COMPANY LAW
(PART III)

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DIRECTORS

• Section 529 defines a director to include *inter alia*:
  
  (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, 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.
DIRECTORS

• 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.

• Articles will govern the proceedings of the board of the company.

• 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 – a company must have at least ..................; and a public company must have at least .........................
CERTAIN TYPES OF DIRECTORS

• Executive Directors – extensive management powers have been delegated to them by the articles. 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 – commonly found in larger companies. Generally occupy a more advisory or supervisory role. 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 – 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. 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.
QUALIFICATION OF DIRECTORS - SECTION 202

- Disqualified persons:
  - a person who is under 18 years of age;
  - a person who is 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 section 213 or section 214 of this 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.
DISQUALIFICATION UNDER SECTION 213

- Where a person—
  (a) has been convicted of any **offence** under the Companies Act which is **punishable by imprisonment**;
  (b) has been convicted of an **offence** involving **dishonest or fraudulent acts**;
  (c) is adjudged **insolvent** under the Insolvency Ordinance (Cap. 97); or
  (d) adjudged to be of **unsound mind**,

such person shall not, during the period of ................ after the conviction or adjudication, as the case may be, be a director or promoter of or in any way, whether directly or indirectly, be concerned or take part in the management of a company, **unless that person first makes an application to obtain the leave of the court**. Leave may be given on such terms and conditions as the court thinks fit.

- A person who acts in contravention of this section or of any order made under this section, shall be guilty of an offence and be liable on conviction to a **fine not exceeding .................. or to a term of imprisonment not exceeding .................. or to both** such fine and imprisonment.
Where a person—

(a) is prohibited from being a director of company under section 213;

(b) while a director of a company, has persistently failed to comply with the provisions of the Companies Act

(c) has been convicted of an offence of involving dishonest or fraudulent acts in a country other than Sri Lanka; or

(d) was a director of a company which became insolvent and that person’s conduct as a director of that company or of any other company makes that person unfit to be a director of a company, the court may make an order that the person shall not, without leave of court, be a director or promoter of or in any way whether directly or indirectly be concerned or take part in the management of a company, for such period not exceeding ...................... as may be specified in the order.

Every person who acts in contravention of an order made under this section shall be guilty of an offence and be liable on conviction to a fine not exceeding ...................... or to a term of imprisonment not exceeding ...................... or to both such fine and imprisonment.
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 .................................................................
REMOVAL AND VACATION OF OFFICE 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.

• Section 207 – The office of director of a company shall be vacated if the director:
  (a) resigns from his office;
  (b) is removed from office in accordance with the Companies Act or the articles;
  (c) becomes disqualified in terms of section 202;
  (d) dies;
  (e) vacates office pursuant to Section 210 (2) (attaining age of 70 years); or
  (f) otherwise vacates office in accordance with the articles.
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 – directors not validly appointed have signed documents as if they were validly appointed. It was held that the debentures issued by the company under their signature was a valid contract.
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.
DUTIES OF DIRECTORS

• 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.

• 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.
DUTIES OF DIRECTORS

• 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:
  - duty to act in good faith and in what the director believes to be in the best interests of the company (Section 187);
  - duty not to act or agree to the company acting in contravention of the Companies Act or the articles (Section 188);
  - 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 – .................................................................................................................................

• Coleman v Myers [1977] 2 NZLR 225 and Peskin v Anderson [2001] BCLC 372 – Court 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 ……………………………………………………………………….
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 – 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. 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.
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.
DUTY OF DIRECTORS ON SERIOUS LOSS OF CAPITAL – SECTION 220

• If at any time it appears to a director that the net assets of the company are less than half of its stated capital, the board must within 20 working days of that fact becoming known to the director, call an EGM of shareholders to be held not later than 40 working days from 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 authorises 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 .........................
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.

• The above will apply to a director, if, and only if, the director:
  (a) acts in good faith;
  (b) makes proper inquiry where the need for inquiry is indicated by the circumstances; and
  (c) has no knowledge that such reliance is unwarranted.
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.

• 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 …………………
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.
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.

*Regal (Hastings) Ltd. v Gulliver (1942) 1 All ER 378* – Good faith of the director and the fact that the company did not suffer a loss was irrelevant. Basis of liability arose from the fact of profits being made and not disclosed. Failure to disclose made it a secret profit.
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.

• 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.