COMPANY LAW – PART III
(DIRECTORS)

(1) DIRECTORS

- When the companies get larger and larger, it becomes difficult to get the shareholders involved in the management of the day to day affairs of the company. Therefore, a separation of powers was developed between those who own the company (shareholders) and those who manage it (directors). Even though companies are legal persons recognized by company law as a body corporate they have to act through a board of directors because of not being natural persons. Directors can enter into employment of contact with the company and act as an employee while being a director of the company in a dual capacity.
- Section 529 defines a director to include:
  (a) a person occupying the position of director regardless of the name used;
  (b) a person in accordance with whose directions or instructions a director/the board may be required or is accustomed to act;
  (c) a person who exercises/ is entitled to exercise/ controls the exercise of/ is entitled to control the exercise of the powers which, apart from the Articles of Association ("articles"), would be required to be exercised by the board;
  (d) a person to whom a power or duty of the board has been directly delegated by the board with that person's consent or acquiescence, or who exercises the power or duty with the consent or acquiescence of the board.
- The management of a company is a statutory power delegated to the board of directors of a company, subject to the provisions of the articles of the company.
  Section 184 – Subject to the provisions contained in the articles of a company—
  (a) the business and affairs of a company shall be managed by or under the direction or supervision of the board of the company;
  (b) the board of a company shall have all the powers necessary for managing and for directing and supervising the management of, the business and affairs of the company.
  The articles will govern the proceedings of the board of the company.
  The articles may also mandate that certain matters require shareholder approval.
  The number of directors of a company is also usually determined by the articles. However, Section 201 states that a company must have at least 1 director; and a public company must have at least 2 directors.

- <u>Certain types of directors:</u>
  - Executive Directors – They are the full-time working directors of the company. Extensive management powers have been delegated to them by the articles. They have a higher responsibility towards the organization. In addition to his role as a director, may also hold executive or managerial positions like the managing director (uppermost executive director).
  - Non-Executive Directors – They are non- working directors and are not involved in the day to day running of the business of the company. They might take part in the planning or policy-making process. They generally occupy a more advisory or supervisory role and challenge the executive directors to come up with decisions and solutions that are in the best interest of the company. Traditionally, they were expected to do little or nothing, other than to attend a reasonable number of board meetings or sit in committees. However, due to the fall in the standard of directors, the difference between executive and non-executive is now a non-existing concept.
  - Alternate Directors – The articles should provide for the appointment of an alternate director. Appointed by a director of the board who would be absent for a period of time. Therefore, acts as a director for a temporary period. Can only hold office as permissible to the director whose

office this director holds and generally entitled to perform all the duties and functions of the appointer in his/her absence.

- Sleeping Directors – directors with merely an investment interest. Do not engage actively in the management of the company. However, the law does not distinguish between active and sleeping directors anymore.
- Independent directors – They do not have any direct relationship with the company. Their experience is their asset and gives expert advice to the board when required. Generally, in order to be an independent director, a person must have expertise and experience and must be a person of integrity.

(2) QUALIFICATIONS - SECTION 202

- Any person is qualified to become a director unless disqualified from being appointed or holding office as a director under the Companies Act, No. 7 of 2007 (as amended) ("Companies Act").
- Disqualified persons:
  - a person who is **under 18** years of age;
  - a person who is an **undischarged insolvent**; [a person who is unable to pay his debts as they are due or whose liabilities cannot be covered by his assets is an insolvent person. An insolvent can have insolvency proceedings initiated against him. A court can "discharge" the debtor and release him of his debts through some financial arrangement, like attachment of his movable and non-movable assets. As long as an insolvent is not thus discharged by the court, he remains an "undischarged insolvent".]
  - a person who is or would be **prohibited** from being a director of or be concerned or taking part in the promotion, formation or management of a company, **under the Companies Act, No. 17 of 1982** but for the repeal of the same;
  - a person who is **prohibited** from being a director or promoter of or being concerned or taking part in the management of a company **under specified sections of the Companies Act**;
  - a person who has been adjudged to be of **unsound mind**;
  - a person that is **not a natural person** (i.e. a body corporate);
  - in relation to any particular company, a person who **does not comply with any qualification** for director contained **in the articles** of that company.

(3) APPOINTMENT OF DIRECTORS

- Section 203 – A person will be appointed as a director of a company if he has, in the prescribed form (a) **consented** to be a director; and (b) **certified that he is not disqualified** from being appointed or holding office as a director of a company.
- Section 204 – A person named as a director in the application for incorporation/in an amalgamation proposal (**first director/s**), is entitled to hold office as a director from the date of incorporation/amalgamation, as the case may be, until that person ceases to hold office as a director in accordance with the provisions of the Companies Act. However, all **subsequent directors** of a company, unless the articles otherwise provide, must be appointed by way of an **ordinary resolution** passed by the shareholders.

(4) REMOVAL OF DIRECTORS – SECTION 206

Subject to the articles of the company, a director may be removed from office **by ordinary resolution** passed at a meeting called for that purpose or for purposes that include the removal of the director.

(5) VACATION OF OFFICE OF DIRECTORS – SECTION 207

The office of director of a company shall be vacated if the director:

- resigns from his office;
- is removed from office in accordance with the Companies Act or the articles;

- becomes disqualified in terms of section 202;
- dies;
- vacates office pursuant to Section 210 (2) (i.e. attaining age of 70 years); or
- otherwise vacates office in accordance with the articles.

(6) RETIRING AGE OF DIRECTORS – SECTION 210

- A person who has attained the age of **70 years** is not capable of being appointed a director of:
  - a **public company**; or
  - of a **private company which is a subsidiary of a public company**.
- When a director of a public company or of a private company which is a subsidiary of a public company, **reaches the age of 70 years**, he/she **must vacate office** at the conclusion of the annual general meeting commencing next after he attains the age of 70 years.
- If a person is reappointed as a director after attaining the age of 70 years, he must vacate office at the annual general meeting following that reappointment.
- Section 211 – However, the appointment of a director who has attained the age of 70 years cannot be prevented, or require a director who has attained that age to retire, if the appointment is or was made or approved by a resolution passed by the company at a general meeting which declares that the age limit referred to in section 210 will not apply to that director. Any such resolution will be valid only for 1 year from his appointment.

(7) VALIDITY OF DIRECTOR'S ACTS – SECTION 209

- The acts of a person as a director shall be valid notwithstanding the fact that:
  (a) the person's appointment was defective; or
  (b) the person is not qualified for such appointment.
- *Haddow Nominees Ltd. v Rarawa Farm Ltd. (1981) 2 NZLR 16 CA* – In this case, directors who were not validly appointed to the board have signed documents for the issue of debentures as if they were validly appointed. It was held that the debentures issued by the company under their signature was a valid contract.

(8) DUTIES OF DIRECTORS

- Since the Companies Act has granted powers to the board of directors to manage day to day affairs of the company, it was necessary to devise a way of controlling the directors in the exercise of those powers. Strict fiduciary principles designed to ensure certain minimum standards were applied under the common law.
- "Fiduciary" refers to trust and confidence. A fiduciary is someone who acts for, or on behalf of, another person, in a relationship of trust and confidence which imposes a duty of loyalty on the fiduciary. Fiduciary duty of loyalty is a duty not to utilize the fiduciary position in a way which is adverse to the interests of the person for whom the fiduciary is acting.
- The fiduciary duty of directors is a mandatory element of company law. Directors came to be looked upon as trustees, partners, or agents of the company, and accordingly, they were considered to have a "fiduciary relationship" with the company.
- Though the management powers of the company are conferred on the board collectively, the fiduciary obligation of directors are owed by directors to the company individually.
- The Companies Act sets down the 3 fundamental statutory duties of directors as follows:
  (a) duty to act in good faith and in what the director believes to be in the best interests of the company (Section 187);
  (b) duty not to act or agree to the company acting in contravention of the Companies Act or the articles (Section 188);
  (c) duty not to act in a manner which is reckless or grossly negligent and to exercise the care, diligence and skill a reasonable director would exercise (Section 189 - standard of care).

- DUTY TO ACT IN GOOD FAITH AND IN THE INTERESTS OF THE COMPANY – SECTION 187
  - A person exercising powers or performing duties as a director of a company must act in **good faith**, and in what that person **believes to be in the interests of the company**.
  - However, a director of a company which is a wholly owned subsidiary of another company (parent) may, if expressly permitted to do so by the company's (subsidiary) articles, act in a manner which he **believes is in the interest of that other company (parent) even though it may not be in the interests of the company (subsidiary) of which he is a director**.
  - *Percival v Wright* (1902) 2 Ch 421 – It was held that the directors owe duties to the company not to the individual shareholders.
  - *Coleman v Myers* [1977] 2 NZLR 225 and *Peskin v Anderson* [2001] BCLC 372 – Courts held that the principle in *Percival v Wright* is the general rule. However, it is subject to exceptions where the circumstances are such that a director may owe a greater duty to an individual shareholder, such as when that shareholder is known to be relying upon the director for guidance, or where the shareholder is a vulnerable person.

- DUTY NOT TO CONTRAVENE THE LAW OR THE ARTICLES – SECTION 188
  - A director of a company must not act or agree to the company acting, in a manner that contravenes any provisions of the Companies Act, or the provisions contained in the articles of the company.
  - If a director acts or proposes to act in contravention of the Companies Act or the articles, a shareholder can restrain such director by obtaining a restraining order.

- DIRECTORS' STANDARD OF CARE – SECTION 189
  - *A person exercising powers or performing duties as a director of a company:*
    (a) shall not act in a manner which is reckless or grossly negligent; and
    (b) shall exercise the degree of skill and care that may reasonably be expected of a person of his knowledge and experience.
  - *Re Brazilian Rubber Plantations and Estates Ltd* [1911] 1 Ch 425 – The director did not have knowledge of the rubber industry and made losses from rubber speculation. Court lay down a **subjective test** for a duty of care, where the **director need only exercise such care as could be reasonably expected of him having regard to his knowledge and experience**. A director was not expected to bring any special qualifications to the office. A director is not expected to be an expert, unless appointed as such. Incompetency does not amount to a breach of fiduciary duties.
  - *Norman v Theodore Goddard* [1991]. The court held that when performing his functions as an executive director, an executive **director is required to exercise his knowledge, skill and experience which he actually has and which a person carrying his function should be expected to have – objective test**.

- Other duties under the Companies Act
  (a) Duty of directors on insolvency – section 219:
    - A director who believes that the company is unable to pay its debts as they fall due, shall forthwith call a meeting of the board to consider whether the board should apply to court for the winding up of the company and the appointment of a liquidator or an administrator or carry on further the business of the company.
    - Where a director fails to comply with the above requirement and at the time of that failure the company was unable to pay its debts as they fell due, and the company is subsequently placed in liquidation, the court may on the application of the liquidator or of a creditor of the company, make an order that the director shall be liable for the whole or any part of any loss

suffered by creditors of the company as a result of the company continuing to carry on its business.

- If a meeting is called and the board does not resolve to apply to court for the winding up of the company and for the appointment of a liquidator or an administrator; at the time of that meeting there were no reasonable grounds for believing that the company was able to pay its debts as they fell due; and the company is subsequently placed in liquidation, the court may, on the application of the liquidator or of a creditor of the company, make an order that the directors, other than those directors who attended the meeting and voted in favour of applying to court for the winding up of the company and for the appointment of the liquidator or an administrator, shall be liable for the whole or any part of any loss suffered by creditor of the company as a result of the company continuing to carry on its business.

(b) Duty of directors on serious loss of capital – section 220:

- If at any time it appears to a director that the net assets [total assets minus total liabilities] of the company are less than half of its stated capital [the value of the assets received or receivable by the company on the issue of its shares], the board must within 20 working days of that fact becoming known to the director, call an extraordinary general meeting ("EGM") of shareholders to be held not later than 40 working days form that date of calling of such meeting.
- The notice calling a meeting must be accompanied by a report prepared by the board, which advises shareholders of— (a) the nature and extent of the losses incurred by the company; (b) the cause or causes of the losses incurred by the company; (c) the steps, if any, which are being taken by the board to prevent further such losses or to recoup the losses incurred.
- Where the board of a company fails to call an EGM, every director who knowingly and willfully auothorises or permits the failure or permits the failure to continue, shall be guilty of an offence and be liable on conviction to a fine not exceeding Rs. 200,000/-.

(9) USE OF INFORMATION AND ADVICE – SECTION 190

- A director may **rely** on **reports, statements, and financial data and other information** prepared or supplied, and on **professional or expert advice** given by any of the following persons:
  (a) an **employee** of the company;
  (b) a **professional adviser or expert** in relation to matters which the director believes to be within the person's professional or expert competence;
  (c) any other **director or committee of directors** in which the director did not serve, in relation to matters within the directors or committee's designated authority.
- A director may rely on the above, if, and only if, the director:
  - acts in good faith;
  - makes proper inquiry where the need for inquiry is indicated by the circumstances; and
  - has no knowledge that such reliance is unwarranted.

(10) DISCLOSURE OF INTEREST – SECTION 192

- When a **director** becomes aware of the fact that he is **interested** in a **transaction or proposed transaction with the company**, he must **immediately** cause to be entered in the **interests register** and if the company has more than 1 director, **disclose to the board** of the company, the nature and extent of that interest.
- It is sufficient disclosure to have a **general notice** entered in the interests register or disclosed to the board.
- A **failure** by a director to enter in the interests register **will not affect the validity** of a transaction entered into by the company or the director.
- Every director who **fails to enter** in the interests register will be **guilty** of an offence, and be liable on conviction to a fine not exceeding Rs. 200,000/-.

- Meaning of "interested" – section 191

  A director is interested in a transaction to which the company is a party if, and only if, the director:
  (a) is a party to or will or may derive a material financial benefit from the transaction;
  (b) has a material financial interest in another party to the transaction;
  (c) is a director, officer or trustee of another party to or person who will or may derive a material financial benefit from the transaction, not being a party or person that is:
    (i) the company's holding company being a holding company of which the company is a wholly-owned subsidiary;
    (ii) a wholly-owned subsidiary of the company; or
    (iii) a wholly-owned subsidiary of a holding company of which the company is also a wholly-owned subsidiary;
  (d) is the parent, child, or spouse of another party to or person who will or may derive a material financial benefit from the transaction; or
  (e) is otherwise directly or indirectly materially interested in the transaction.

- Avoidance of transaction – section 193
  - A transaction entered into by the company in which a director of the company is interested, may be avoided by the company at any time before the expiration of 6 months after the transaction, and the director's interest in it have been disclosed to all the shareholders (whether by means of the company's annual report or otherwise).
  - A transaction shall not be avoided under this section if the company receives fair value under it. For this purpose, whether a company receives fair value under a transaction shall be determined on the basis of the information known to the company and to the interested director, at the time the transaction is entered into.
  - If a transaction is entered into by the company in the ordinary course of its business and on usual terms and conditions, the company shall be presumed to have received fair value under the transaction.
  - Section 194 – avoidance of a transaction under section 193 shall not affect the title or interest of a person in or to property which that person has acquired, if the property was acquired:
    (a) from a person other than the company;
    (b) for valuable consideration; and
    (c) in good faith without notice of the circumstances as a consequence of which the transaction becomes voidable.

(11) USE OF COMPANY INFORMATION – SECTION 197

- A director of a company who has **information** in his **capacity as a director or employee** of the company which would not otherwise be available to him, shall **not disclose** that information to any person or **make use of or act on** the information, **except**:
  (a) for the **purposes of the company**;
  (b) as **required by law**;
  (c) if the director is first **authorised to do so by the board** if the board is satisfied that to do so will not be likely to prejudice the company and **particulars of the authorisation are entered in the interests register**; or
  (d) in any other circumstances in which the **company's articles authorise** the director to do so.
- The underlying concept with regard to this is that the directors must not make secret profits by virtue of his/her position.
- *Regal (Hastings) Ltd. v Gulliver (1942) 1 All ER 378* – It was held that the good faith of the director and the fact that the company did not suffer a loss was irrelevant. The basis of liability arose from the fact of profits being made by the director and not disclosed. Failure to disclose made it a **secret profit**.

(12) DISCLOSURE OF SHARE DEALING BY DIRECTORS – SECTION 200

- Every director who **has a relevant interest in any shares** issued by the company must **forthwith**:
  (a) **disclose to the board** the **number and class of shares** in which the relevant interest is held and the **nature of the relevant interest**; and
  (b) ensure that the particulars disclosed to the board are **entered in the interests register**.
- This is a **continuing obligation**.
- A director who **acquires or disposes of a relevant interest** in shares issued by the company must **forthwith** after the acquisition or disposition:
  (a) **disclose to the board** the **number and class** of shares in which the relevant interest has been acquired/ was disposed of; **nature of the relevant interest**; **consideration** paid/ received; and **date** of the acquisition/ disposition; and
  (b) ensure that the particulars disclosed to the board are **entered in the interests register**.

- Meaning of "relevant interest" – section 198
  - A director has a relevant interest in a share issued by a company (whether or not the director is registered in the share register as the holder of it) if the director:
    (a) is a beneficial owner of the share;
    (b) has the power to exercise any right to vote attached to the share;
    (c) has the power to control the exercise of any right to vote attached to the share;
    (d) has the power to acquire or dispose of the share;
    (e) has the power to control the acquisition or disposition of the share by another person;
    (f) under or by virtue of any trust, agreement, arrangement or understanding relating to the share (whether or not that person is a party to it) may at any time have the powers listed from (b) to (e) above.
  - Where a person who is not a director has an interest in the shares and is controlled by a director, that director also has a relevant interest.