

Directors' Duties & Responsibilities

by

Philip TN Koh

Advocate & Solicitor, High Court of Malaya
Senior Partner, Mah-Kamariyah & Philip Koh



Who then is a Director ?

- “Director” includes any person occupying the position of director of a corporation by whatever name called... and a person in accordance with whose directions or instructions the majority of directors... are accustomed to act and an alternate or substitute director
- De Jure: formally appointed by consent and in compliance with Art of Assoc. / the Act
- De Facto: assuming the function and status
- Shadow: subservient and acting regularly to a particular person; if board then the governing majority acts regularly on directions of the alleged shadow

Senior Management team is imposed Directors' Duties

- The Act states that for purposes of key sections dealing with Directors' Duties & Responsibilities "director" includes the Chief Executive Officer (CEO), Chief Financial Officer (CFO), Chief Operating Officer (COO) or any other person primarily responsible for the management of the company
- Yap Sing Hock v PP [1991] 2 MLJ 334; [1992] 2 MLJ 714

The Nature & Basis of Directors' Duties

- In early days, directors were described as trustees as in unincorporated form. Property is vested in key officers as “trustees”
- Courts used trust concepts so that self dealing and conflict in transactions that was detrimental to a company may be judicially examined
- Trustees are imposed restraints in investment whilst directors are expected to be entrepreneurial and be permitted to take more risks
- In economic reality: fiduciary duties navigate the complex web of an agency relationship in a corporate enterprise circumscribing the open-ended bargain between shareholders and corporate officers

Directors' Duties & Corporate Governance

- Governance concerns the exercise of powers in a corporate enterprise
- The Cadbury Report (1992) defines “the system by which companies are directed and controlled”. It deals with the relationship between the constituent parts of a company – the directors, the board (and its sub-committees) and the shareholders

To Whom Do Directors Owe Their Duties ?

- Shareholder Value vs. Stakeholders: The Anglo–American model as compared with Euro–Asian?
- The cases: “Law does not say there shall be no cake and ale, but that there are to be no cakes and ale except such as are required for the benefit of the company” (Bowen LJ, Hutton v West Cork Ry Co (1883))
- The basic principle is “where a company is both going and solvent, first and foremost come the shareholders, present and no doubt future as well” (Nourse LJ in Brady v Brady (1987))

A modern compromise?

- The Supreme Court of Canada states that “directors have a duty to act in the best interest of a corporation and that means acting to maximise the value of the corporation.”
- “[Directors] [may] observe a decent respect for other interests lying beyond those of shareholders’ in the strict sense... [the board] may be legitimate, given all the circumstances of a given case, for the board of directors to consider, inter alia, the interests of shareholders, employees, suppliers, creditors, consumers, governments and the environment... At all times, directors and officers owe their fiduciary duties to the corporation. The interests of the corporation are not to be confused with the interests of the creditors or those of other stakeholders.” (Peoples’ Department Stores v Wise (2004) DLR (4th) 564)

The Statutory Statement of Directors' Duties (A)

- Functions of the Board: to manage and to direct: S.211(1) and powers necessary for managing, directing and supervising (S211(2))
- Proceedings: subject to the Constitution the Third Schedule: S.212
- Duties and Responsibilities: (a) Fiduciary (S.213(1)); Care & Skill (s.213(2))
- Duty to exercise independent judgment

Case Authorities: Fiduciary Duties

- ReW & M Roith Ltd [1967] 1 All ER 427
- Intraco Ltd v MultiPak Pte Ltd [1995] 1 SLR 313
- Walker v Wimbourne (1975) 137 CLR 1
- Group Interests: are they interlocking shareholding or only common controlling shareholders?
- Constructive trusteeship: Royal Brunei Airlines Sdn Bhd v Tan Kok Ming [1995] 3 MLJ 74
- Collateral Purpose: Howard Smith v Ampol Petroleum [1974]

Case authorities: Care & Skill / Negligence

- Duty to be skillful: an Executive Director has specific managerial responsibilities and also duties under the contract of service. In any one instance of alleged breach the standard of care is an objective body of knowledge and expertise possessed by a reasonable director
- Non executive “need not exhibit in the performance of his duties a greater degree of skill than may reasonably be expected from a person of his knowledge and skill”
- Now a minimum standard is expected, “capability of understanding his company’s affairs to the extent of reaching a reasonably informed opinion of its financial capacity.” (Commonwealth Bank of Aus. v Friedrich (1991))

Duties & Responsibilities (B)

- Reliance on information provided by others: S.215(1): Huckerby v Elliot [1970] 1 All ER 189
- Responsibility for actions of delegatee: S.216(1): Daniels v Anderson (1995) 16 ACSR 607
- Responsibility to enquire and investigate into matters that come to attention
- Responsibility of a nominee director: S.217(1)
- Prohibition against improper use of property, position: S.218

Disclosure Duties

- General Duty to make disclosure: S.219(1)
- Disclosure of interest in contracts, proposed contracts, property, offices: S.221
- Interested Director not to participate or vote: S.222(1)

Transactions needful of Approval of Shareholders

- Directors shall not enter or carry into effect any arrangement or transactions for acquisition, disposal of an undertaking or property of substantial value unless approved by company by way of resolution: S.223
- A company shall not enter into or carry into effect any arrangement or transaction where a director or a substantial shareholder of the company or its holding/ subsidiary or person connected with a director or substantial shareholder unless approved by resolution of the company: S.228
- In both instances, a conditional agreement subject to approval by a general meeting can be effected

Loans & Payments to Director

- Prohibition to making loans or entering into any guarantee and providing any security in connection with a loan to a director: S.224
- Prohibition of loans to persons connected with directors: S.225
- Prohibition of tax free payments to directors: S.226
- Payments to directors for loss of office: S.227

Directors' service contracts

- Two types of service contract: a personal service agreement (S.231(1)(a)); Services... that are made available by a third party to the public company or to the subsidiary of the public company (S.231(2)(b))
- Contracts of service to be made available for inspection (S.232(1)) and right of member to inspect and request a copy (S.233(1))
- Contract with sole member who is also a director: contract if not in writing terms to be duly recorded in the minutes of the meeting of directors immediately after making of the contract (S.234(1)(2))

Directors & Accounts

- This is one of the most significant duties, i.e. to ensure that a profit and loss account and balance sheet is properly prepared showing a true and fair view of the company's financial position together with the Directors' Report
- Directors have a duty to ensure that financial statements are prepared in accordance with applicable accounting standards (defined under the Financial Reporting Act 1997)
- PP v Richard Charles Tarling [1981] 1 MLJ 173 (accounts misleading)
- Khoo Ban Hock v PP [1988] 3 MLJ 22 (accounts window dressed to deceive customers and people dealing with the company)

Directors & System of Internal Controls

- Directors of a public company or subsidiary shall have in place a system of internal control that will provide a reasonable assurance that – (a) the assets of the company are safeguarded against unauthorised use or disposition and to give a proper account of the assets; and (b) all transactions are properly authorised and the transactions are recorded as necessary to give a true and fair view of financial statements

Directors at meetings: Board meetings

- At Board meetings: Third Schedule [S.212]
- Election as Chair and duration for office
- Notice and convening
- Methods: quorum being assembled at the place, date and time appointed or by means of audio, or audio and visual, communication by which all directors participating and constituting a quorum can simultaneously hear each other throughout the meeting
- Voting: There is a presumption that directors have voted in favour of a resolution unless there is express dissent from or a vote to object to the resolution at the meeting

Directors at General Meetings

- Directors should be informed of the constitutional provisions of Proceedings of Meetings and also the Act: Division 5
- All Directors are collectively subject to being queried or their expression as to what their position is on a matter
- Shareholder activism is common and best practice of Corporate Governance gives encouragement for shareholders' participation

Directors' Duties in Insolvency & Corporate Rescue Mechanism

- Corporate Voluntary Arrangement: applicable only to private companies and which has no charge over its property: S.395-402
- Judicial Management: S.403-430
- In near insolvency: directors have to be cognisant of duties to creditors as there could be liability for unlawful trading and misfeasance proceedings
- Cessation of Directors' powers upon appointment of Receiver & Manager / Liquidators

Indemnity & Release of Duties

- Business judgment rule: S.214 (See the Petra Perdana v Tengku Petra & Ors case)
- Power of Court to grant relief: S.581 "... if it appears to the Court that the [director] has acted honestly and reasonably and that, having regard to all the circumstances of the case, he ought to be fairly excused for the negligence, default or breach the Court may release him wholly or in partly from his liability on such terms as the Court thinks fit."

Guidance to directors: 10 Commandments

- Act in the company's best interest, taking everything you think relevant into account in your decision
- Comply with the Company's constitution and all relevant legal regulatory provisions
- Be honest, acting always in good faith, keeping in mind that the company's assets and proprietary information belongs to the company and NOT to you or any individual shareholders; when exercising power ensure no collateral purpose
- Be diligent, prudent and keep informed exercising due care and attention to matters. If you have specific skills or experience apply that to the company's benefit
- Ensure that records are kept properly of decisions
- Keep in mind that you remain responsible and accountable for work you delegate to others
- Keep away from conflict and if in doubt disclose and desist until authorised
- Seek proper professional advice with sources of respected expertise
- Keep updated with developments in corporate governance reforms and be informed about the industry
- Keep informed and have an understanding of financial and accounting standards and economic and socio-political developments

THE END

