Developing a corporate governance framework - Overview

Garry Downs Bell Gully

The term “corporate governance” is used to describe the systems and processes by which an organisation (typically a company) is directed, managed and controlled in the interests of its shareholders or other stakeholders.

An initial point to note is the importance of approaching the topic of corporate governance from a best practice perspective. There is no set system of corporate governance, it must be tailored to suit the interests and needs of the particular company. Accordingly, this topic sets out a general explanation of corporate governance which may be used to help directors, the board and in-house and external counsel remain confident in meeting the accountability and responsibility standards required to protect the company’s stakeholders.

See Corporate governance - introduction.

When establishing a new corporate governance framework a number of factors must be considered, including:

- entity type,
- applicable rules and legislation,
- general governance principles, and
- organisational leadership.

See Developing a corporate governance framework.
Corporate governance - introduction

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What is corporate governance?
Generally, corporate governance is the framework of interlocking values, principles and practices through which a company is directed and controlled. Through this framework, directors exercise authority and make decisions to achieve the company’s purpose and goals. Corporate governance also includes the methods through which accountability of those in control is achieved.

Good governance frameworks state aspirations of best practice for optimising corporate performance and accountability in the interest of shareholders and the broader economy. They are guidelines, designed to produce an efficient, quality outcome with integrity.

Best practice perspective
The importance of corporate governance has been emphasised by the Financial Markets Authority which stated in its 2003 report that:

To grow and prosper, New Zealand businesses must inspire confidence in local and international investors, partners, suppliers and customers. For this to happen, our Corporate Governance must be world-class ... Good governance is vital not only for public, listed companies but for other forms of business entity as well ... Ultimately, good governance should help businesses become more innovative, competitive and financially sustainable. (Jane Diplock AO, Chairman, Securities Commission, Corporate Governance in New Zealand - Consultation on Issues and Principles, September 2003, p 3).

Corporate governance must be approached from a best practice perspective. To do otherwise risks governance being dominated by process and form filling only, rather than overall compliance with overarching corporate governance principles. All stakeholders in an organisation need to play their part in ensuring governance is approached in a principled manner in order to achieve optimal outcomes.

A best practice perspective also requires the acknowledgement and appreciation that risk taking is an essential, and legitimate, part of business. All companies undertake a range of entrepreneurial risk and this risk is encouraged as an important part of economic growth. Consequently, directors must be effective risk managers and responsible risk takers. A company that follows principles of corporate governance to the highest professional standards will be well placed to take risks that are appropriate to its business.

The Financial Markets Authority provides guidance on the core principles that companies exercising good corporate governance should incorporate as follows:

Corporate Governance is the set of structures and behaviours by which a company or other business entity is directed and managed. The structures and behaviours guide how the entity sets objectives, develops strategies and business plans, monitors and reports
on performance, and manages risks. They also guide how directors and managers meet all expectations and that they be responsible and accountable in their respective roles. (Securities Commission, Corporate Governance in New Zealand - Consultation on Issues and Principles, September 2003, p 7).

The HIH Royal Commission Report, written by Justice Neville Owen by appointment from the Australian Parliament, also contains a good summary of corporate governance. Justice Owen highlighted that at its broadest:

... the governance of corporate entities comprehends the framework of rules, relationships, systems and processes within and by which authority is exercised and controlled in corporations ... Boards and management that are focused on the use of corporate resources for the benefit of their shareholders and others with an interest, other than their own benefit, in effective management of risk, accurate and reliable financial reporting and proper disclosure are well on the way to good corporate governance. (Justice Neville Owen, Report of the HIH Royal Commission, Volume I - The failure of HIH Insurance: A corporate collapse and its lessons, Part Three - Directions for the future, 6.1 The meaning of corporate governance, April 2003, accessed 29 August 2013, http://www.hihroyalcom.gov.au/finalreport/Chapter%206.HTML).

Post-Global Financial Crisis
The significance of corporate governance and corporate social responsibility has been increasing since the Global Financial Crisis (GFC) and the resulting collapse of finance companies in 2007 and 2008. The GFC triggered regulatory reforms both in New Zealand and globally to achieve greater accountability and tighter regulation and thus lessen the chance of a recurrence. Institutions now face increased scrutiny of their operations and professional conduct by the public, governing bodies and the courts.

The strength of corporate governance practices and procedures of entities can be severely tested during difficult economic times. For example, if the entity is nearing insolvency, the director’s duty under s 135 of the Companies Act 1993 to not recklessly trade (i.e., where the director is causing or allowing the entity to carry on in such a way that is likely to create a substantial risk of serious loss to its creditors) is of crucial significance. At this time entities are likely also to have heightened disclosure obligations to shareholders, investors, financiers and regulators.
Developing a corporate governance framework

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When establishing a new corporate governance framework a number of factors must be considered.

Consider - entity type
For example, the type of organisation and the individuals involved should be taken into account. There is no “one size fits all”. What is best for a listed company will not always be entirely appropriate for an SOE or other government body. Similarly, a suitable structure for a small family business will not necessarily be best for a partnership or trust. There are also specific rules which apply to certain organisations such as listed companies, government bodies and partnerships.

Ultimately, the particular structures and behaviours that are best for one entity will depend on such factors as its form, size, type and stage of development. But with any good corporate governance model, there is an emphasis on ethical conduct, transparency, legal compliance and sound business practice. Good governance frameworks set out aspirations of best practice for optimising corporate performance and accountability in the interest of shareholders and the broader economy. They are guidelines, designed to produce an efficient, quality outcome with integrity.

Consider - applicable rules and legislation
The first thing to do when developing any governance framework will be to examine the specific rules which are applicable to the organisation. For companies these are found in the Companies Act 1993 and occasionally in the company’s constitution. If the company is listed the NZX Listing Rules also apply. For government bodies and others, the establishing legislation will commonly prescribe at least some of the governance rules. One such example is the Crown Entities Act 2004 which provides an overall framework for the governance of Crown entities. This is supplemented by policy papers issued by the State Services Commission. Banks, insurance companies and others will have industry rules which will apply and trusts are governed by their trust deeds.

In addition, various types of organisations are subject to a number of other legislative requirements which may also have an important bearing on the development of corporate governance rules. These may include applicable financial reporting standards for the purposes of the Financial Reporting Act 2013 and a number of operational requirements that affect entities in different parts of the private and public sectors. They may also include requirements that are imposed as a result of income tax treatment (eg for charitable organisations) or by virtue of the sources of funding being provided to the organisation.

See The law, rules and regulations.

Consider - general governance principles
Relevant to all organisations are the more general good governance principles (such as those provided by the Financial Markets Authority - see Corporate Governance in New Zealand: Principles and Guidelines - A Handbook for Directors, Executives and Advisers). These are often more difficult
to establish and put in place than the prescriptive rules. They are more principles based and, as such, are more open to differing approaches by different types of organisations and individuals.

What are these general principles, what is involved, and why are they important? It is now widely accepted that better governance means improved stakeholder value. This is borne out by a number of studies. Good governance is about “whole of organisation management” and striving for best practice. As such the legal aspects are only a subset of governance principles focusing on topics such as legal obligations, risk, compliance and process. However, governance principles and their importance go well beyond this.

**Consider - organisational leadership**

As with similar organisational matters, such as “visions and values”, it is imperative that the importance of corporate governance is embraced by the leaders of the organisation. The board (in the case of a company) should take the lead in agreeing that these principles be adopted and discussing what governance approach is appropriate for the organisation. The central role of the board is recognised by the Companies Act 1993 and other rules and legislation.

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Other relevant specific factors in developing a corporate governance framework

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Further to the applicable legislative and regulatory framework, a number of additional factors must be considered when establishing a corporate governance framework. These include the following matters set out below.

Entity type
The type of organisation and the individuals involved in that organisation should be taken into account. There is no “one size fits all” approach to corporate governance. What is best for a listed company will not always be entirely appropriate for a state owned enterprise or other government body. Similarly, a suitable structure for a small family business will not necessarily be best for a partnership or trust. There are also specific rules which apply to certain organisations such as listed companies, government bodies and partnerships, as described above.

Ultimately, the particular structures and behaviours that are best for one entity will depend on such factors as its form, size, type and stage of development. But with any good corporate governance model, there should be an emphasis on ethical conduct, transparency, legal compliance and sound business practice.

General governance principles
General good governance principles are relevant to all organisations (such as those provided by the Financial Markets Authority and the Institute of Directors - see Corporate Governance in New Zealand: Principles and Guidelines - A Handbook for Directors, Executives and Advisers). Whilst these are often more difficult to establish and put in place than the prescriptive rules, they can help the company improve stakeholder value. General governance principles are also more open to differing approaches by different types of organisations and individuals.

Good governance is about “whole of organisation management” and striving for best practice. As such, the legal aspects are only a subset of governance principles focusing on topics such as legal obligations, risk, compliance and process. Other subsets of governance are set out below.

Organisational leadership
It is imperative that the importance of corporate governance is embraced by the leaders of the organisation. The board (in the case of a company) should take the lead in agreeing that corporate governance principles be adopted and discussing what governance approach is appropriate for the organisation. The central role of the board is recognised by the Companies Act 1993 and other rules and legislation.

Read more about this from LexisNexis® Commentary
The Laws of New Zealand > Companies > Part V Company Officers > (28) Powers of Management > 187 Management of company
The law, rules and regulations - Overview

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A company’s corporate governance framework should provide an adequate platform to ensure compliance with the governance obligations applicable to the organisation. Therefore, the first thing to do when developing any governance framework will be to identify the specific legislation and other rules which are applicable to the organisation.

As a starting point, companies are governed by the Companies Act 1993 and occasionally the company’s constitution (if the company has one). The Companies Act 1993 governs directors’ individual duties. If the company is listed on the New Zealand Stock Exchange, the NZX Main Board/Debt Market Listing Rules (Listing Rules) also apply. In addition, various types of organisations are subject to a number of other legislative requirements which may have an important bearing on the development of corporate governance rules. These include applicable financial reporting standards for the purposes of the Financial Reporting Act 2013, the Financial Markets Conduct Act 2013 and a number of operational requirements that affect entities in different parts of the private and public sectors. The recently established New Zealand Corporate Governance Forum has also released a set of corporate governance guidelines to promote good corporate governance practice in New Zealand. The guidelines are based on international principles and frameworks that institutional investors globally regard as best practice. Other rules and guidance prescribed or set out by bodies, like the Financial Markets Authority, the Ministry of Business, Innovation and Employment and the Institute of Directors, will make up the body of requirements a company should have regard to in considering its corporate governance framework.

For certain government bodies, that entity’s establishing legislation will commonly prescribe at least some of the applicable governance rules. One such example is the Crown Entities Act 2004 which provides an overall framework for the establishment, governance and operation of Crown entities. This is supplemented by policy papers issued by the State Services Commission. Banks, insurance companies and others are subject to industry specific rules, and trusts are governed by their trust deeds. Other relevant considerations are requirements that are imposed as a result of income tax treatment (for example, those requirements imposed on charitable organisations under the Charities Act 2005) or by virtue of the sources of funding being provided to the organisation. In addition, that framework should operate to assist directors in complying with their individual duties, being those imposed by the Companies Act 1993 - see Directors' duties under the Companies Act and The courts' views on directors' duties.

Other sources of corporate governance regulation include the NZX Listing Rules as well as other legislation and guidance from such bodies as the Financial Markets Authority). See:

- The Financial Markets Authority,
- Governance and NZX listed companies,
- Other legislation and other jurisdictions, and
- New Zealand Corporate Governance Forum.
Directors’ duties under the Companies Act

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A director has the following duties under the Companies Act 1993:
- to act in good faith and in the best interests of the company (s 131),
- to exercise powers for a proper purpose (s 133),
- to comply with the Companies Act 1993 and the company’s constitution (s 134),
- to not engage in reckless trading (s 135),
- to not enter into certain obligations (s 136),
- a general duty of care (s 137),
- to disclose interests (s 140),
- to supervise the share register (s 90),
- to disclose share dealings (s 148), and
- other duties in relation to the use of company information (s 145).

Each of these duties is briefly explained below.

**Duty to act in good faith and in the best interests of the company (s 131)**
A director must act in good faith in what the director believes to be in the best interests of the company. Where the company is a wholly owned subsidiary of another company, the directors of that wholly owned subsidiary are permitted to act in a manner which the director believes is in the best interests of the holding company, provided that the subsidiary’s constitution permits the directors to do so.

This duty is expressed subjectively. What is important is what the director himself or herself “believes”. A decision to exercise a power will be set aside if it is manifestly unreasonable, however, in practice, courts are generally reluctant to intervene.

*Read more about this from LexisNexis® Commentary*
*The Laws of New Zealand > Companies > Part V Company officers > (29) Directors’ duties > 190. Director must act in good faith and in company’s best interests*

**Duty to act for a proper purpose (s 133)**
Directors must exercise their various powers for the purpose for which they are intended. The duty is expressed objectively, in contrast to the duty to act in the best interests of the Company, which is expressed subjectively in terms of what the director actually believes those best interests to be.

*Read more about this from LexisNexis® Commentary*
*The Laws of New Zealand > Companies > Part V Company officers > (29) Directors’ duties > 192. Powers to be exercised for proper purpose*
Duty to comply with Companies Act and constitution (s 134)
A director must not act or agree to the company acting in breach of the Companies Act 1993 or the company’s constitution. It is therefore important that directors are aware of the requirements of the Companies Act 1993 and of the contents of the company’s constitution.

Read more about this from LexisNexis® Commentary
The Laws of New Zealand > Companies > Part V Company officers > (29) Directors’ duties > 193. Directors must comply with legislation and company’s constitutional documents

Duty not to engage in reckless trading (s 135)
A director must not agree to (or cause or allow) the company’s business being carried on in a manner likely to create a substantial risk of serious loss to the company’s creditors.

Read more about this from LexisNexis® Commentary
The Laws of New Zealand > Companies > Part V Company officers > (29) Directors’ duties > 194. Reckless trading

Duty in relation to incurring obligations (s 136)
A director must not agree to the company incurring an obligation unless the director believes that the company will be able to perform the obligation when required to do so. The director’s belief must be based on reasonable grounds which must exist at the time the obligation is incurred.

It is an offence for a director to dishonestly incur debt when the director knows that the company is insolvent or will become insolvent by incurring the debt.

Read more about this from LexisNexis® Commentary

General duty of care (s 137)
A director must exercise the care, diligence and skill that a reasonable director would exercise in the same circumstances, taking account of, amongst other things:

- the nature of the company,
- the nature of the decision, and
- the position of the director and the nature of the responsibilities undertaken.

Section 137 makes clear that the standard to assess directors’ skill and care is the objective standard of a “reasonable director”. The director’s knowledge and experience is no longer relevant. However, with the factors above being taken into account, a subjective element is introduced. An executive director, for example, might be expected to be more familiar with the daily running of a company than a non-executive director. As a consequence the comparison to a “reasonable director” might be different in the case of executive and non-executive directors.

As a general rule, if a director has acted honestly, a court will be reluctant to find that the director is in breach of this duty of care. Although the test is reasonableness, the director is unlikely to be liable for a mere error of judgement. Furthermore, an important limitation on the duty of care is
the ability of a director to rely on information or advice prepared by certain persons (s 138 of the Companies Act 1993).

**Duty to disclose interests (s 140)**
A director must disclose to the board of directors any interest he or she has in a transaction or proposed transaction with the company. If the interest is quantifiable in monetary terms, then the nature and monetary value of the interest must also be disclosed. Where the interest is not quantifiable in monetary terms, the nature and extent of the interest must be disclosed. If proper disclosure is not made there is a risk that the transaction will be able to be avoided by the company or by a third party.

A director will have an interest in a transaction if:

(a) the director is a party to the transaction,
(b) the director may or will obtain a material financial benefit from the transaction,
(c) the director has a material financial interest in another party to the transaction,
(d) the director is a director, officer or trustee of another entity which is a party to or which will or may receive a material financial benefit from the transaction,
(e) the director is a parent, child spouse, civil union partner or de facto partner, of a person who is a party to or who will or may receive a material financial benefit from the transaction, or
(f) the director is otherwise directly or indirectly materially interested in the transaction.

There is an exception for related company transactions. Generally, a director who is also a director of another company within a 100% owned group will not be interested in a transaction with that other company simply by reason of his directorship of the other company. There is also an exception for ordinary course of business transactions. A director is not required to disclose an interest if:

(a) the transaction is between the director and the company, and
(b) the transaction is to be entered into in the ordinary course of the company’s business and on usual terms and conditions.

**Further Reading - you will need a LexisNexis® subscription**
*The Laws of New Zealand > Companies > Part V Company officers > (30) Directors’ interests > Transactions involving self interest > 199. Meaning of “interested”*
Duty to supervise the share register (s 90)
It is the duty of each director to take reasonable steps to ensure that the share register is properly kept and that share transfers are properly entered into the register in accordance with the Companies Act 1993.

Further Reading - you will need a LexisNexis® subscription
The Laws of New Zealand > Companies > Part III Capital and securities > (12) Share register > 88. Share register - 1993 Act

Directors' use of company information (s 145)
Directors must not disclose, use or act on information that they have obtained through their position with the company, except:

- where there is no prejudice to the company, the prior approval of the board is obtained and the particulars of the disclosure are recorded in the interests register,
- for the purposes of the company, or
- as may be required by law.

Unless prohibited by the board, such company information may also be given to a person whose interest the director represents or to a person who directs or instructs the director. Where information is given to a person who directs or instructs the director, the name of that person must be disclosed to the board and recorded in the interests register.

Read more about this from LexisNexis® Commentary
The Laws of New Zealand > Companies > Part V Company officers > (29) Directors' duties > 197. Use of information and advice

Further Reading - you will need a LexisNexis® subscription
The Laws of New Zealand > Companies > Part V Company officers > (30) Directors’ interests > Use of company information > 204. General

Other duties
Directors may have other duties when carrying out specific actions, such as the issue of shares, the making of a distribution (e.g. a dividend), the repurchase or redemption of shares, the provision of financial assistance, authorising the remuneration of directors and the provision of directors’ indemnities and insurance. When carrying out any of these actions, directors should seek legal advice as to what additional obligations or duties may apply.
The Financial Markets Authority

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Complementing the directors’ duties contained in the Companies Act 1993, the Financial Markets Authority (FMA) identified nine principles for corporate governance in their 2014 handbook Corporate Governance in New Zealand: Principles and Guidelines, which updates and replaces the Corporate Governance handbook that was first produced by the then Securities Commission in 2004.

These principles are:

- directors should observe and foster high ethical standards,
- there should be a balance of independence, skills, knowledge, experience, and perspectives among directors so that the board works effectively,
- the board should use committees where this would enhance its effectiveness in key areas while retaining board responsibility,
- the board should demand integrity both in financial reporting and in the timeliness and balance of disclosures on entity affairs,
- the remuneration of directors and executives should be transparent, fair, and reasonable.
- the board should regularly verify that the entity has appropriate processes that identify and manage potential and relevant risks,
- the board should ensure the quality and independence of the external audit process,
- the board should foster constructive relationships with shareholders that encourage them to engage with the entity, and
- the board should respect the interests of stakeholders within the context of the entity’s ownership type and its fundamental purpose.

The updated handbook contains guidelines for setting out structures and processes to help entities achieve each principle. The handbook, Corporate Governance in New Zealand: Principles and Guidelines - A Handbook for Directors, Executives and Advisers is available for download from the Financial Markets Authority website. The handbook is “intended as a reference for directors, executives and advisers, as they decide how to best apply the principles to their particular entity” and as such provides useful guidance for entities developing general principles of a good corporate governance framework.

Compliance with the updated handbook is not required by legislation or the NZX Listing Rules. However, the FMA has said that it expects entities that have an economic impact in New Zealand, or are otherwise accountable to the public, to comply with the principles and guidelines. This includes listed issuers, other issuers of securities, SOEs, community trusts, public sector entities, and other companies. Given such a wide intended audience, the nine core principles in the updated handbook (unchanged since the 2004 edition) are drafted broadly and are not prescriptive. It should be noted that not all of the principles will be relevant to every organisation.
The updated handbook provides that boards and management should consider the nature and needs of their businesses when considering how each principle applies to their particular entity and should be prepared to explain how they comply with each principle. This differs from the “comply or explain why not” policy used by NZX and ASX in their respective corporate governance codes.

The FMA notes that where detailed reporting is already required under another corporate governance code (such as those published by NZX and ASX), there may be no need to supply additional information against a particular principle set out in the updated handbook.

The principles set out in the updated handbook include reporting on corporate governance practices to shareholders and other stakeholders, which, for most entities can be achieved in the annual report, or through links to online content. The FMA makes it clear that before information is prepared, directors should consider both the performance of their entity and themselves against each of the principles. The principles should be “owned” by the board, rather than being approached through a simple “tick the box” compliance system delegated entirely to management.

The FMA recommends that listed issuers that do not cover all of the corporate governance areas set out in the updated handbook in their reports under NZX Listing Rule 10.4.5(h) should examine their practices with a view to adopting and reporting on all of the principles.

Key changes to the updated handbook include:
- the acknowledgment that reporting against the principles can be achieved by publishing on investor relations pages of company websites in addition to, or instead of in, the annual report,
- more detailed recommendations on board composition, particularly around diversity requirements which have been expanded to include considerations of gender (consistent with the 2012 amendments to the NZX Listing Rules), ethnicity, cultural background, age and specific relevant skills,
- greater recognition of the role of board committees, particularly audit committees and the need to adjust their use according to the size and particular needs of the relevant board,
- further discussion on maintaining integrity in financial reporting and on the timeliness and balance of corporate disclosures. For listed issuers, the FMA recommends that the board has appropriate policies and procedures in place to enable timely disclosure, review continuous disclosure compliance at each board meeting and to ensure that directors and officers of the issuer understand their disclosure obligations, and
- the guidelines on ethical standards have been brought into line with the ASX Corporate Governance Principles and Recommendations released in March 2014.

Read more about this from LexisNexis® Commentary
Morison’s Company Law (NZ) > Commentary > Chapter 1 Introduction to company law > [1.4] New regulator for public issuers
Governance and NZX listed companies

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When a company becomes listed on NZX Limited (NZX), there are a number of specific corporate governance requirements which the company must satisfy in order to comply with the NZX Main Board/Debt Market Listing Rules (NZX Listing Rules). An outline of these requirements is set out below.

Note that NZX is currently reviewing its corporate governance requirements, which have not been updated in more than a decade. NZX said in a paper on the review that it wanted to address the fact that its current corporate governance rules lacked clarity and that New Zealand’s reporting regimes were fragmented. These are expected to be in place by the end of 2016.

The Code
NZX has established a Corporate Governance Best Practice Code (the Code) (Appendix 16 to the Listing Rules). Compliance with the Code is not mandatory, but the Code contains principles that NZX considers may be desirable and which a listed issuer should consider and determine whether to adopt. Under NZX Listing Rule 10.4.5(i), every listed company must disclose in its annual report the extent to which its corporate governance processes materially differ from the principles set out in the Code.

The Code includes recommendations covering formal governance procedures for the board and its committees, including further guidelines for an audit committee, remuneration committee, a (director) nomination committee and code of ethics.

NZX has commenced a consultation process to update the Code reporting provisions. It also intends to review the NZX Listing Rules’ mandatory corporate governance requirements as part of a proposed broader review of the NZX Listing Rules targeted for the second half of 2016.

As a starting point for its review, NZX proposes to use the principles outlined in the FMA’s handbook, ‘Corporate Governance in New Zealand Principles and Guidelines’ published in December 2014 as a basis for a revised reporting regime. This is to help ensure that there is a more consistent approach between the respective regimes.

NZX also proposes to introduce a new tiered approach to reporting according to principles, recommendations (or guidelines) and commentary. Under this structure, the principles would be supplemented by recommendations which outline in more detail the particular matters which are expected of issuers in relation to the principle discussed. These recommendations would be more prescriptive than the principles and would be required to be met on a “comply or explain” basis. The final layer will outline commentary in relation to the application of the relevant recommendations and additional best practice commentary in areas where issuers may choose, but would not be required, to report against. In addition there would continue to be the mandatory corporate governance provisions set out in the NZX Listing Rules.
Composition and functioning of the Board

The NZX Listing Rules prescribe that the minimum number of directors (other than alternate directors) is three, at least two of whom must be ordinarily resident in New Zealand. Whilst the Companies Act 1993 is silent as to the number of independent directors a company must have, the NZX Listing Rules require a minimum of two independent directors. If there are eight or more directors, three or one-third (rounded down to the nearest whole number) of the total number of directors, whichever is the greater, must be independent.

The Code states at paragraph 2.1 that “[a] director should not simultaneously hold the positions of Chief Executive and chairman of the Board of the same Issuer”. In addition, the Code contains recommendations dealing with board appointment processes, training and performance review, nature of information to be provided to the board and director remuneration.

Audit Committee

The Listing Rules require that an audit committee with a minimum of three members and a majority of independent members should be established. One of these directors should have an accounting or financial background. The audit committee has various minimum responsibilities as set out in NZX Listing Rule 3.6.3.

The Code recommends that audit committees only be made up of non-executive directors whose membership should be noted in the company’s annual report. The committee should produce a written charter, against which the committee is regularly reviewed by the board. The committee should also address the issue of auditor independence and the chair of the board should not also be the chair of the committee (paragraph 3.5 of the Code). Attendance at audit committee meetings for those who are not members should be by invitation only.

Disclosure obligations

A listed company has a fundamental obligation to ensure that the market is kept fully informed. NZX Listing Rule 10.1.1 requires that, subject to certain exceptions, once a listed issuer becomes aware of any “Material Information” concerning it, the issuer must immediately release that Material Information to NZX.

“Material Information” is information in relation to an issuer that a reasonable person would expect, if it were generally available to the market, to have a material effect on the price of the issuer’s securities if that information relates to particular securities or particular issuer(s) rather than to securities or issuers generally.

The notes to NZX Listing Rule 10.1.1 set out examples of information which is likely to fall within the category of Material Information for the purposes of these disclosure obligations. Examples include a change in the issuer’s financial forecast or expectation, and a recommendation or declaration of a dividend or distribution.

In order to manage its continuous disclosure obligations, good corporate governance practice indicates that a listed company should establish a committee to take responsibility for making
decisions and monitoring release of information about itself. This committee should comprise both board members and representatives of management.

**Financial reporting**
A listed company must release details of its half-yearly and annual financial results to NZX. The form and content of the financial information that must be released is set out in Appendix 1 to the NZX Listing Rules. The company’s results must be announced as soon as the information (which is Material Information) is available and, in any event, within 60 days following the end of the financial half-year or year to which that information relates and before the release of the half-yearly report or annual report (Listing Rule 10.4).

Within three months after the end of each financial half-year, or within three months of the end of the company’s financial year, the listed company must release to NZX and send to its quoted security holders a half-yearly report or annual report, respectively. The content of those reports must comply with the NZX Listing Rules (NZX Listing Rule 10.4).

Further to the financial reporting obligations contained in the Listing Rules for listed companies, s 207E of the Companies Act 1993 imposes financial reporting obligations on “large” overseas companies and any “large” companies with overseas shareholders or shareholders not ordinarily resident in New Zealand where that shareholding carries the right to exercise or control 25% or more of the voting power at a company meeting.

Companies subject to s 207D(1) of the Companies Act 1993 are required to file a copy of their financial statements with the Companies Office Registrar together with a copy of the auditor’s report on those statements within 5 months after the balance date of the company.

**Related party transactions**
The Listing Rules state that an issuer may not enter into a “Material Transaction” if a “Related Party” (as those terms are defined in the Listing Rules) is likely to become a direct or indirect party to that Material Transaction or to at least one of a series of related transactions of which the Material Transaction forms part without obtaining shareholder approval.

A “Related Party” is defined widely and includes directors or officers of the issuer, substantial product holders of the issuer and “associated persons” of the issuer or of directors of substantial security holders of the issuer (NZX Listing Rule 9.2.3).

A “Material Transaction” is one where:
- assets or liabilities to a value of more than 10% of the issuer’s average market capitalisation are dealt with. This extends to the purchase, sale or leasing (as lessor or lessee) of assets and to the borrowing, lending, paying or receiving of money, or the entering into a guarantee or the giving of security, or
- a company provides or obtains services which are likely to exceed 1% of average market capitalisation in any financial year, or
- an amalgamation (except between wholly owned subsidiaries of the issuer) (NZX Listing Rule 9.2.2).
Gender composition in annual reports

NZX Listing Rule 10.4.5(j) requires NZX Main Board listed issuers to include, in each annual report, “a quantitative breakdown, as to the gender composition of the issuer’s directors and officers as at the issuer’s balance date and including comparative figures for the prior balance date of the Issuer”. NZX guidance states that an issuer does not comply with NZ Listing Rule 10.4.5(j) simply by reporting diversity data in relation to its directors and officers in a proportionate manner (i.e., by referring to the percentage of its directors and officers which are male and female). To ensure that gender diversity reporting is transparent and readily comparable between issuers and reporting periods, NZX has ruled that issuers should, at a minimum, disclose:

- the number of male and female directors at the balance date, and
- the number of male and female officers at the balance date.

The New Zealand Corporate Governance Forum

In 2015 the New Zealand Corporate Governance Forum released a set of corporate governance guidelines to promote good corporate governance practice in New Zealand. The guidelines are intended to be used by both companies and institutional investors, designed as a contemporary governance reference for share holders, chairpersons, directors and senior executives of listed companies. The FMA guidelines form the basis of the Forum’s guidelines, with the same nine principles set out by the Forum. However, in several areas the Forum has extended the FMA guidelines in order to provide more detailed guidance for companies and investors in the listed company environment. The majority of additions come from international principles and frameworks that institutional investors globally regard as best practice. These include the guidelines of the International Corporate Governance Network, UK Financial Reporting Council and the Australian Council for Superannuation investors. The guidelines will be reviewed periodically to take into account the evolving regulatory and governance landscape.

The New Zealand Corporate Governance Forum recognises that each company is different and deviations from the guidelines are sometimes appropriate. However, transparency with owners is important and the New Zealand Corporate Governance Forum expects that boards should explain the reasons why a particular guideline is not being followed.
Best practice in health and safety

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Of note in the corporate governance legislative and regulatory framework is a move towards more stringent health and safety corporate governance practices. In May 2013 the Ministry of Business, Innovation and Employment (the Ministry) together with the Institute of Directors published a guideline on good governance practices in relation to health and safety in the workplace. Following the publication of this document, the government announced a comprehensive reform package which aims to overhaul the current workplace health and safety legislative regime.

This “Working Safer” reform package, introduced in August 2013, intends to deliver on the Government’s goal to reduce New Zealand’s workplace injury and death toll by 25% by 2020. Consequently, companies will face greater responsibility in controlling risks to health and safety. In addition, the new regime proposes to impose a personal duty upon directors of companies and others in governance roles and (separate from the company’s duty).

Good Governance Practice Guidelines for Managing Health and Safety Risks (Guideline)

As a precursor to the Working Safer reform package, the Ministry and the Institute of Directors published a guideline on health and safety in the workplace in May 2013 as a result of the key findings and recommendations contained in the Royal Commission’s final report on the Pike River Coal Mine Tragedy. A second edition of the Guide, renamed Health and Safety Guide: Good Governance for Directors, was published by WorkSafe New Zealand and the Institute of Directors in early 2016.

References:
Health and Safety Guide: Good Governance for Directors (Guide)

Although the Guide is not a policy statement and does not have statutory standing, a court may take into account a company’s failure to comply with the Guide as evidence of breach of health and safety obligations. It is therefore prudent from a best practice perspective for directors be familiar with and take into account the Guide when setting the company’s direction for health and safety management.

The Guide identifies the essential principles of health and safety governance as leadership, worker participation and legislative compliance.

The key four purposes of the Guide are to provide advice to directors on health and safety governance and:

- to demonstrate how directors can influence health and safety performance,
- provide a framework for how directors can lead, plan, review and improve health and safety,
- to assist directors to identify whether their health and safety management systems are of a standard and quality that is effective in minimising risk, and
to encourage directors to create strong, objective lines of reporting and communication to and from the board.

The Guide emphasises the active role directors should take in the governance of health and safety. Action is expected on the part of directors as well as management. The Guide identifies the four key elements to the role of directors. These are:

- **Policy and planning:** there should be a high level health and safety strategy and policy approved and owned by the board. Targets should be measurable, challenging and realistic. Management should be held to account for implementing this.

- **Delivery of a fit-for-purpose health and safety management system:** a system should be put in place to identify and address hazards and risks. The system should incorporate processes for reporting and investigating incidents and ensure resources are operating safely.

- **Monitoring of the health and safety performance of the organisation:** directors need to ensure health and safety strategies are actually being implemented. Health and safety issues should be on the board’s agenda and reviewed on a regular basis.

- **Periodic formal review of health and safety performance of the organisation:** the review should check on the effectiveness of health and safety systems and evaluate the need for change. Reviews should include both internal and external audits.

**Overhaul of Health and Safety in Employment Act 1992**

Following the publication of the first edition of the Health and Safety Guide: Good Governance Practices (Guide) by Ministry and the Institute of Directors, on 7 August 2013 the Government announced their “Working Safer” reform package, which overhauls the current workplace health and safety legislative framework.

One of the objectives of the reform package was for the Health and Safety in Employment Act 1992 to be replaced by a new Health and Safety at Work Act. This new Act has now been enacted and will be discussed below.

**The Health and Safety at Work Act 2015**

The new Health and Safety at Work Act 2015 (HSWA) came into force on 4 April 2016, replacing the previous health and safety legislation.

The HSWA places a primary duty on a person conducting a business or undertaking (PCBU) to ensure, so far as reasonably practicable, the health and safety of its workers, and other workers whose activities the PCBU influences or directs. This primary duty extends to ensuring, so far as reasonably practicable, that the health and safety of other persons is not put at risk by the work of the PCBU, including visitors and other people in the vicinity of the workplace.

A PCBU will usually be a business entity, such as a company. However, an individual can be a PCBU, such as a sole trader or self-employed person. The definition of PCBU is broad enough to include all types of modern working arrangements such as joint ventures, principal-contractor,
employer-employee, and franchise arrangements. Notably, a PCBU does not include people who work in, or are officers of, a PCBU, or specific volunteer associations without paid employees. It is the PCBU that owes the obligation to protect their workers and other people (so far as is reasonably practicable).

The HSWA has brought about specific changes for directors in relation to health and safety. Under the Health and Safety in Employment Act 1992, directors could only be held liable for health and safety breaches of their companies if they participated in, or contributed to, a health and safety failure (i.e. directors only had secondary liability). For directors, there was no clear requirement for positive intervention or a due diligence duty regarding health and safety systems or performance. This meant that directors of large entities, who may have little or no practical involvement in the business, have avoided scrutiny.

The HSWA now places a positive duty on directors – as officers of a PCBU – to exercise due diligence to ensure that the business complies with its health and safety duties and obligations. The term ‘officers’ includes those who hold positions that enable them to significantly influence the management of the business. This means that senior leaders in an organisation (such as CEOs) may also be officers and owe a due diligence duty.

Specifically, the definition of officers includes:
- company directors,
- partners in a partnership and general partners in a limited partnership,
- a person who holds a position comparable to a director in a body corporate or unincorporated body (eg members of Boards of Crown entities, members of school trustees, Board or Committee members for community or not-for-profit organisations), and
- people who hold positions that enable them to significantly influence the management of the business or undertaking (eg CEOs).

Due diligence requires directors (as officers) to take reasonable steps to understand the PCBU’s operations and health and safety risks, and to ensure that they are managed so that the organisation meets its legal obligations.

Due diligence is defined in section 44(4) of the HSWA as taking reasonable steps to:
- acquire and update knowledge of health and safety matters,
- gain an understanding of the operations carried out by the organisation, and the hazards and risks generally associated with those operations,
- ensure the PCBU has, and uses, appropriate resources and processes to eliminate or minimise those risks,
- ensure the PCBU has appropriate processes for receiving and considering information about incidents, hazards and risks, and for responding to that information in a timely way,
o ensure there are processes for complying with any duty, and that these are implemented, and
o verify that these resources and processes are in place and being used.

Directors (and other officers) must exercise the care, diligence and skill that a reasonable director (or officer) would exercise in the same circumstances. What is considered reasonable will depend on the particular circumstances, including the nature of the business or undertaking, and the director or officer’s role and responsibilities. All officers, including directors, may seek health and safety advice from experts or others within their organisation, such as managers. Where they choose to rely on this advice, the reliance must be reasonable.

Directors and other officers will be personally liable if they breach their due diligence duty. The maximum penalty for a serious breach of the due diligence duty is imprisonment for up to 5 years and/or a fine of up to $600,000. It is unlawful under the HSWA to be insured or indemnified (or agree to be insured or indemnified) by another person for liability to pay a fine or infringement fee under the HSWA. Certain officers are immune from being prosecuted for a failure to meet the due diligence duty. Immune officers include:

- elected members of local authorities (councillors) under the Local Electoral Act 2001,
- members of local or community boards elected or appointed under the Local Electoral Act 2001,
- members of school boards of trustees appointed or elected under the Education Act 1989, and
- volunteer officers.

The due diligence duty supports the primary duty of care and other PCBU duties. It places a duty on individuals whose decisions significantly influence the activities of a PCBU, therefore influencing whether or not the PCBU meets its duties. However, the PCBU’s duties and the officer’s due diligence duty operate independently. If a PCBU fails to meet any of its duties it does not necessarily mean that the directors or other officers have failed to exercise due diligence. Conversely, a director or other officer may be found guilty of an offence for failing to discharge their due diligence duty whether or not the PCBU has been found liable.
The Institute of Directors

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The Institute of Directors in New Zealand (Inc) (the Institute) is a membership organisation which represents directors’ interests and facilitates their professional development through education and training. A founding document is the Code of Practice for Directors (Directors’ Code), produced by the Institute in 2010, which forms part of the corporate governance legislative and guidance framework.

Whilst the Directors’ Code is binding only on members of the Institute, it provides guidance relevant to all directors of the standard to which the Institute expects directors to perform. The Directors’ Code is not exhaustive, and deals more with moral and ethical responsibilities than those imposed by law. It is designed to be read in conjunction with applicable law such as the Companies Act 1993, the NZX Listing Rules and the provisions of the company’s constitution. Some key elements to the framework are set out below.

Values
The Directors’ Code identifies six core values that should guide the behaviour and performance of directors. These are integrity, enterprise, fairness, transparency, accountability and efficiency.

High ethical standards
Directors are expected to display and encourage high ethical standards, over and above the purely legal threshold. The Directors’ Code suggests this be implemented through a Code of Conduct.

Monitor and regularly evaluate board and management performance
Directors should ensure appropriate systematic reviews of the performance of individual directors, the chairman, the board and the CEO are undertaken to help address weakness and achieve accountability.

Further to the Directors’ Code, the Institute together with the Financial Markets Authority, has also published a document titled “A Director’s Guide”. It outlines some of the essential behaviours directors are expected to demonstrate to meet applicable legal, regulatory and ethical standards.
Other legislation and other jurisdictions

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Industry-specific regulations
Some industries are subject to specific legislation which prescribe specific rules of corporate governance. For example, the Crown Entities Act 2004 provides for a consistent framework for the establishment, governance, and operation of Crown entities. State-owned enterprises are subject to the State-Owned Enterprises Act 1986 which includes a requirement that employers operate a personnel policy incorporating provisions on good and safe working conditions.

Other non-government industries are also subject to industry-specific regulation. For example, the New Zealand Institute of Chartered Accountants is required by statute to have a code of ethics that governs the professional conduct of its members. The code of ethics sets out fundamental principles and provides guidance on professional conduct that chartered accountants should follow.

It is important for companies to be aware of and identify the regulations and legislation that will govern their activity. This includes general corporate governance legislation like directors’ duties under the Companies Act 1993 and industry-specific legislation, depending on the nature of the particular company’s operations.

Other legislation
Directors may also have responsibilities and obligations under various other pieces of legislation which may impact on the entity generally or in relation to particular types of activity. For example, the Financial Markets Conduct Act 2013, which was granted Royal assent on 13 September 2013, introduces a number of changes to market conduct. The Act was brought into effect in stages in 2014 (key dates being 1 April and 1 December).

Consequently, as part of the process of becoming familiar with their role, directors should become familiar with the impact of such legislative requirements and keep abreast of any relevant statutory updates. Where appropriate, directors should seek legal advice about the extent to which those requirements impact on the manner in which they carry out their role.

Other jurisdictions
Reference should also be had to corporate governance developments in other countries - in particular, Australia has an active corporate governance development programme via CLERP 9 (Corporate Law Economic Reform Program - 2004) and the ASX Listing Rules.

OECD Principles of Corporate Governance
The OECD conducted a review of the OECD Principles of Corporate Governance, which were last updated in 2004. The review process started in 2014. The updated principles were launched at the meeting of G20 Finance Ministers and Central Bank Governors in Ankara on 4-5 September 2015. They were subsequently endorsed at the G20 Leaders Summit in Antalya on 15-16 November 2015.
The OECD Principles of Corporate Governance are a non-binding public policy instrument that can be adapted to the specific circumstances of individual countries and is intended to:

- assist governments and regulators to improve their legal, regulatory and institutional framework for corporate governance, and
- provide guidance for stock exchanges, investors, corporations and others with a role in the process of developing good corporate governance.

The OECD Principles of Corporate Governance provide guidance through recommendations and annotations across six chapters:

- ensuring the basis for an effective corporate governance framework,
- the rights and equitable treatment of shareholders and key ownership functions,
- institutional investors, stock markets and other intermediaries,
- the role of stakeholders in corporate governance,
- disclosure and transparency, and
- the responsibilities of the board.

Changes to the OECD Principles of Corporate Governance address recent developments or issues in capital markets. The changes that may be most relevant to New Zealand’s listed issuers include:

- fairness was added to the values that corporate governance should promote (alongside transparency and efficiency) to ensure effective supervision and enforcement, and
- institutional investors acting in a fiduciary capacity should disclose their corporate governance and voting policies with respect to their investments, including the procedures that they have in place for deciding on the use of their voting rights.

The revised text of the OECD Principles of Corporate Governance also addresses certain issues regarding shareholder rights, including the need for shareholders to be sufficiently informed about, and have the right to approve or participate in, decisions concerning fundamental corporate changes. Stronger requirements around the disclosure of remuneration agreements for directors and senior executives was also addressed.
The courts’ views on directors’ duties

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The Companies Act 1993 prescribes the duties that all directors are required to comply with. However, there is much discussion on the application of directors’ duties in cases that have been heard before the courts. This commentary is useful for understanding how these duties apply practically and will assist in creating a solid corporate governance framework.

General reluctance to intervene
Generally, the courts have been reluctant to review business decisions made by directors of solvent companies that continue to trade. Judges recognise that they are not in business and they do not have the requisite experience and expertise, nor any mandate from shareholders, to manage companies by court order. However, court decisions are useful in identifying the standards expected of directors generally and the circumstance in which courts are likely to hold directors liable for failing to meet their obligations.

Minimum baselines
In particular, the collapse of finance companies in New Zealand and resulting court cases has focused the spotlight on directors’ duties in recent years. Like many legal developments, it is only ever the egregious factual situations which come before the courts, nevertheless the practical implications of the recent Australian and New Zealand cases provide minimum baselines for boards of high quality companies to measure best practice. Counsel can provide insight to directors into the practical application of principles arising from these cases, both generally, and specifically in relation to certain decisions and processes.

Directors’ decisions making: relying on advice
Increasingly, directors are seeking comfort from counsel that what they are doing is legally sound and that they are fulfilling their duties as directors. The legal basis for this is s 138 of the Companies Act 1993, which states that directors are entitled to rely on proper advice to assist them in decision-making. However, the Court of Appeal recently emphasised in Jeffries v R [2013] NZCA 188 that advice from management is not a substitute for the requirement that directors fully consider information put before them and exercise independent judgement in determining the reliability of this information.

References:
Jeffries v R [2013] NZCA 188

Further examples of where the courts have become more willing to review decisions
Further examples where the courts have become much more willing to review decisions made by directors of companies include the following.
Where companies have collapsed after a protracted period of trading while insolvent, resulting in substantial losses to creditors

Although the courts will not hold directors liable for taking legitimate and reasonable business risks, they take a much tougher stance with directors who take unreasonable and unjustified risks by allowing an insolvent or marginally solvent company to continue to trade, without a reasonable basis for believing that the company will be able to trade its way out of its financial difficulties.

For example, in Re South Pacific Shipping Ltd (in Liq) (2004) 2 NZCCLR 8, a director of the company caused the company to keep trading despite the fact it had been insolvent for some time. The director had an incentive to keep the company trading and went so far as to expand the company despite the risks to trade creditors in doing so. The company was placed into liquidation just under four years later. The court considered the director should have put up his own money or ceased trading. The court also found the director’s governance of the company “lamentable”, and far below the standard expected of directors responsible for companies in a hostile business environment such as that faced by the company. The court concluded that the director’s conduct “departed so markedly from orthodox business practice and involved such extensive and unusual risks to the creditors that it [could] fairly be stigmatised as reckless.”

References:
Re South Pacific Shipping Ltd (in Liq) (2004) 2 NZCCLR 8

Where directors have sacrificed the interests of the company and its shareholders to further their own personal interests

This includes insider trading, misappropriating company funds and business opportunities for themselves, and interfering with the constitutional make up of a company to entrench their position and concentrate their ownership and control of the company by unlawful means.

For example, in Pacifica Shipping Co Ltd v Anderson [1986] 2 NZLR 328, the director was held liable for misusing company information (provided to him in his capacity as director) for his personal benefit. He had been involved in board meetings, company discussions and had access to board reports relating to the acquisition of a vessel the company wished to acquire for its freight services. The owner of the vessel offered it to the director personally. The director subsequently gave notice of his resignation from the board with the intention of using the vessel in a new shipping venture similar in nature to what the company had been proposing to undertake. The company successfully brought proceedings to prevent the (former) director from using the vessel in competition with the company’s operations. The court held that the director had an obligation not to profit personally from his position as a director and not to allow a conflict of interest to arise between his duty as a director and his own self-interest.

Where directors fail to take all reasonable steps to be in a position to guide and monitor

Other learnings from recent cases in respect of directors’ duties include the recognition that governance and management are two distinct bodies. The court in Australian Securities and Investments Commission v Healey [2011] FCA 717 held that it is not sufficient to merely set a strategy then allow management to execute that strategy. Directors must “take all reasonable
steps to be in a position to guide and monitor.” In particular, directors may not delegate their tasks and duties to auditors or other management bodies and cannot abdicate responsibility.

**References:**
*Australian Securities and Investments Commission v Healey (2011) 278 ALR 618*

**Where directors fail to fully consider information and exercise independent judgement**
Advice from management is not a substitute for the requirement that directors fully consider information put before them on important matters that fall specifically within the board’s responsibilities and exercise independent judgement in determining the reliability of this information. The court in *R v Graham [2012] NZCCLR 6* noted that offer documents must disclose “everything of relevance that is likely to be material to the investment decision.” Even if the directors’ reliance on advice from management has led them to reasonably believe the offer document is correct, the court in *R v Graham* held that in such an instance, the “director’s obligations in relation to the accuracy of content of offer documents are non-delegable.” Directors therefore remain ultimately responsible for ensuring financial statements and offer documents involving seeking funds from the public accurately represent the position of the company.

**References:**
*R v Graham [2012] NZCCLR 6*

Each director of a listed company must be able to read and understand financial accounts, regardless of whether they are on the audit committee or not.

**References:**
*R v Moses HC Auckland CRI 2009-004-1388, 8 July 2011, BC201162400*

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*Morison’s Company Law (NZ) > Commentary > Chapter 24 Directors’ powers and duties > Duties of directors > [24.6]*
Directors’ decision making

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Directors’ decision making - Overview

When making decisions, directors must consider a range of factors in order to ensure that their statutory duties are properly discharged.

It is important that records are kept that reflect the decision making process, especially for significant decisions.

See Considerations for directors.
Considerations for directors

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Considerations

Mervyn King, the leading individual on corporate governance in South Africa, posed the following eight simple questions that a director should bring to each decision to ensure the discharge of his or her duties in his book “The Corporate Citizen: Governance for All Entities” (Penguin Books, 2006):

- Do I have a conflict of interest in making this decision?
- Do I have all the facts to enable me to make a decision?
- Is the decision I am making a rational business decision based on all the facts?
- Is the decision in the best interests of the company?
- Is the communication of the decision to all relevant stakeholders transparent?
- Is the company acting in a socially responsible manner?
- Am I acting as a good steward of the company’s assets?
- Would the board be embarrassed if its decisions and processes employed in reaching those decisions appeared on the front page of a national newspaper?

These eight questions are useful in providing an effective framework against which decisions undertaken to seek profitable outcomes and understanding risk can be measured.

Recording decisions

As noted at “The courts’ views on directors’ duties”, the courts have become more willing to examine how directors have met their individual responsibilities. Directors should therefore ensure that, in relation to significant decisions, the basis on which the decisions are made (and where possible) the supporting information on which the decisions are based is identified and recorded. Documenting important decisions in this way should assist in justifying the grounds, purpose and reasonableness of the directors’ actions, if compliance with their objective duties is called into question.

The decision of the New South Wales Supreme Court in Australian Securities and Investments Commission v Macdonald (No.11) (2009) 256 ALR 199 is a significant case for New Zealand from a best practice perspective. In this case the Australian Securities and Investment Commission bought civil proceedings against former directors and certain senior executives of the former parent company of the James Hardie group of companies. The Court’s high level of scrutiny on the preparation and approval of board minutes and the content and timeliness of board illustrates that documentation should not be viewed as a purely administrative exercise, but as an important risk minimisation step for directors.
In the decisions of Australian Securities and Investments Commission v Healey (2011) 278 ALR 618 and R v Moses HC Auckland CRI 2009-004-1388, 8 July 2011, BC201162400, the courts held that directors are entitled to delegate the preparation of the company’s books and financial accounts to management, accountants and auditors. The courts further acknowledged that the audit committee continues to play an important role in the review and sign-off process as an effective means of allocating tasks and resources. However, ultimate responsibility for internal processes and documentation remains with each director.
How do lawyers deal with corporate governance? - Overview

Garry Downs Bell Gully

The lawyer is well placed to assist in the promotion, development and implementation of governance policies. Good governance should be considered when assisting clients to meet their obligations in all aspects of work, whether involving regulatory matters, transactions or advice.

See The role of the lawyer.

Advice from counsel in respect to corporate governance may be required in a number of different scenarios, such as at the establishment stage of an entity, on an annual basis, in response to particular issues or in the context of large transactions. See:

- When and how to get involved,
- Some practical examples, and
- Legal opinions in large transactions.
The role of the lawyer

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Both in-house and external counsel can have a critical role to play in assisting directors to become fully informed before reaching an independent opinion on important decisions. A key to this will be providing an early, pro-active, dispassionate and independent view on the applicable corporate governance requirements.

Justice Owen has observed:


This is a question lawyers should ask themselves when giving advice.

A lawyer has the skills and resources to help directors to tackle governance issues. Relevant sources include the lawyer’s background knowledge in ethics, relevant specific rules applicable to the company and best practice examples from colleagues in similar organisations. The lawyer can use this information to discuss and promote meaningful discussion of corporate governance with the directors and the board. This can then form the basis of policies and provisions to be drafted and used in documents such as joint venture agreements and internal procedures.
When and how to get involved

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At establishment
When the organisation is being established, governance topics will naturally be on the agenda. For existing entities, the introduction of a new director, CEO, or in-house counsel may also provide an opportune time for a review of existing governance practices. Other appropriate times include where new shareholders are introduced, the company decides to apply for listing or relevant legislation is introduced.

For in-house counsel of an unlisted company, the minimum statutory obligations under the Companies Act 1993 will be the initial reference point in drafting a corporate governance framework. Whilst the Companies Act 1993 is also relevant to in-house counsel of a listed company, in this circumstance, it is essential that the in-house counsel also consult the NZX Corporate Governance Best Practice Code.

See Governance and NZX listed companies.

A starting point when drafting a corporate governance framework could be comparing the corporate governance statements of similar-sized companies in similar industries. This will provide insight into the possible approaches to corporate governance.

For listed companies, paragraph 1 of the NZX Corporate Governance Best Practice Code requires that a code of ethics be implemented. Paragraph 1.3 of the Code lists relevant points to consider when drafting the code of ethics for a listed company. Although unlisted companies are not required to introduce a code of ethics, the board and executive could consider applying the principles set out in the Code and also prepare a code of ethics.

Finally, the policies and procedures adopted should be consistent with the company’s organisational culture. It is important that in-house counsel encourage the board and executive to ensure the framework is implemented by the company in practice.

Annually
An annual review paper for the board on best practice/governance trends may also be a useful way to introduce corporate governance issues for consideration. Best practice would involve requiring mandatory participation of relevant stakeholders. Companies should consider having governance rules and practice on the annual standing agenda to keep up-to-date with developments.

The Financial Markets Authority advised in its report Corporate Governance in New Zealand: Principles and Guidelines - A Handbook for Directors, Executives and Advisors that, as an integral element of good governance, the board and directors should:

“regularly assess their own performance and that of their individual members against predefined measures of the efficiency and effectiveness of board processes, and on the contributions of individual directors”.
The Financial Markets Authority also identified in its report that boards should regularly verify that the entity has appropriate processes that identify and manage potential and relevant risks. An annual review should consider whether the entity’s processes still align with best practice.

**In response to issues**
The lawyer’s professional role empowers him or her to prompt discussion on some of the more sensitive topics in governance whenever such issues arise. Examples of some situations in which external counsel are instructed to give governance advice are dealt with in Some practical examples.

**Training**
Internal counsel can be helpful in assisting directors and management in the training and development of knowledge in corporate governance. This may be done via reference to governance bodies such as the Institute of Directors and by attending law firm seminars.
Some practical examples
Garry Downs Bell Gully

Design of governance framework
External counsel may be instructed to help with the design of a governance framework to:
- complement the relevant organisation,
- assist in the design of governance structures for start-up companies,
- distil the relevant specific rules,
- advise on the general principles applicable and assist in focusing on the most relevant best practice rules, and
- advise on what is typical, based on their experience, including best practice from other organisations, what committees may be appropriate and the base legislation (eg the Crown Entities Act for Crown entities).

Response to governance issues
Specific governance issues for all forms of entities as and when they arise are commonly referred to external counsel. In addition, external counsel can assist the boards or other management areas in developing policies, processes and training. External counsel are also well placed to share best practice and current regulatory thinking.

Directors’ duties
There are many examples of situations where external counsel can advise in this manner, depending on the nature of the company and its business. One example is where a company makes a commitment in its corporate governance policies to comply with specific laws, regulations and good practice industry standards in relation to a specific context, such as health and safety or the environment. This company may wish to seek external advice on whether a particular business decision will comply with the governing legislation, generally, or, specifically, in relation to a particular provision or legislative requirement. Further, in times of significant legislative reform, external counsel can provide in depth information on the likely or proposed effect of such reform on a company’s business and advice on how best to prepare for any governance changes that may be necessary to implement.

See also The courts’ views on directors’ duties for considerations in-house counsel should take into account when advising directors on discharging their duties.
Legal opinions in large transactions

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A relatively recent development in relation to very large transactions is to have a separate law firm from the deal lawyers advise the board (or in some cases its independent directors) that a proper process has been followed in undertaking the transaction and the board (or independent directors) have properly fulfilled their director duties. These opinions are similar to the more common “due diligence” opinions given to directors on prospectus liability. In those, an opinion is given as to whether the directors have acted reasonably and the process should provide a due diligence defence.

Other opinions given in transactions can include sign off on proper process, for example, that a party conducted a sale or request for proposal process pursuant to the governing documents, and that certain parties to the transaction acted consistently with principles of probity at key decision making points.
Corporate social responsibility - Overview

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A final topic worthy of note is corporate social responsibility (CSR). CSR is an emerging area of concern for directors considering recent developments in the corporate governance arena. CSR is defined by the European Commission as “a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis”. Businesses can derive numerous benefits from adopting socially responsible policies as part of their overall corporate governance strategy. See The concept of CSR.

While the primary responsibility for CSR in a corporate entity lies with the board, in-house counsel have a major role to play in ensuring the formulation and implementation of CSR policies. See In-house counsel and CSR.

Examples of CSR can also be seen in the public sector. See The public sector.
The concept of CSR

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The concept of corporate social responsibility (CSR) is relatively new to the business world. As such, its parameters are yet to be precisely defined. However, the typically used definition of CSR originates from the European Commission, and is stated as being

... a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis. (Commission of the European Communities, Green Paper: Promoting a European framework for Corporate Social Responsibility, COM(2001) 366, Brussels, 18 July 2001, at [20]).

CSR comprises three basic components:
- doing business responsibly,
- taking a leadership position in community investment and social issues relevant to the business, and
- taking accountability for the impact of company behaviour on social and environmental outcomes.

CSR and corporate governance

CSR can be contrasted with corporate governance. The latter consists of binding and enforceable law, which companies must comply with alongside other more broad governance principles and guidance.

In comparison, CSR encompasses ethical, voluntary and non-enforceable principles, which can help companies manage their roles in society in a responsible way and help to restore the trust of the public in corporate integrity and responsibility. This is especially important in light of prominent cases of financial fraud such as the 2001 Enron scandal, where Enron shareholders lost USD 74 billion in the four years before the company’s bankruptcy.

Benefits of CSR for businesses

There are numerous known benefits which provide commercial sense for any business to adopt socially responsible policies as part of their overall corporate governance strategy, including:
- increased customer loyalty,
- enhancing and differentiating brand reputation,
- strengthening staff and team spirit,
- attracting a committed workforce through being a responsible employer,
- consolidating business partnerships,
- increasing competitiveness through innovation,
- increased revenue,
- reduced environmental impact and associated costs, and
- reduced government intervention.
**In-house counsel and CSR**

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While the primary responsibility for CSR in a corporate entity lies with the board, in-house counsel have a major role to play in ensuring the formulation and implementation of CSR policies. The privileged position of in-house counsel in relation to the board means they can have a real influence in turning the board’s mind towards CSR issues.

In-house counsel can include CSR as part of their mandate through:

- preventative measures in memoranda,
- legal audits,
- compliance monitoring,
- formulation of CSR policy,
- legislative proposals,
- review of company policies,
- corporate structure,
- new projects and developments, and
- settlements of company disputes.

Additionally, as the company’s ethical adviser (especially within the context of the Rules of Conduct and Client Care for Lawyers), in-house counsel are equipped to assist with setting the social framework and defining the manner in which a company should operate to meet the ethical, legal, commercial and public expectations that society expects of it.

**CSR in practice**

In-house counsel can help drive a number of CSR initiatives that can improve efficiency within the company and encourage staff morale. Some examples of CSR issues which are topical include:

- maximising employee health and safety, including occupational health and stress management,
- allowing flexible working hours for staff,
- facilitating and financing employee training, internally and externally,
- promoting a positive work atmosphere,
- having internal policies with an ethical dimension including human rights, risk management, environmental and government policies,
- organising and encouraging staff to participate in sports activities, and
- adopting progressive environmental policies.
The public sector

Garry Downs Bell Gully

Examples of CSR can now be seen in the public sector. In late 2007, a formalised framework for CSR applying to all State Owned Enterprises (SOEs) was announced by the Government. SOEs are required under the State Owned Enterprises Act 1986 to show a sense of social responsibility and by having regard to the interests of the community in which they operate as part of their objective to be a successful business.

References:
State Owned Enterprises Act 1986, s 4(1)(c)

The framework sets particular CSR targets in each SOE’s annual Statement of Corporate Intent, which will be independently monitored and reported against, just like financial targets. See the 2007 Corporate Social Responsibility (CSR) Framework for SOEs - Cabinet Paper and associated Corporate Social Responsibility (CSR) Framework for SOEs - Cabinet Minute on the Crown Ownership Monitoring Unit website, which outline the CSR framework. The framework emphasises both CSR programmes and the behaviours and values evident in a company’s day-to-day operations. See also the 2008 Corporate Social Responsibility (CSR) Framework for SOEs - Cabinet Paper and associated Corporate Social Responsibility (CSR) Framework for SOEs - Cabinet Minute, which report on progress regarding implementation of the framework.

A specific illustration of the implementation of the CSR framework for SOEs is the Community Post initiative by New Zealand Post, involving the donation of postage-included envelopes to not-for-profit organisations. Over 100 organisations benefited from Community Post in 2012. This initiative is now monitored under a formalised framework.