the objective connotation which arise from the use of the term "reasonable director" and supports the interpretation that a "reasonable director" does not mean a reasonably skilful person or director.*[21]

It is therefore submitted that section 137 does not convey in unambiguous terms what duty of care is required of the director. It appears to be a hotchpotch of dual or multiple standards which the courts are left to interpret in due course. It must be noted however that when before the court the expert reasonable director could well appear to give evidence (with the benefit of hindsight) that he or she as a reasonable director would have acted

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[20] David O Jones "A guide to the Companies Act 1993" Butterworths 1993

[21] Above n20, 121

differently. This again makes the standard of care required from a director open ended and undefined.

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IX CITY EQUITABLE TRANSACTION B - CUSTODY OF INVESTMENT MONIES

A Facts

The firm of investment brokers acting for the company had in their hands from time to time large sums of money belonging to the company over which not one director of the board exercised any control and in respect of which no account was ever asked for or seen by any of the directors.[22]

Originally an advance of monies to the brokers was authorised by way of a resolution of the finance sub committee of the board to the effect that a loan would be granted for the sum of £30,000 against securities to be lodged with the company with a 10% margin by the brokers. One of the directors recalled that this loan was later increased to £200,000. However in reality this sum had increased significantly at the broker's own initiative without any of the directors being aware. This was only made possible as there were always large sums of unsupervised monies in the hands of the brokers. These monies were derived from, the sale of the company's investments carried out by the brokers on behalf of the company. They did send accounts of their dealings to the company, but it only went as far as the accounts division of the company, none of the directors had any opportunity to sight these purported accounts.

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[22] Above n4, 461 to 474

Due to these slack procedures in the company the chief executive of the company who was also a partner of the same broker firm could take advantage of the situation and was able to deal as he thought fit with the available cash resources that were not required for investment decided by the finance sub committee. If he wanted a few more thousand pounds for his own purposes of the monies reposing in the hands of the brokers (the existence of which he would quite easily become aware of as he was a partner in the firm of brokers), he only had to direct the accountant of the company to debit his firm's loan account with the sum required and it would promptly get done. Hence it was not surprising that the authorised loan of £30,000 to the firm of brokers had swelled to £720,000 at the date of commencement of the liquidation proceedings.

As far as the board were concerned they thought that the finance committee was looking after all investments and therefore believed the control of monies whether in permanent or temporary investment, were all being looked after by this committee. However two of the directors who were also members of the finance committee were of a different impression, i.e. that the finance committee was only responsible for the permanent investments of the company and that the chief executive and the general manager of the company were responsible for the temporary investment of the company's funds. As a result of this chaotic misapprehension of responsibilities by members of the board the monies not in permanent investment were able to be totally mishandled by the chief executive without inquiry from the board of directors.

An example of this was when the finance committee decided to reduce the company's aggregate holdings in industrial securities and the chief executive was authorised to sell certain holdings, the proceeds of which was to be invested in government bills in due course. Accordingly various sales were carried out by the firm of brokers at the chief executive's behest following which the cash in their hands on investment account was over £550,000. By means of entering a perfectly fictitious purchase of treasury bills and war bonds and by an unauthorised transfer to loan account, the balance shown as cash in the hands of the brokers was reduced to £73,650 in the company's books. In reality the entire sum of £550,000 remained uninvested in the hands of the brokers down to the date of liquation. National war bonds and treasury bills purported to have been bought were never delivered to the company, ultimately never being questioned by any of the directors.

What had in fact happened at the instigation of the chief executive was that following the finance committee resolution to divest itself of its investments in industrial securities, the chief executive instructed the brokers to sell nearly £320,000 worth of securities to a syndicate of which the chief executive himself was (possibly) the sole member. Shortly afterwards these securities were purportedly resold to the company without authority which reduced the brokers account balance by £319,517. The proceeds of this pretended resale was credited to the brokers account much later. The balance due from the brokers in spite of them being credited with the proceeds of the re-sale of securities was shown on the company's books at the lower level of £50,000 which was made possible by the chief executive appropriating £190,000 for the purpose of investing in a Brazilian ranch and £40,000 in

shares of the company, United Brass Founders, in both cases without the knowledge or authority of his associate directors. Finally when it became obvious to the chief executive that the brokers' indebtedness could no longer be concealed, at his behest the brokers firm unloaded a number of doubtful securities on the company and debited the company with a further large contribution to the Brazilian ranch. Due to this and some other fictitious cash payments to the company the amount due from the firm of brokers both on loan and investment account had disappeared and in fact the company's books showed an amount of £13,950 as being owed to the brokers! In actual fact the monies owing from the brokers was £720,000, the collateral security held by the company realised £30,859!!

B Findings

On the foregoing facts Romer J held that the advancing of monies not immediately required by the company for current business purposes or permanent investment if made upon adequate security was a legitimate method of employing the company's funds and there was no reason why such an advance should not be made. There was no evidence to prove that either of the directors was aware or should be aware that there was insufficient cover of security for the loan at anytime when intervention on his part could have served any useful purpose.

In response to the defence that the directors were not aware that the finance sub committee had the task of overseeing the temporary investment of the company as well as the long term investments Romer J held that the facts of

the case put before him showed that the finance committee was responsible for all investments generally. He said it was the duty of each director to see that the company's monies are from time to time in a proper state of investment. Romer J was of the view that the directors who were on the board but not a part of the finance committee were justified in delegating this general duty to the finance committee. However the two members who were main board directors as well as a part of the finance committee were negligent of their duties to think that the chief executive and the general manager were responsible for these investments. Romer J said that the shareholders had elected six or seven other directors to be associated with the chairman and chief executive and it was not for these other directors to leave the chief executive to discharge one of the most important of the duties that had been entrusted by the shareholders to the board as a whole, however reasonable and however safe. He held that the two directors were in breach of their duties in failing to control and safeguard the monies of the company that were not in a state of permanent investment. He said if they felt that the finance committee were not responsible for the temporary investments then they should possibly have thought that the whole board was, not just the chief executive and general manager of the company.

Although holding that the rest of the directors outside the finance committee were not responsible for seeing that the monies of the company were in a proper state of investment as that task was properly delegated to the finance committee, Romer J held that all the directors were collectively responsible for the losses occasioned by the improper way in which the chief executive was actually able to dispose of those monies so far as such disposition came

to their notice or would have come to their notice had they made proper enquiries.

He went on to find that all the directors of the board although justified in trusting to the finance committee to perform properly the duties delegated to them, they still had a duty to inquire as to the making of a report to the company in general meeting as to the state of the company's affairs. He said that the amount recommended to be paid in dividend to the shareholders was a duty of the board of directors as a whole and not the finance committee alone.

Romer J held that it was the duty of each director to have inquired and obtained a list of the company's assets or investments for the purposes of scrutinising the balance sheets of the company in each year. He held that such a list would have shown in detail all the investments that were lumped together under general headings in the balance sheet. He said each director might then have formed some idea as to whether the total sum brought in as the value of investments under each general heading was justified for the general purposes of the balance sheet and for the specific purpose of the dividend that was being recommended. Romer J concluded that had the directors made or caused such inquiries to be made especially as to the items that appeared in the balance sheet as "loans at call or short notice" under which headings the loans to the general manager and the advance to the firm of brokers was included, a considerable sum of money might have been saved to the company. Romer J held that in not making or causing to be made these inquiries the respondent directors had failed to come up to the strict standard

of their duty. He concluded that the directors did less than what the law required of them as to the extent of their duty. He summed up on the director's duty of care with regard to the facts surrounding the loss of investment monies in the words:[23]

> *When presenting the annual report and balance sheet to their shareholders, and when recommending the declaration of a dividend directors ought not to be satisfied as to the value of their company's assets merely by the assurances of their chairman, ... nor with the expression of the belief of an auditor as competent and trustworthy as ...... As I have already stated a list of the company's assets should have been prepared, and this was never done. But for the 150th article of association I should in my judgement have to hold the respondent directors liable in varying degrees for the loss to the company that might have been prevented had such a list been called for on the occasion of the approval by the board of the balance sheets for the years 1919, 1920 and 1921 ....*
>
> *....... The other respondent directors, however are relieved from liability by reason of the article, for I am quite satisfied that they erred in perfect good faith and in ignorance of what was their duty to the company in this respect.*[24]

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23 Above n9.

24 Above n23.

Romer J was in the above circumstances applying the law as in the Common Law of Negligence whereby he interpreted the director's duty to be that of looking beyond what was being presented by the company's officials and the company's auditor as the reported amounts in the balance sheets. He was not applying the lenient standard of "gross negligence" as interpreted earlier in the paper i.e. he was not saying the director was not required to take all possible care. The standard of care applied by Romer J was under the Law of Negligence per se, however he was obliged to be attentive to the company's articles which imposed a more lenient standard of "wilful negligence".

It is however submitted that the "Wilful Negligence" standard applied by Romer J was not as lenient as the "Gross Negligence" standard as analysed earlier on in the case.[25] Under the latter standard Romer J said referring to **Neville J in Overend and Gurney Co v Gibb:**[26]

> *Whether or not the directors exceeded the powers entrusted to them or whether if they did not so exceed their powers they were cognisant of circumstances of such a character, so plain, so manifest and so simple of appreciation, that no men with any ordinary degree of*

25 See above p8.

26 LR5 H.L.480.

> *prudence acting on their own behalf would have entered into such a transaction as they entered into?*[27]

Whereas under a standard of wilful negligence Romer J said the word "wilful" in article 150 did not qualify a director's liability for negligence . He said "that an act or an omission to do an act is wilful where the person knows what he is doing (or not doing) and intends in so doing (or not doing)".[28]

It was only under this standard of wilful negligence that the directors of the board were absolved of liability in the circumstances described above.

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[27] Above n4,428.

[28] Above n4,434.

X APPLICATION OF SECTION 137 TO TRANSACTION B - CITY EQUITABLE

Romer J's findings in transaction B could be summarised as:

1. The board of directors were justified in delegating the task of investments generally to the finance committee.

2. Members of the finance committee could not be justified in leaving the function of temporary investment to the chief executive and general manager of the company.

3. The directors were collectively responsible for allowing the slack procedure in safeguarding temporary cash resources of the company.

4. The directors should each be responsible to inquire into the balance sheet figures reported each year by company officials and the auditors. They should obtain for scrutiny a list of the company's assets/investments in each year for this purpose.

The collective responsibility of the board for transactions involving committees of the board and employees and officials of the company was being assessed by Romer J in the facts related above.

Section 138 of the Companies Act 1993 focuses on this aspect of the duty of care required from directors. Section 138 says:

Section 138 (1)

A director of a company, when exercising powers or performing duties as a director, may rely on reports, statements and financial data and other information prepared or supplied, and on professional or expert advice, by any of the following persons.

a. *An employee of the company whom the director believes on reasonable grounds to be reliable and competent in relation to the matters concerned:*

b. *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:*

c. *Any other director or committee of directors upon which the director did not serve in relation to matters within the directors or committee's designated authority.*

Section 138 (2)

Subsection (1) of this section applies to a director only if the director

a. Acts in good faith and

b. Makes proper inquiry where the need for inquiry is indicated by the circumstances; and

c. Has no knowledge that such reliance is unwarranted.

In the City Equitable context section 138 (1) (c) permits reliance on a committee of directors and section 138 (1) (a) permits reliance on employees of the company. Thus the directors of the board could rely on the finance committee to take responsibility for investments generally. Such reliance would also be justified on the ground that the finance committee was made up of very reputable and well qualified persons. It is fair to say that the reliance was being placed in good faith and a need for inquiry had not arisen and nor was there any need for suspicion that such reliance was not warranted. Thus the qualifications under section 138 (2) are being satisfied to a large extent with regard to the duty of care owed by the board as a whole.

Romer J was however, treating with more severity the extent of care required from members of the finance committee in comparison with the rest of the board with regard to the decision of temporary investments of the company. As he understood the facts, investments per se had been delegated to the finance committee . He held that the two directors of the finance committee had neglected their duty in assuming that the finance committee was only responsible for permanent investments and that the chief executive and

general manager of the company had taken the responsibility for temporary investments.

On an application of section 137 and 138 to the responsibilities owed to the company by the two directors in the finance committee it could be argued that a more lenient standard is being articulated on these two directors under the Companies Act 1993. It is submitted that section 137 (c) brings in a subjective, almost contractual connotation in the words "duties undertaken by the director"[29] which could be interpreted in this context as being that these two directors did not undertake the responsibility of overseeing the temporary investment of the company as they believed in good faith that the chief executive and general manager had assumed responsibility for these transactions. They also had no knowledge that such reliance was unwarranted.[30]

It could also be argued that applying section 138 (1) these two directors relied on an employee of the company who they believed on reasonable grounds to be reliable and competent in relation to the matters concerned. ie The chief executive, or the general manager or both. Thus it is submitted that section 138 in association with section 137 could quite easily impose a lesser duty of care on these two directors than what Romer J said was required of them in the Re City Equitable judgement. Romer J absolved

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29 See above pp20,21

30 Section 138 (2) (c)

these two directors of liability only due to the requirement in the article 150 of "wilful negligence" from the directors concerned. It appears that under section 137 such an outcome would still be possible despite there being no "wilfully negligent" provisions.

As regards Romer J's findings that the board as a whole was negligent in allowing the slack procedures in safeguarding the temporary cash resources of the company which made it possible for the chief executive to actually dispose of the monies as he thought fit, it could be argued under section 137 that a reasonable director of a company of the size of City Equitable could easily place reliance on the company officials to safeguard cash resources not in a state of permanent investment. However it is possible to expect of such a reasonable director who works on a sub committee such as the finance committee, following the resolution by the finance committee to divest itself of the company's holdings in industrial securities, to make inquiry as to the outcome of the implementation of such a decision. Even if it be as submitted earlier that section 138 would permit reliance on an employee for the task of making temporary investments the finance committee member would be required under section 137 (c) in view of the "duties undertaken" in respect of permanent investment that such director makes inquiry as to the implementation of the decision to invest in treasury bills and war bonds. Hence section 137 would impose a similar standard to that applied by Romer J on the directors on the finance committee but not on the entire board for allowing the lack of accountability which made it possible for the chief executive's misfeasance to occur. Here again the section 137 standard of care required of the board as a whole is more lenient than Romer J in City

Equitable. The standard would be similar with respect to the directors on the finance committee. Thus it is submitted that it is possible to treat directors differently under the section 137 standard, but as a collective responsibility, the standards under 137 and 138 are more lenient than that articulated by Romer J.

As regards the decision of inquiring into the reported figures in the annual reports prior to recommending payment of dividend to shareholders, although an application of section 137 would require the reasonable director to take all reasonable care, it is possible that under section 138 the director could still rely on reports, statements and financial data supplied by employees of the company who he reasonably believes to be reliable and competent. In the case of City Equitable there was no ostensible reason to doubt this seeing that section 138 (2) only expects inquiry to be made if the need for inquiry is indicated by the circumstances. Romer J insisted on the need for obtaining a list of assets in each year. It appears that nothing in section 138 of the Companies Act 1993 would warrant that. Section 137 on the other hand with the "catch all", all encompassing phrase " care, diligence and skill of a reasonable director" could warrant inquiry into a list of assets in investigating a company's balance sheet in a specific year. Yet it cannot be said that these words in section 137 makes it an unambiguous requirement for a director to inquire into such detail, as section 138 permits reliance on third parties under certain circumstances for such information. Thus in applying the provisions of sections 137 and 138 to the facts of the transaction B related above and in comparing the holdings of Romer J it is submitted that the standard of care required under the Companies Act 1993 could again be

more lenient than that applied by Romer J and that the final outcome would be very similar under both standards.

It is submitted that the words "Reasonable director" in section 137 is contradictory to what is being said in the latter part of the section 137, closely followed by the content of section 138.

This position should however, be examined under section 130 of the Companies Act 1993.

XI DELEGATION OF POWERS OF DIRECTORS

A SECTION 130

The Companies Act 1993 recognises the necessity for the board of directors to delegate some of its powers for the efficient running of the company.

Section 130 (1) says:

> *Subject to any restrictions in the constitution of the company, the board of a company may delegate to a committee of directors, a director or employee of the company, or any other person, any one or more of its powers other than its powers under any of the sections of this Act set out in the second schedule to this Act.*

Section 130 (2) says:

> *A board that delegates a power under subsection (1) of this section is responsible for the exercise of the power by the delegate as if the power has been exercised by the board unless the board*
>
> *(a) Believe 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 this Act and the company's constitution and*

> (b) *Has monitored, by means of reasonable methods properly used, the exercise of the power by the delegate.*

Section 130 does not fully absolve the board of liability when powers have been delegated. It states that the board that delegates a power under this section is responsible for the exercise of this power by the delegate as if the board was itself exercising the power and this responsibility could only be avoided if the board under subsection (a) believes on reasonable ground that the delegate will exercise the delegated powers in conformity with the directors duties under the Act and Constitution and (b) has monitored by reasonable methods the delegate's performance.

It is well settled that the delegation of a function does not alone constitute compliance by a director with the director's duty of care obligations with respect to the function.[31]

In Re City Equitable Romer J said a director was justified in trusting the finance committee to perform properly the duties delegated to them. However he said the responsibility lay with the directors in the finance committee to control and safely manage the monies left for investment. It was not for those two directors in that finance committee to leave that function to the general manager of the company to decide upon the method

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[31] American law institute - Principles of Corporate Governance in Part IV, p223.

of investment of a company's cash resources. On an application of section 130 of the Companies Act there are two issues in relation to the City Equitable facts. They are whether firstly the board as a whole could delegate the function of investments to the finance committee and take no responsibility thereafter. Secondly, if the finance committee could leave the function of temporary investments to the general manager of the company.

On the first issue although the board could under section 130 delegate the investment function to the finance committee it will be required to "believe on reasonable grounds at all times before the exercise of the power that the delegate will exercise the power in conformity with the duties imposed on directors by the Act and the company's constitution".[32] In City Equitable the delegation was to a finance committee comprising of very competent people in their respective fields. Delegation would be permissible in this instance as the belief "at all times before the exercise of the power" would be meritorious of the fact that the power would be exercised properly as required by this section. However under section 130 (2) (b) the board would have had to monitor by means of reasonable methods properly used, the exercise of the power by the delegate. In the judgment of City Equitable Romer J absolved the board as a whole from liability in respect of the temporary investments. Also as submitted earlier this would be a possible outcome under sections 137 and 138. In contrast to this, under section 130 the City Equitable board as a whole could not be fully absolved of liability

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[32] Section 130(2) (a).

as it did not comply with the requirement of "monitoring by reasonable methods the exercise of the power by the finance committee".[33] What is meant by the words "monitored by reasonable methods" in this section is not at all clear. However it can be quite easily contended that section 130 imposes a higher standard than that articulated by Romer J in respect of the board as a whole towards its responsibilities over the function of the delegate, as the board had literally washed its hands off the finance committee on the subject of investments generally. This will not be acceptable conduct under the provisions of section 130.

In the second instance of delegation in the City Equitable context where the finance committee left the task of temporary investment to the general manager of the company it could be said that on an application of section 130 of the Companies Act a similar finding to that articulated by Romer J would be inevitable. Romer J said the two directors were in breach of their duty to leave a function that was delegated to them as he understood it, to an employee of the company with no control over the function. Section 130 would impose a similar duty on these two directors under subsection (2) (b) requiring the delegates actions to be monitored by reasonable methods properly used.

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[33] Section 130 (2) (b)

It is submitted therefore that section 130 would apply a higher standard of care on the facts of City Equitable than Romer J. The Scottish Institute of Chartered Accountants said in its report:

> *A board of directors is normally permitted by the Articles of Association to delegate its functions either to management or to committees of directors. A danger is that the use of such committees may create, in the minds of some members of the board, the idea that the responsibilities of the directors vary depending on whether they are involved in a particular committee. This is not so. The purpose of committees is to go into greater depth than is possible in full board meetings, certain issues for which the full board retains responsibility.*[34]

The New Zealand legislation appears to follow this line of thought in the wording of section 130.

In the New Zealand Courts the extent of delegation of a board was considered in the case of **Jagwar Holdings Ltd v Julian and Ors.**[35]

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[34] Report on Directors' Responsibilities for Financial Statements, Institute of Chartered Accountants Scotland, Ch3 p10.

[35] (1992) 6NZCLC 68,040.

In this case potential investors in recently listed Fullers Corporation Ltd (FCL) of which the defendants were directors were sent a "Share Package" which contained a Corporate profile and a Financial Profile. The profiles consisted of profit forecasts of the company, an Auditors Report signed by Price Waterhouse (PW) and net asset positions among other representations. All documents were prepared by senior staff at Fullers in consultation with Price Waterhouse.

An invitation was extended by one of the directors of Fullers Corporation to the chairman of Jagwar Holdings Ltd (Jagwar) to take up shares in the Fullers Corporation float and a share package was sent to Jagwar Holdings Ltd. Jagwar Holdings Ltd did not take up the share offer at the time of the float, but immediately following the float Jagwar Holdings Ltd entered into discussions with Fullers Corporation Ltd about purchasing shares. The price was arrived at between Jagwar's financial analyst and directors of Fullers Corporation following which Jagwar offered to take 20% of Fullers Corporation's capital.

A year later Fullers Corporation was in major financial difficulty and it became apparent that the share package sent to potential investors including Jagwar consisted of inaccurate profit forecasts and that estimates given to Jagwar's financial analysts by the directors of Fullers Corporation were false. Jagwar sued Fullers Corporation and its directors in negligence and under the Fair Trading Act for breach of section 9 alleging misleading and deceptive conduct.

As regard the inaccuracies contained in the financial profile sent to potential investors the directors contended that they had no part in the collation or formulation of the information, all the work being done by the financial controller of Fullers Corporation. Thorpe J was accepting of the fact that the directors had relied on the financial controller who in turn had consulted the auditors to ensure that the forecasts were properly calculated. However in considering if the directors were entitled to leave the preparation and checking of forecasts to the financial controller and auditors, Thorpe J said it had to depend on the extent of the director's obligation to inform themselves about their company's financial position and the extent to which they could properly delegate such business to other directors or officers of the company.

Thorpe J harked back to the standard interpretation of the Re City Equitable standard of care expected of directors in carrying out their duties ie that directors must exhibit the degree of skill reasonably to be expected from a person of his knowledge and experience having regard of the circumstances pertaining to his responsibilities and that if acting honestly he is not liable for errors of judgement.[36] His honour also considered the comments of the Earl of Halsbury LC in **Dovey V Corey**.[37]

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[36] See above n35 at 68,074.

[37] (1901) AC477 p486.

Failure to allow directors to delegate some of their responsibilities would render anything like an intelligent devolution of labour impossible and the business of life could not go on if people could not trust those who are put in a position of trust for the express purpose of attending to details of management.

Agreeing with Romer's interpretation and applying these principles Thorpe J held that there was no evidence that the defendant directors should have suspected that their financial controller was anything other than a competent and reliable officer of the company with appropriate qualifications for his position and therefore it was not a dereliction of duty for the directors to delegate the responsibility for compiling the forecasts to the financial controller especially so as he was conferring with the auditors.

Applying section 130 of the Companies Act to the situations above firstly dealing with the facts of **Jagwar v Julian**[38] it would appear that even if delegation per se would not be objectionable under the Act, section 130 (2) (b) requires the board to monitor by means of reasonable methods properly used, the exercise of the power by the delegate. The mere fact that the financial controller was well qualified and considered competent, together with the fact that he consulted the auditors of the company may not be sufficient under the Act as a reasonable method of monitoring the delegate's function.

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[38] Above n35.

In the case of Re City Equitable Romer J absolved the directors outside the finance committee of liability and held the function of investments were properly delegated to the finance committee. Here again an application of section 130 of the Companies Act would require the board as a whole to use reasonable methods in monitoring the functions of the delegate, in this instance the finance committee. The section 130 (2) b requirement advocates abstaining from the "washing hands off" stance adopted in the facts set out above. This is in keeping with the dissenting judgement of **Kirby P in Metal Manufactures Ltd v Lewis.**[39]

It must also be noted that the two exceptions to section 130 (2) of the Act are available only in combination with each other. Hence the directors must satisfy the court that they believed the delegate at all times would exercise the power in conformity with the directors' duties **and** the directors must have monitored by reasonable methods the delegate's exercise of power. This is a higher standard than the common law has been up to now on the subject of delegation.

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[39] (1988) 6ACLC725.

B RELATIONSHIP OF SECTION 130 TO SECTION 138 OF COMPANIES ACT 1993

Despite being required to "monitor" a delegate's function "by reasonable methods" in section 130 which as submitted earlier is a higher standard of care provision of this section, the director could avail himself to the defence available under section 138 that such monitoring was not necessary "as the circumstances did not indicate such action was necessary". It is possible to arrive at a similar conclusion to that of Thorpe J's judgement in applying section 138 to the facts of Jagwar v Julian.[40] Section 138 permits reliance on information and data submitted by employees who the director "believed on reasonable grounds to be reliable and competent in relation to matters concerned".[41] In the facts of Jagwar v Julian this was the case with the financial controller who was normally quite competent.

This makes this whole area of delegation indefinite and uncertain. Section 130 (2) (b) conveys that the delegate's actions should be monitored at all times through reasonable methods. It does not describe or explain such monitoring as to when such monitoring should be done for example by saying in words "when circumstances indicate such monitoring is necessary etc".... However further on under section 138 (1) reliance could be placed on a delegate for reports and statements and under 138 (2) (b) inquiry should only

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[40] Above n35.

[41] Section 38(1) (a).

be made "if the need for inquiry is indicated by the circumstances". This points to an anomaly which clearly needs to be clarified. This brings an element of uncertainty to the area of delegation and reliance on information from committees of directors, employees etc.

C USE OF INFORMATION AND ADVICE

Section 138 of the Companies Act says

138 (1) ... A director of a company, when exercising powers or performing duties as a director, may rely on reports, statements, and financial data and other information prepared or supplied, and on professional or expert advice given by any of the following persons:

(a) An employee of the company whom the director believes on reasonable grounds to be reliable and competent in relation to the matters concerned:

(b) 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.

(c) Any other director or committee of directors upon which the director did not serve in relation to matters within the director's or committee's designate authority.

138 (2)..... subsection (1) of this section applies to a director only if the director .

(a) Acts in good faith and

(b) *Makes proper inquiry where the need for inquiry is indicated by the circumstances; and*

(c) *Has no knowledge that such reliance is unwarranted.*

In the discussion above on the City Equitable facts in transaction B it was submitted that the standard of care required from directors under section 137 together with section 138 in relation to reliance on employees for reports and financial data etc could well be a lesser standard[42] than that pronounced by Romer J who required directors to look behind reported figures submitted by the company officials in the annual accounts in requiring a list of assets prior to the directors recommending a dividend to the company's shareholders. Later on in the discussion relating to section 130 of the Act it was submitted that the standards under the present legislation would require a higher standard than that applied by Romer J in requiring directors to monitor the actions of the delegate.[43] Hence it could be deduced that section 138 contributes to a certain extent to this ambiguity in the standards imposed by the Act.

Section 138 by itself gives directors the right to rely on employees, committees of directors, experts and advisers which is necessary as quoted earlier in the words of the Earl of Halsbury "for an intelligent devolution of

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42 See above p31.

43 See above p36.

labour" to take place in the company.[44] The inclusion of section 138 in the New Zealand legislation has its origins from the United States. The American Law Institute's Principles of Corporate Governance says in:[45]

Section 4.03

In performing his or her duty and functions a director who acts in good faith and reasonably believes that reliance is warranted, is entitled to rely on:

(a) The decisions judgments and performance ... of a duly authorised committee of the board on which the director does not serve, with respect to matters delegated to that committee provided that the director reasonably believes, the committee merits confidence

Section 4.02

In performing his or her duty and functions, a director or officer who acts in good faith and reasonably believes that reliance is warranted, is entitled to rely on information, opinions, reports, statements

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44 Above n37.

45 American Law Institute "Principles of Corporate Governance - Analysis and Recommendations" Draft 1992.

(including financial statements .....) decisions judgements and performance within the scope of Section 4.01 ....

It is submitted that although section 138 of the Companies Act 1993 performs a vital function, yet in combination with the standard of care required in section 137 in the words "must exercise the care, diligence and skill of a reasonable director" it appears to confuse the standard of care required of the director. Under the US equivalent of section 137 as expressed in section 4.01 of the Principles of Corporate Governance it says:[46]

4.01 (a) A director or officer has a duty to the corporation to perform the director's or officer's functions in good faith, in a manner that he or she reasonably believes to be in the best interests of the corporation and with the care that an ordinarily prudent person would reasonably be expected to exercise in a like position under similar circumstances.......

(1) The duty in subsection (a) includes the obligation to make, or cause to be made, an inquiry when, but only when the circumstances would alert a reasonable director ...... to the need therefor.......

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46 Above n45.

It can be said under the US Model that the standard in the provision noted above in 4.01 correlates easily to the standard in 4.02[47] which permits reliance on reports etc and only requires the care of an ordinarily prudent person in 4.01 which appears to correlate and co-exist on the same level playing field.

In the New Zealand context section 138 appears to require a different standard to section 137 which by itself alone has similar ambiguities within the section. It is also submitted that section 138 does not appear to correlate to the standard of care required under the delegation provision in section 130 as section 130 does not say when the delegate's actions should be monitored. It is submitted section 138 is therefore not able to serve its function as it is not a stand alone provision of the Act and in combination with section 137 and section 130 it is not able to provide the facility for intelligent devolution of labour, for which specific purpose it was incorporated into the legislation.

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47 See above p53.

XII THE DEEMED DIRECTOR

The Companies Act 1993 under section 126 defines a director as not only someone who is by appointment a director, but also other categories of persons who could be deemed as directors for the part they play in the process of decision making by the director. The director is defined as:

- A person occupying the position of director.
- A person is accordance with whose directions a director is accustomed to act.
- A person with whose instructions the board is accustomed to act.
- A person who exercises or is entitled to control the exercise of power which would normally fall to the board.
- A person to whom the directors powers have been delegated with the person's consent or a person who exercises that power with the consent of the board.
- A person in accordance with whose directions directors maybe required to act.

The Companies Act 1955 on the other hand defined two categories only. They were

(1) A person occupying the position of director.

(2) A person in accordance with whose directions or instructions the persons occupying the position of director are accustomed to act.

Under the expanded definition of the word "director" in the 1993 legislation the delegate who exercises power under delegation from the board would be exercising the power as a director itself. Following the discussion above in this paper on the directors responsibilities with regard to delegation, the 1993 Act imposes a similar responsibility on the delegate in the capacity of deemed director. It is questionable if because the delegate assumes responsibilities as deemed director for his or her actions whether the 1993 Act would distance the main director itself form liability for the actions of the delegate who is now deemed a director under the expanded definition of the 1993 legislation. It is also quite open to interpretation as to where the duty of care responsibility i.e personal liability stops in the corporate establishment's hierarchy under this expanded definition. If the delegate per se is a deemed director then he or she should be complying with sections 130, 137 and 138 with regard to that delegation in relation to his or her own delegate. In these circumstances would the director by appointment be relieved of his responsibility of care? It is submitted that this would not be

the spirit of the legislation i.e. the director would still be held to his/her responsibility under sections 137 and 130.

In the Principles of Corporate Governance interpreting the US law as it stands today, the duty of care provisions were drafted to include the director and the officer.[48] Whereas in New Zealand the officer would normally be exempted from personal liability under the law of vicarious liability, except in the case of the officer acting in the capacity of deemed director under the present legislation. However it is contended that the director v officer gap is narrowed down with the deemed director provisions in the Act and it is unclear as to where the deemed director's responsibility of care ends.

48 Section 4.01 Principles of Corporate Governance, American Law Institute.

XIII SOME RECENT DECISIONS AND AN APPLICATION OF COMPANIES ACT 1993

The qualifications in section 137 whereby the extent of the duty of care required from the "reasonable director" would take into account the nature of the company, the nature of the decision and the position, nature and responsibilities undertaken by the director are commonly referred to as the Awa qualifications. These qualifications were espoused by Rogers CJ in **Awa Ltd v Daniel.**[49] In this action directors duties were being examined against a background where Awa Ltd were suing the company's auditors in negligence and the auditors claimed the directors of the company were contributorily negligent in not closely supervising the company's foreign exchange operation which appeared to be run single handedly by the manager in charge of the operation. Rogers CJ held that non executive directors could not be held liable for negligence, in the words:[50]

> *It is an anachronism to expect non executive directors, meeting once a month to contribute anything much more than decisions on questions of policy and in the case of large corporations, only major policy. This necessarily means that in the execution of policy, senior management is in the true sense of the word exercising the powers of*

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[49] (1992) 10 ACLC933.

[50] N49 above 988.

decision and of management which in less complex days used to be reserved to the board of directors.

He also said the directors had no reason to believe that the policies laid down by the board in relation to foreign exchange operations were not being followed. Neither the chief executive nor the auditors ever mentioned this to the board. The directors were in the absence of knowledge entitled to rely on the senior management that systems of control were in place. He concluded that only if they had a knowledge of the true facts that any inaction on their part could have been described as negligent. However, Rogers CJ maintained that merely because standards of care may vary in individual cases does not mean that there is a variation in duty which would disqualify the applicability of the general law of negligence. Rogers CJ was interpreting that the common law standard of negligence was applicable in subjective circumstances.

It is this approach by Roger CJ that has been adopted in the section 137 duty of care provisions where a common law standard of care is being expected of the "reasonable director" in subjective circumstances having regard to the nature of the company, the decision and the nature of responsibilities undertaken by the director.

Considering the factual circumstances in Awa Ltd it is submitted that although it is possible to arrive at a similar conclusion to the decision in Awa in applying sections 137 and 138, section 130 could pose a problem as it requires the delegate's actions to be monitored by reasonable methods.

Whether the auditors function in Awa Ltd was a reasonable method of monitoring under section 130 or whether anything else should have triggered the monitoring process is unclear under section 130. The directors in Awa could be held to have been negligent of their duties under the Companies Act 1993.

Another decision where the director's duty of care was considered is **Greyburn v Laing.**[51] The action came before Gallen J in the High Court in New Zealand. The plaintiff in this case was a chartered accountant who had been a professional non-executive director in many public companies with considerable experience. He was a director of Cory Wright and Salmon Ltd (CWS) and this action was brought by him against Mr Laing who was appointed official liquidator of CWS following the technical insolvency of the company. Greyburn (G) was seeking an injunction to prevent Laing (L) from proceeding against him in negligence as director of CWS. CWS had seven directors including Mr Philpott (P) who was group managing director. On a proposed date for a board meeting G was not able to attend and had notified the chairman of his prior commitment to travel overseas. At the meeting the rest of the board had ratified transactions proposed by P with regard to issuing a debenture stock to Elders Finance, Hongkong and a guarantee for borrowings of Razor Corporation. A subsequent meeting was called after the return of G and he was not able to attend again this time. Minutes of the previous meeting were read out at this meeting in G's absence.

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51 [1991] INZLR483.

At the following board meeting it was business as usual but prior to the next meeting the chairman informed G that the group managing director had made some inter company borrowings and that he (the chairman) had issued a warning to the chief executive and informed G that he was satisfied it was a one off transaction. At a subsequent board meeting when questions were raised about CWS' involvement in certain aircraft sales the group managing director convinced the board that it did not involve CWS in ownership or liabilities. Subsequently it became apparent that CWS did own an aircraft involving a complex scheme of transactions and that P had repeatedly misinformed the board about the involvement of CWS in aircraft sales.

Gallen J applied the principles of Romer J in City Equitable and said that the standard of care should be assessed in relation to the particular responsibilities of the directors concerned towards the company, the nature of the company and the nature of the directorship. In response to the liquidator's position that G should have been put on inquiry when he first received board papers about the guarantee and debenture even though he was not able to attend the meeting, Gallen J said there was nothing in the material which disclosed the particular transactions and G did not have an opportunity to raise any concerns as when such an opportunity arose G was not present and it was untenable to raise (any) concerns on the matter two meetings later.

Gallen J said affixing the company seal to the transactions proposed by P was a joint responsibility of the board and that G did not have any special obligation about any of the transactions. On an application of the Companies

Act 1993 it is possible to say that even though section 137 requires the director to "exercise the care, diligence and skill that a reasonable director would exercise", section 137 (c) would have provided G with some comfort as to the nature of the responsibilities undertaken by him. As stated by Gallen J, G did not undertake any special obligations in respect of either transaction. Section 138 would also provide a defence to G as the board papers did not disclose anything to arouse suspicion and G could rely on his fellow directors to make inquires, which in fact they did. Therefore it is possible that the outcome under section 137 would be similar to that interpreted by Gallen J under the companies Act 1955.

Thus the duty of care provisions under the Companies Act 1993 could impose a higher responsibility on the directors of Awa, but on the facts of Greyburn v Laing the outcome could be similar.

XIV INDEMNITY AND INSURANCE

In view of the discussions above on the duty of care responsibilities of directors and those in deemed director positions it is most appropriate that the Companies Act 1994 provides the opportunity for indemnifying and effecting insurance cover on the director by the company as long as the company's constitution permits such indemnity and insurance.[52] Such a provision was not available in the Act of 1955. The ambiguities in the duty of care expected from a director as discussed above, would need the interpretation of the courts in arriving at clarification of the law as currently submitted. For defending such proceedings through the courts it is necessary to have the provisions in regard to indemnity and insurance included in the Act.

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[52] Section 62, Companies Act 1993.

XV CONCLUSION

In the foregoing analysis of the sections 137, 138 and 130 of the Companies Act 1993 it is apparent that there are troublesome ambiguities in the standard of care required of directors. City Equitable, if decided under the Companies Act 1993 with or without the wilful negligence provisions of Article 150 could not be clearly said to have either relieved or imposed a greater liability on the director. As seen in the analysis above on certain fronts the act imposes a higher duty of care and yet on other transactions it is able to require a lesser duty of care than that required in City Equitable. This ambiguity in the Act makes it unworkable and corporate responsibilities are yet undefined. The debate as to the quantum of care required under the Act is likely to continue.

Section 130 and 137 are clearly in need of definition as to who or what is a "reasonable director", when and what should be done in "monitoring by reasonable methods" the actions of a delegate. The law whether more rigorous or lenient should at least be clear for compliance or non compliance to occur.

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