

Should I stay or should I go?

Directors, leave of absence and liability





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1. Foreword

Life doesn't stand still for directors.

Circumstances can arise where a director may need to, or wish to, step away from a board for a period of time. There can be various reasons for taking some time out, including for personal or family related issues such as parental leave or illness.

When determining whether leave of absence is appropriate, there are numerous factors to consider including whether this may have an impact on the company (e.g. when the company is a listed company and must inform the market or when the company is going through a particular process in which the skills of that director are especially required such as during transformational projects).

If you are answering the question “*should I stay or should I go?*” on a temporary basis, one of your primary considerations should be ensuring that you are not exposed to potential personal liability if you take leave of absence.

New Zealand company law doesn't expressly deal with a director's leave of absence and related liability which creates some uncertainty around the legal position. This uncertainty can lead directors to take the 'safest' option and resign – rather than staying on as a director and risking being liable if something goes awry while they are absent.

The consequences of losing directors due to this situation are potentially far-reaching and disadvantageous to fostering a strong pool of

director talent in New Zealand – particularly for skilled and qualified individuals who may be thinking about starting or growing a family.

We consider that the risk of personal liability while on leave coupled with the lack of options to return (should a director decide to resign rather than take leave of absence) creates a barrier to skilled individuals pursuing corporate governance roles. This is particularly so for women who are, without a doubt, predominantly affected by this when considering the need for parental leave – they may have to resign and may not always have an option to return to their roles afterwards. This is a barrier to creating a strong pipeline of diverse directors for New Zealand companies and other organisations and obstructs the recruitment and retention of women on boards.

The critical importance and need for robust governance and leadership has always been important but has been further highlighted as a result of COVID-19. It is fundamental to good governance and essential to New Zealand's future wellbeing and prosperity that highly skilled and experienced individuals are encouraged to serve as directors.



About the paper

There is limited public guidance for directors in New Zealand for taking leave of absence. A key aim of this paper is to shed light on some of the relevant issues and outline important questions for boards, directors and organisations to consider, including:

- when is a director able to take leave on a temporary basis?
- what are the options for short or extended periods of leave?
- how should such a request be dealt with by the board? and
- what, if any, liabilities could this expose the board and/or that director to?

This paper is also intended to generate discussion and debate among directors and stakeholders and we would welcome feedback to glc@iod.org.nz

Although this paper focuses on companies and directors, the issues and questions are relevant to most organisations and board members.

2. Background

Non-executive directors on boards can face significant challenges in taking leave of absence.

Directors are generally appointed or elected by shareholders to provide director services to a company and can also be removed by the same shareholders by way of ordinary resolution. Directors are not employees and therefore do not have the same rights and protections under law including, for example, access to statutory personal grievance protection.

Many organisations adopt policies that set out the term that a director will serve on the board with an option at the end of such term for them to stand for re-election/re-appointment. Organisations may also have a limit on the number of terms that a director can serve on the board, for example, three x three years (i.e. being a maximum of nine years).

It is widely accepted that effective boards need a diverse range of skills, knowledge, experience and perspectives and, as highlighted in our discussion paper, [Always on duty – the future board](#), governance roles should not be regarded as a retirement gig. We are also seeing the composition of boards of listed companies in New Zealand changing, particularly in relation to gender.

Board composition and diversity is an important issue for stakeholders including institutional investors and the New Zealand Shareholders' Association.

It is vital that directors who serve on multiple boards have enough time to adequately address and fulfil the demands of each governance role. In the last decade, the remit of the board has expanded extensively, and directors serve in an increasingly challenging operating and regulatory environment.

Stakeholder expectations of boards and directors are also higher than ever and there is strong community interest in ensuring that directors adhere to professional standards.

There have also been numerous director accountability proposals and reforms introduced over recent years and directors are more conscious of the availability of litigation funding and activist groups using the courts to hold companies to account.

The issues and questions outlined in this paper should all be considered within this context.

In today's business landscape, courageous, skilled and committed directors are essential to navigating organisations successfully into the future.

3. Current options

The Companies Act 1993 (Companies Act) does not expressly deal with the issue of a director taking leave of absence, but it is possible.

Current options available to directors who need to, or wish to, take leave include:

- for one-off absences, tender an apology for that particular board meeting; or
- for an extended period of leave, formally request leave of absence – and/or appoint an alternate director; or
- resign from the directorship entirely.

An apology from a board meeting is not the same as obtaining approval for leave of absence from the board. Tendering an apology is usually due to an unplanned event such as sickness or conflicting commitments, whereas leave of absence is sought when a director knows, in advance, that they are going to be absent for a period of time. In such circumstances, the director needs to seek board approval prior to the period of absence commencing.

Examples

Medical treatment

In March 2020, NZX listed company Serko Limited announced that its chair Simon Botherway CMIInstD was taking a temporary leave of absence (but would remain as a director) to enable treatment for a recently diagnosed non-life threatening medical condition. He also took leave from his other governance roles.

Parental leave

In July 2019, Lani Evans CMIInstD resigned from her position as a director of Thankyou Payroll to take 6 months of unofficial parental leave. Prior to exiting, Lani secured a mutual agreement that she would be reappointed to the board once her parental leave period was over. Lani also resigned and was reappointed to several other governance roles. She wrote about her experiences on [Medium](#).

4. Leave of absence policy

Boards have broad powers to regulate their own procedure under the Companies Act and this includes approving leave of absence.

Another option is for a company to formally incorporate specific leave of absence provisions in its constitution and/or to have a specific leave of absence policy. Such a policy could:

- outline the process for granting leave of absence
- set out acceptable reasons for approving leave of absence
- set the permitted duration of such leave
- make clear that a director is unable to vote on board matters or attend board meetings while on leave.

There are a range of operational matters that the board would need to consider if a director goes on leave, such as quorum and voting requirements.

Although technically the policy would only need to be approved by the board, it may be prudent to obtain shareholder approval (where appropriate) to the terms of the policy to provide a degree of protection from liability for that director and/or the board as a whole. This may also reduce the likelihood of shareholders later being dissatisfied with the handling of the situation, or the communications around it, at a shareholders' meeting (e.g. by putting forward a resolution requesting to remove director from the board or otherwise).

5. Considerations for the board in granting leave of absence

In deciding whether to grant a director leave of absence a board will need to consider a number of matters including whether doing so is in the best interests of the company.

This will include considering whether a director has particular skills that the company needs and if the director being absent for a period of time exposes the company to additional risk. For example, where the director requesting leave is the only director with a certain type of relevant industry experience or expertise.

This also needs to be weighed against the board's desire to have the director return after the period of leave, which could be jeopardised if the director was forced to

resign from the board. A board should also consider whether a replacement or alternate director (discussed on page 8) needs to be appointed to fill a skills' gap during the period of leave. There will also be times during a company's lifecycle (e.g. during a major transaction, a public offering, a takeover, or a crisis) where it would be appropriate for a director to resign rather than take leave of absence if they were unable to devote the time required during such an undertaking.

6. Alternate directors

A director requesting leave of absence may also consider appointing an alternate director to represent them at board meetings.

Appointing an alternate director can also be a practical solution for some directors and companies to mitigate any skills' gap and/or quorum issues.

While the Companies Act does not expressly deal with the concept of an alternate director it is well understood in New Zealand¹. To appoint an alternate director, this must be permitted by a company's constitution. Typically, the constitution will set out the circumstances in which an alternate can be appointed (and removed), the rights and powers of the alternate and remuneration (if any) payable.

An alternate director, when acting in their capacity as an alternate, generally has the rights, powers, privileges, duties and responsibilities of a director. Where the appointing director is present or acting in

their capacity as a director, the alternate will have no legal status and therefore none of the powers, duties or responsibilities of a director. Notwithstanding the appointment of an alternate, there are still potential liability issues for the director on leave, including for decisions that are made by the board over an extended period of time.

Appointing an alternate director may not be practical in all cases, for instance:

- it may be difficult to find an individual who is prepared to act as an alternate that also has the skills and experience required by the board
- for the alternate to provide value, it may take significant time and commitment to get up to speed on current issues or matters concerning the company.

Example

An example of a director taking this approach is Sir Stephen Tindall CFinD who has been on leave of absence from the board of The Warehouse Group since October 2017 to focus on other pursuits. His son, Robbie Tindall, was appointed as his alternate in 2011 and has been acting in that capacity since Sir Stephen took leave in 2017. The constitution of the company does not provide specifically for leave of absence but does set out alternate director provisions.

In September 2020, it was announced that Sir Stephen would step down as a director. Robbie has been nominated as a director and will stand for election at the company's annual shareholders' meeting.

7. Directors' duties and liability while on leave of absence

Even while on leave of absence, directors have extensive legal duties and can be exposed to potential liability under the Companies Act and other legislation.

The relevant legal framework of a company depends on its operations. Some legislation, for example, is business/industry specific or transaction/business specific (such as the Financial Markets Conduct Act 2013).

We are not aware of a case where a director's leave of absence and related liability has been tested in the courts in New Zealand. However, we make some comments on this issue in relation to the Companies Act, the Health and Safety at Work Act 2015 and the Financial Markets Conduct Act 2013.

Companies Act

Under the Companies Act, directors owe certain duties to the company which are well known and set out in sections 131 to 137. A director will continue to have ongoing obligations and duties owed to the company notwithstanding their absence. However, some obligations, such as the duty to act in good faith and the duty to exercise reasonable care, diligence and skill, only apply where a director is 'exercising' a power or 'performing' a duty. Similarly, certain other duties such as duties relating to trading and incurring obligations, require the director not to agree to the company acting in a certain manner. It is arguable, therefore, that during a period of absence, a director is not exercising any powers or performing any such duties nor are they involved in the decision making of the company and in such circumstances should not be liable.

The Companies Act also places certain obligations on the board and the company

itself. In many cases a breach of these obligations by the company will result in both the company and every director of the company committing an offence (e.g. a breach of the obligation to file financial statements or to maintain a share register). In such cases all directors will potentially be liable for the offence, and it will fall on each director to try to establish a defence.

The most likely defence available to a director on leave of absence will be under section 376 of the Companies Act. Under this provision a director must prove that in the circumstances they could not reasonably have been expected to take steps to ensure that the board complied with the requirements of the Companies Act.

While there are arguments that can be made to potentially reduce or eliminate liability, the lack of statutory clarity in New Zealand means that strictly speaking, the only way to truly protect a director from potential liability is to resign and request to be reappointed as a director in the future. However, if a director is on an approved leave of absence where the company has in place an appropriate policy and the board (or shareholders) has otherwise exercised its powers to approve leave of absence, there are avenues available to argue that the director should not be liable under the Companies Act for decisions made, or not made, during their period of leave. Even so, the problem with taking such an approach can be a costly exercise (both financially and emotionally) in the event a director is caught up in legal proceedings.

Other legislation

It is not just the Companies Act that directors need to consider in understanding their potential liability while on leave of absence. There are other Acts, two of which we discuss below.

Health and Safety at Work Act

The Health and Safety at Work Act 2015 requires ‘officers’ (which includes directors) to exercise due diligence in ensuring that the company complies with its health and safety obligations. Due diligence requires officers to acquire and keep up-to-date knowledge of health and safety matters, gain an understanding of the operations of the organisation and the hazards and risks generally associated with those operations, ensure there are processes in place to eliminate and/or minimise the risks and ensure that they are being implemented. Such duties are personal and cannot be delegated, modified or transferred and are continuous even during leave of absence (and there is no specific defence available).

Financial Markets Conduct Act

The Financial Markets Conduct Act 2013 (FMCA) imposes potential personal (both civil and criminal) liability on directors of a company that offers financial products in breach of part 3 of the FMCA. Where a director is deemed to have contravened a civil liability provision of the FMCA, a director’s defence relies on their ability to prove that they took all reasonable and proper steps to ensure that the offeror (being the company) complied with its obligations under the FMCA or they otherwise placed reasonable reliance on information supplied by another person.

There is a question as to whether a director would be able to rely on this defence given that they would be absent during the decision-making process while on leave (and therefore not actively undertaking any decision-making activities). The specific answer will probably depend on the type of corporate transaction being undertaken and also on the processes and mechanisms in place at the company to ensure proper compliance with the FMCA requirements.

Ultimately, a director should consider whether resigning is more appropriate than taking leave of absence if the company is undertaking a significant corporate transaction (including some of those regulated by the FMCA).

There are no defences to criminal liability under the FMCA, however, in each case a director must be reckless or otherwise have knowledge of the illegal action(s). It would be difficult to argue that a director had knowledge when they were absent during the decision-making process, so our view is that criminal liability would be unlikely to arise for directors on leave of absence.

D&O insurance

Directors should ensure that the company they serve on has in place appropriate insurance policies and confirm, to what extent, such policies cover a director when they are on leave. An important consideration will include understanding who is covered as an insured person, (i.e. the director on leave and/or any alternate appointed).

Remuneration

Boards and directors will also need to consider remuneration and this could be considered in a leave of absence policy (if there is one). Some non-executive directors may also have access to paid parental leave under the Parental Leave and Employment Protection Act 1987 as self-employed contractors.

8. Where to next?

We have explored some of the arguments that can be made to potentially reduce or eliminate liability in the event a director takes leave of absence.

However, the onus is still on the director to make their case and this is a considerable burden with significant potential personal risk.

Depending on the risk appetite of a director (and the board generally), the 'safest' option in most circumstances will be for a director to simply resign. It is noted that when a director resigns (e.g. to take parental leave), boards are not required to hold the role open for the director or offer them a future vacancy (although this is something that boards could consider).

As highlighted in the foreword, the consequences of this outcome are potentially far-reaching and disadvantageous to fostering board diversity and the talent pool of directors in New Zealand – particularly for individuals who may want to start or grow a family. As women are predominantly affected by this, it becomes an obstacle to having more gender diversity on company boards.

Good governance has the power to transform organisations, communities and the country. Ensuring highly skilled and experienced individuals want to serve as directors in the future is fundamental for New Zealand's future wellbeing and prosperity. It is important to remove barriers that may impact on this. This includes enabling directors to take leave of absence in appropriate circumstances rather than resigning in fear of potential legal ramifications.

Global developments to watch

Many of the issues in this paper are also generally relevant to non-executive directors globally and this is highlighted in a June 2020 article by German law firm Kliemt.HR *Do board members have a legal right to a family break in Germany?*² The article notes that there is discussion in Germany about amending the German Stock Corporation Act that would essentially suspend all director rights and obligations for a defined period in specific circumstances.

The article also notes that non-executive directors in many European countries and other jurisdictions are not covered by employee protection laws including parental leave. Denmark is slightly different in that the Danish Act on Maternity, Paternity and Parental Leave applies to both employees and board members who are considered self-employed.

Your view

We are interested in hearing from IoD members and stakeholders about any of the issues raised in this paper. Feedback can be provided to glc@iod.org.nz

9. Endnotes and key resources

Endnotes

- 1 See *Strathmore Group Limited v Fraser & Ors* (1991) 5NZCLC 67, 163 where Robertson J held, 'In my view an alternate is a director pro tem. During those times when he is acting as a director, he has the rights, powers and privileges and necessarily the consequential duties and responsibilities of a director.'
- 2 *Do board members have a legal right to a family break in Germany?* Kliemt.HR, June 2020

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The IoD is New Zealand's leading organisation for directors and at the heart of the governance community. We believe in the power of good governance to create a strong, fair and sustainable future powered by best practice governance. Our role is to drive excellence and high standards in governance. We support and equip our 9000+ members and the broader governance community who lead a range of organisations from listed companies, large private organisations, state and public sector entities, small and medium enterprises, not-for-profit organisations and charities.

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