Qualification disqualification, appointment, duties and liabilities of directors ...

Business, Company

Company law in Malaysia is governed by Companies Act 1965. This Act is modelled on English Companies Act 1948 and Australian Uniform Companies Act 1961. Therefore, references will be made to English and Australian cases for interpretation of the law on certain areas.

In every company there are directors to manage and direct the company. A company’s directors and officers are responsible for managing the company’s business and affairs. In small companies, particularly small family companies, some or all of the shareholders will typically be involved in the management of the company. Section 4(1) of Companies Act 1965 state that a director is a person who occupies the position of a director and the definition includes a shadow director and de facto director. However, larger companies will have specialised managers conducting the business of the company. These managers may own only a small proportion of the company’s shares. Furthermore, the term director includes Chief Executive Officer (CEO), Chief Operating Officer (COO) and Chief Financial Officer (CFO) is stated in Section 132(6) of Companies Act.

A shadow is a person who is formally appointed as a director but the Board of Director is accustomed to act in accordance with such person’s instruction and directions. Thus, a de facto director is a person who acts as a director although he is not formally appointed as a director. The actions of a shadow director and a de facto director will bind the company. This is because the board of director has accepted and carried out the instructions and directions as regard to the shadow director and has allowed the de facto director to act as a director of the company.

There are many types of directors in company. First is governing director which is usually found in a small private company. They are the major decision maker in the company. Second is a managing director who is full-time director and actively involved in the management of the company. They also considered as an employee and an officer of the company. Third type of director is someone who is most the time will chair the general meeting of the shareholder. The director called as chairman and he/she will sign the minutes of the meeting. Forth, an alternate director or substitute director is a person who will replace a director for certain period of time. He has the powers, rights, duties and responsibilities of a director and therefore he is an officer of the company. Fifth is a nominee director that appointed to represent the interest of certain persons for example is shareholder, employees or creditors.

The Companies Act 1965 under Section 122(1) required all company to have at least two (2) directors, who are natural persons (normal person). The directors are collectively referred to as the board of directors . The directors are selected in the manner agreed between the members and reflected in the company’s articles of association. Upon incorporation, the name of these two directors must be specified in the memorandum or articles of association. The articles of association of the company contain the rules governing the internal regulation and operation of the company, and include rules dealing with the power of the relationship between management and the shareholders, the appointment of directors, the conduct of general meetings, and the right and obligations of shareholders. The directors are

usually responsible for managing the business of the company. The precise scope of the director’s powers, and the division of decision making power between members and directors, depend on the law and the company’s articles of association. These directors cannot be alternate or substitute directors.

There are many factor that can be disqualified a director of company. The factors that will be disqualified a person from being a director is if he is an undercharged bankrupt. Under Section 125 (1) of Companies Act 1965, the director can be disqualified from being a director if he is an undercharged bankrupt unless leave of the court which declared him as bankrupt is obtained.

Next, if he has been convicted of any offence in connection with the promotion, formation or management of a corporation. A director who has convicted of any offence involving fraud or dishonesty punishable on conviction with imprisonment for three months or more also can be disqualified or as on under Section 132 of Companies Act 1965 state that if the director failure to perform any of duties as a director. Section 303 of Companies Act 1965 also state that a disqualification of director is due to failure to keep proper accounts. Such person can be disqualified for up to five years as in Section 130(1) of Companies Act 1965.

In addition, under Section 130(A) of Companies Act 1965, a director disqualified due to involvement in two or more failed companies. The court may disqualify a person from managing a company if that person is or has

been a director of a company which has at any time gone into liquidation (whether while he was a director or subsequently) and was insolvent at that time, and a director of such other company which has gone into liquidation within five years of the date on which the first-mentioned company went into liquidation. In determining whether the disqualification is justified, the court will look at the person’s conduct as director of any one of these companies to decide if he is unfit to be concerned in the management of a company.

Section 129 of Companies Act 1965 provides that a person who is above 70 years old cannot become a director of a public company. This means that he will have to be re-elected annually. For private companies, there is no age limit on the director. Moreover, under Section 127 of Companies Act 1965 state that if a disqualified person is appointed and he has carried out certain function as a director, his actions are binding on the company. The acts of director or manager or secretary shall be valid notwithstanding any defect that may afterwards be discovered in his appointment or qualification. This is because an outsider cannot be expected to know whether the particular director is disqualified or not. In fact, the duty is on the company to check whether the particular person is disqualified or not.

The minimum number of director required in a company is two based on section 122 (1), Companies Act 1965. However, in Wong Kim Fatt v Leong & Co Bhd (1976) the court held that it is acceptable to have only one director as long as he is taking the necessary steps to appoint another within the grace period allowed by the Companies Act 1965. The director must be residing in Malaysia, he need not be a Malaysian citizen but he must reside

in Malaysia. For a new company that is being registered, the persons who are to be the first to director of the company must be named in the M/A and the A/A. There are known as first director and are appointed by the original members or investor. In existing companies, directors are appointed by the members. The constitution of the company may also allow directors to appoint additional directors. Articles 68, table A provide that other directors mat appoint additional director. This may be to add to the existing director or to fill a casual vacancy. A casual vacancy may arise when death, bankruptcy or some other reason causes an existing director to vacate his office. However, any new appointments must not exceed the number of company directors as specific in the A/A.

For public companies, there must be a separate resolution to appoint every director unless the members of the company have unanimously agreed that such a rule shall not apply. If this is done, then there can be a single resolution to appoint more than one director. Based on section 126(1), Companies Act 1965. To be eligible to be appointed as a director , the person must be natural person and not a company based on 122(2) Companies Act 1965 , a director also must be of full age at least 18 years of age, based on section 122(2) , Companies Act 1965 . However a director also must consent to the appointment based on section 123, Companies Act 1965 and not be disqualified from being a director based on Section 125, section 130 and section 130(A) , Company Act 1965 .

There is no requirement for a director to own or buy shares in the company unless this is required by the A/A. If there is such a requirement, the director

must buy the shares within two month of his appointment based on section 124, Companies Act 1965. If he fails to do so, he will lose his office as a director.

Every director is under a fiduciary duty because trust and confidence are reposed on a director by the shareholders, employees, other officers, creditors of the company and other companies within the group. The duties of a director can be divided into two board categories. First board is loyalty and good faith that can be divided into four specific duties. There are duty to act good in the interest of the company, to act proper purpose, duty to retain discretion and duty to avoid conflicts' of interest. These common law duties of loyalty and good faith are also reflected in statutory. When we say that a director must act bona fida, it means that the directors must be acting in good faith or honestly. In case Re Smith and Fawcett Ltd (1942), it state that the director must not for his own interests or for the interest of other person. Duty is also not owned to other companies within the group. The interest of group companies is not in priority to company interest. This can be illustrated in case Walker v Wimborne (1976).

Although management must not be stifled but neither can unfettered, unsupervised, absolute discretion be permitted. Therefore a director has been given powers, which must be exercised for proper purpose and not for a collateral purpose. The directors should not use his powers in the interest of some other person or body.

Another aspect of a director fiduciary duty is the director must retain discretion. This means that in a company, the directors must be independent in making their decision. There should not be any limitation, restriction or prohibition by the previous directors has imposed a limitation, restriction or prohibition, they are in breach of their duties. Directors are under a fiduciary duty also needed to avoid any conflict of interest. The court has recognised that this principle must be strictly adhered to regardless of whether the contract is fair or unfair; there is loss to the company or a profit for the director and etc.

The applicable case law in Malaysia for duty of care, skill and diligence of a director is still Re City Equitable Fire Insurance Co Ltd (1925), which sets a low standard for this duty in example as in the absence of suspicious circumstances, a director may trust another company official to carry out those duties which may properly be delegated. Director’s liability arises because of their position as officers of the company as also for being in the position of trustees or having fiduciary relation with the company or its shareholders. These liabilities are in contract, some are in tort, some are under the criminal law and others are statutory. The courts have decided the liability of directors, taken into judgment a director’s position as a whole.

Directors are link to use fair and legal diligence in discharging the duties and to act honestly, and act with such care as is reasonably expected from him, having regard to his knowledge and experience. In R. K. Dalmia v. The Delhi Administration it was held that “ A director will be personally liable on a company contract when he has accepted personal liability either expressly or

impliedly”. Directors are the agents or the trustees of a company. “ Breach of warranty of authority explaining if directors to outsiders that they have authority to conclude a particular transaction on behalf of the company and no such authority exists, then the director or indeed other person is liable for the breach of the warranty of authority.

Directors often concluded a contract on behalf of their company; they will also give collateral guarantee. This is particularly the case where the company borrows money from its bank and the bank require security from the company‘ s officers. In such as situation if the primary liability fails, the outsider may sue the guarantor on the collateral guarantee. Pre-incorporation contracts as has already been examined, where a company cannot make a contract before it is incorporated because, before incorporation, it has no legal existence. Therefore, a Company after incorporation cannot ratify a contract previously made. It must make a fresh contract. But, those who act on behalf of the unincorporated company may find themselves personally liable.

Director may be tortuously liable as follows in fraud, a director may be liable in the fraud to subscribers and even purchasers on the open market in relation to statement made in a company prospectus or listing particulars under the principle Derry v Peek. In a similar way s director may be liable in tort for the tort of negligent misstatement to subscribers and purchasers under the principle in Hedley Byrne for misstatement in a prospectus or listing particulars. In rare circumstances where a director has warranted his own personal skill and care, he may be liable to the outsider notwithstanding

that the contract has been concluded with the company rather than with the director. Thus in Fairland Shipping Corporation that the perishable goods stored in the company’s refrigeration would be safe. In fact the goods were ruined . it was held that he was personally liable. The company itself could not pay damages as it had gone into liquidation.

A director is bound by the maxim delegate’s non-protest delegate. Shareholders appoint him because of their faith in his skill, competence and integrity and they may not have the same faith in another person. It was held in the case of J. K. Industries v. Chief Inspector of Factories that the directors being in control of the company’s affairs cannot get rid of their managerial responsibility by nominating a person as the occupier of the factory. The rule is, however, not inflexible. The Act or Articles of Association of the Company may make a delegation of functions to the extent to which it is authorized. Also, there are certain duties, which may, having regard to the exigencies of business, properly be left to some other officials. A proper degree of delegation and division of responsibility is permissible but not a total abrogation of responsibility. A director might be in breach of duty if he left to others the matters to which the Board as a whole had to take responsibility. Directors are responsible for the management of the company and cannot divest themselves of their responsibility by delegating the whole management to agent and abstaining from all inquiries. If the latter proves unfaithful, the liability is that of the directors as if they themselves had been unfaithful.

The term “ independent” mean that the director is not in the full time employment of the company, and has no other ties with the company such as family ties, professional and business ties including that of representing a major shareholder. An independent director is detached from the company’s daily operations and can therefore be expected to bring a variety of strengths to the board. The responsibilities of an independent director is as an wider general experience of strategy formulation than is available within the company’s senior staff, and having independent views that are not influenced by consideration of career, status or personal empire.

Then, an independent director also gives an objective and independent view of the performance of management in attempting to achieve the results to which the strategy of the company is directed. On the other hand, the professionalism of independent director also to ensure that the board uses adequate systems to safeguard the interests of the company even where these may conflict with the personal interest of the executive directors. For example is in the setting of remuneration policies for senior executives, in succession planning, and in the adequacy and audit of financial information.

Moreover, the optimum number of independent directors is a function of the total number of directors. If there are ten directors then a lone independent director is unlikely to make the desired difference but t three or four might. The listing requirements require 1/3 of the total number of the board to be independent. Even the smallest of consequences can benefit from having an independent director.

In conclusion, the broad effect of Art 73, Table A is that the board of directors has power to decide all matters other than those expressly reserved to the shareholders in general meeting by articles themselves, by a valid resolution of the company in general meeting made before the power is exercised, or by the Companies Act 1965. However, company law recognises certain extensions of the general meeting’s decision making powers in extension circumstances, relating to the decision to instigate, the question of ratification of breach of directors’ duties, and in circumstances where the board is unable to act.