

Minimising risks for company directors

It wasn't so long ago that there existed a degree of glamour attached to being a company director with some company directors enjoying a status normally enjoyed by celebrities. Things have changed considerably. Company directorships now bring with them a complex range of responsibilities, and a considerable personal and professional risk, which has seen many individuals refuse to accept directorships.

Risks for directors

Regardless of the size of your company, as a director you have many responsibilities and duties under the law.

Directors are potentially liable not only for breach of their duties under the Companies Act 1993, but also for breach by their companies of a wide range of law.

Risks that directors potentially face include:

- ✦ Actions by outsiders due to wrongful actions of management.
- ✦ Actions by creditors as a result of the company contracting when the company is unable to pay its debts as and when they fall due.
- ✦ Prosecution for failure to comply with other provisions of the Companies Act, such as:
 - ✦ taking all reasonable steps to ensure the company's accounting records correctly record and explain the transactions of the company; and
 - ✦ ensuring the company's financial statements and annual report are prepared and signed within the specified period.
- ✦ Personal liability for, among other matters:
 - ✦ breach of director's duties;
 - ✦ breach of any applicable legislation; and

- ✦ torts (wrongs) committed on behalf of the company and exceeding authority in entering into contracts.

If found liable a director may suffer a fine and/or imprisonment.

Insurance and indemnity

To help a director meet the costs associated with defending or settling claims in connection with acts or omissions in their capacity as a director, a company can indemnify a director or take out insurance for the benefit of that director – but only in certain situations (outlined below). Other than in these situations, the Companies Act prohibits such indemnity or insurance.

An indemnity is a contract between a company and a director providing that the company's resources will be used to meet costs incurred in defending or settling a claim.

If expressly authorised by its constitution, a company can indemnify a director for the following situations where the claims or proceedings relate to acts or omissions in their capacity as a director:

- ✦ For costs incurred in proceedings in which judgment is given in their favour, they are acquitted, or which are discontinued; and
- ✦ In respect of liability to any person (other than the company or a related company) or costs incurred in defending or settling any claim or proceeding relating to any such liability, other than criminal liability or a liability for breach of the duty to act in good faith and in the best interests of the company.

If expressly authorised by its constitution and with the prior approval of its board, a company may effect insurance for a director for the following situations where the claims or proceedings relate to acts or omissions in their capacity as a director:

- ✦ Liability (except criminal liability);
- ✦ Costs incurred in defending or settling any claim or proceedings relating to any such liability; and
- ✦ Costs incurred by that director in defending any criminal proceedings in which they have been acquitted.

It is clear from the above that companies cannot generally effect insurance for directors against criminal liability. It is also important to note that it is illegal to insure against fines for a breach of the Health and Safety in Employment Act 1992. However, insurance against court costs and compensation is permitted.

Documentation

If insurance is taken out, directors must sign a certificate stating that, in their opinion, the cost of the insurance is fair to the company. The company's board (if applicable) or the director must ensure that particulars of any indemnity or insurance for its directors are entered in the interests register.

It is important that directors ensure the constitution expressly permits such insurance, that board approval (if applicable) has been given, and that directors have completed their certificates.

The director who is a beneficiary of the insurance will be personally liable to the company for the cost of the insurance if:

- ✦ The procedural requirements are not met;
- ✦ There is no constitutional authority; or
- ✦ Reasonable grounds do not exist for the opinion set out in the certificate, except to the extent that the director is able to

show it was fair to the company at the time it was effected.

Policy content

Directors' insurance policies often have two parts:

- ✦ Company reimbursement for indemnity payments; and
- ✦ Directors' liability insurance.

The premium needs to be appropriately apportioned. A 90:10 split is often referred to by commentators as being the acceptable cost split between the company and the directors.

Particularly in respect of insurance (but also to a significant extent with indemnities), the fine print is crucial. What is covered and what is not, and the inter-relationship between company reimbursement, contractual indemnity, and directors' liability insurance – all need to be reviewed carefully and critically.

Taxation issues

The insurance premiums paid by the company should be deductible as an ordinary business expense. A director who receives no fees and is an employee may not be able to deduct the cost of the premium paid by them. If the director is paid director's fees, deductions may be allowed. If no deductibility exists, grossing up of fees or salary is an option.

An indemnity payout should also be deductible as an ordinary business expense. The indemnity payment will usually be a financial service for the purposes of GST, and therefore exempt.

See us first

Talk to us before accepting any directorship. Make sure you have considered the full implications of your decision, especially what might happen if things go wrong.

Disclaimer

Important: This is not advice. Clients should not act solely on the basis of the material contained in this fact sheet. Items herein are general comments only and do not constitute or convey advice per se. Changes in legislation may occur quickly. We therefore recommend that our formal advice be sought before acting in any of the areas. We believe the contents to be true and accurate as at the date of writing but can give no assurances or warranty regarding the accuracy, currency or applicability of any of the contents. This fact sheet is made available to our clients as a helpful guide for their private information. Therefore it should be regarded as confidential and should not be made available to any person without our prior approval.

Remember, if the business fails, creditors may not only look to recover money from the business but also your personal assets.

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