

# Long journey but okay result on vexed directors' crimes issue

It took several iterations and three Supplementary Order Papers, but the result justifies the effort – we now have a workable solution to the vexed directors' crimes provisions in the recently passed Companies Amendment Act.

## Clause by clause analysis

The Amendment Act,<sup>1</sup> which was broken out from the Companies and Limited Partnerships Amendment Bill following a final SOP,<sup>2</sup> criminalises misconduct relating to the existing good faith and reckless trading duties in the Companies Act (contained within sections 131 and 135 respectively).

We summarise below the new offences in the final Amendment Act, which reflects extensive engagement with governance experts, including Chapman Tripp.

## Good faith and best interests

*(new section 138A Companies Act)*

A director of a company commits an offence if the director exercises powers or performs duties as a director of the company:

- (a) in bad faith towards the company and believing that the conduct is not in the best interests of the company, and
- (b) knowing that the conduct will cause serious loss to the company.

## Undue enrichment

*(amendment to section 378(a) Companies Act)*

Every director, employee, or shareholder commits an offence who fraudulently takes or applies property of the company for his or her own benefit *or for a use or benefit of a person other than the company*.

## Dishonestly incurring a debt

*(amendment to section 380 Companies Act)*

A director commits an offence if:

- (a) the company incurs a debt when insolvent or that, on its own or taken with other debts, has the effect of tipping the company into insolvency, and
- (b) he or she knew of the existing insolvency or knew that the company would become insolvent, and
- (c) the director's failure to prevent the company incurring the debt was dishonest.

## Penalties

Directors convicted of these offences are liable to a term of imprisonment not exceeding five years or to a fine not exceeding \$200,000.

## A long trip but the destination is worth the journey

It has been a long road to this destination – three SOPs, exhaustive consultations and countless hours of officials' time – and we still consider that sufficient redress was already available through the Crimes Act and the Companies Act.

But the fact that each of these new offences now requires an element of both knowledge and dishonesty does deal with our most serious concerns.

The Bill as first drafted provoked unease in boardrooms around the country and even invited criticism from international commentators because it extended criminal sanctions into what is effectively normal commercial risk-taking and undermined the stated purpose of the Companies Act – this being to “affirm the value of the company as a means of achieving economic and social benefits through... the taking of business risks”.

The benchmark for assessing how these offences will impact on business decision-making is how the law would lead a responsible legal adviser to advise a director client in a typical work-out scenario. The effect of earlier versions of the reckless trading provisions in particular would have created an argument for directors to put up the shutters even if there was a reasonable prospect of the company trading through.

This could result in diminished returns to the creditors, whose interests the legislation seeks to protect in these circumstances. It also contradicts the directors' own fiduciary duties which, in situations of compromised solvency, effectively switch from the shareholders to the creditors.

The law as it has finally emerged has moved away from some earlier attempts to resolve this through specific prescriptions and safe harbours, to an approach which focuses on whether the directors' actions in the circumstances amount to dishonesty. We prefer this approach because it is more flexible, is easily understood and is consistent with the basis on which workouts are undertaken against the backdrop of existing section 135 duties.<sup>3</sup> As a result, we consider this law should not create a substantial additional barrier to properly conducted work-outs.

Chapman Tripp has commented extensively on this aspect of the Bill and on the search for a solution:

Jail time for serious breach of directors' duties<sup>4</sup> – Chapman Tripp's commentary on the Bill's introduction.

Significant risk in criminalising breaches of directors' duties<sup>5</sup> – Chapman Tripp's submission on this section of the Bill.

Literally insane? Maybe not. Ill-advised? Definitely<sup>6</sup> – Chapman Tripp article

Criminalisation of directors' duties – another go, another disappointment<sup>7</sup> – Chapman Tripp on the November SOP

## Footnotes

1. [http://www.legislation.govt.nz/act/public/2014/0046/latest/DLM4094913.html?search=ad\\_act\\_companies+amendment+act\\_\\_\\_\\_\\_25\\_ac%40bn%40rn%40dn%40apub%40aloc%40apri%40apro%40aimp%40bgov%40bloc%40bpri%40bmem%40rpub%40rimp\\_ac%40ainf%40anif%40aaif%40bcur%40rinf%40rnif\\_h\\_aw\\_se&p=1](http://www.legislation.govt.nz/act/public/2014/0046/latest/DLM4094913.html?search=ad_act_companies+amendment+act_____25_ac%40bn%40rn%40dn%40apub%40aloc%40apri%40apro%40aimp%40bgov%40bloc%40bpri%40bmem%40rpub%40rimp_ac%40ainf%40anif%40aaif%40bcur%40rinf%40rnif_h_aw_se&p=1)
2. [http://www.chapmantripp.com/publications/Pages/Long-journey-but-okay-result-on-vexed-directors'-crimes-issue.aspx?utm\\_source=SM%20Long%20journey%20but%20okay%20result%20on%20vexed%20directors'%20crimes%20issue&utm\\_medium=email&utm\\_campaign=Long%20journey%20but%20okay%20result%20on%20vexed%20directors'%20crimes%20issue](http://www.chapmantripp.com/publications/Pages/Long-journey-but-okay-result-on-vexed-directors'-crimes-issue.aspx?utm_source=SM%20Long%20journey%20but%20okay%20result%20on%20vexed%20directors'%20crimes%20issue&utm_medium=email&utm_campaign=Long%20journey%20but%20okay%20result%20on%20vexed%20directors'%20crimes%20issue)
3. As set out for example by the Court of Appeal in *Mason v Lewis* [2006] 3 NZLR 225
4. <http://www.chapmantripp.com/publications/Pages/Jail-time-for-serious-breach-of-directors-duties.aspx>
5. <http://www.chapmantripp.com/news/Pages/Significant-risk-in-criminalising-breaches-of-directors-duties.aspx>
6. <http://www.chapmantripp.com/publications/Pages/Criminalise%20breaches%20of%20directors%27%20duties.pdf.aspx>
7. <http://www.chapmantripp.com/publications/Pages/Criminalisation-of-directors%27-duties-another-go-another-disappointment.aspx>



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