

Corporate Governance and Directors Duties

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ABSTRACT

System of corporate governance in the economic environment is considered as a modern structure that covers various Science and involves multidisciplinary. Corporate Governance is concerned with the scope of various groups including majority and minority of shareholders, board of director and etc. The board of directors of a company is responsible for monitoring progress. Each director has a duty to act, in the best interests of the company. But there may be conflict between personal interests of director and interests of the manager who is responsible for managing it or does not comply with the company's interests. In this article we will examine the civil and criminal sanction of director's authority.

KEYWORDS: Corporate governance; director duties; responsibility

INTRODUCTION

The requirement of corporate governance is binding on the company. Corporate governance is defined as 'the process and structure used to direct and manage the business and affairs of the company towards enhancing business prosperity and corporate accountability with the ultimate objective of realizing long-term shareholder value, whilst taking into account the interests of other stakeholders.'^{*} It also refers to the joint responsibility imposed on the Board of Directors and management to protect shareholder rights and enhance shareholder value. In practice, the Board is the real representative of shareholders and acts as a check against management. The Board of director must ensure, among other things, that the company is accountable to shareholders, that it gives equitable treatment to all its "owners", small as well as large, and that it acts transparently.[†]

Thus, the shareholders increasingly through AGMs, letters and shareholders communication with the managements request the company and the management to rejuvenate the company's business and financial performance.

This position of the shareholders, of course, gives the board of directors the power to carry out their duties in accordance with the request of the AGM / the shareholder within the scope and the limit that is granted to them by the law. That is since they have being empowered by the shareholders and most especially through the AGM. The scope of the duty of the directors as provided by the Company Act 1965, include:

- a. Section 157,
 1. A director is bond to take reasonable care and exhibit a reasonable degree of skill and knowledge.
 2. A director must act honestly at all times.
 3. A director must use reasonable diligence in the discharge of his duties.
- b. Section 58, A director must not use inside information to gain personal benefit.
- c. Section 165, A director must disclose his shareholding to the company.
- d. Section 165, A director must disclose his interest in any contract made by the company.

Thus, director is basically manager of a company. They control its affairs and are answerable to its members. A director is both agent of the company and principal in his capacity as a member as well as a trustee of the company on its asset which is held in trust. The status of a director is fiduciary to the company. His actions must be in the best interest of the company. It must not be in conflict with the interest of the company.[‡]

^{*} The Malaysian High Level Finance Committee Report on Corporate Governance defines corporate Governance.

[†] The Wall Street Journal (23 June 1999).

[‡] la uat Hwa, Business Firms and Companies, (Kuala Lumpur: Time Books International, revised and edited version, 1999), at 86.

However, despite this, the action of the board should be restricted within the scope and the limit of their duties which is *ultra vires*. Otherwise, the approved consent of shareholder should be sought. That is to say, that any action on the request of the shareholders for the rejuvenation of the operation of the company, does not negate the principle of corporate governance which requires the seeking for the consent of the shareholders in matters which are not explicitly spelt out within the exclusive duties and powers of the board of directors.

Thus, although, the decision of the majority of the board's members in attendance of the meeting to carry out the acquisition is within the ambit of the law, despite the disagreement of minority in attendance, and the absence of some of the important members such the CFO, does not contravene any law. That is to say, the quorum that is required by the law for the board meeting was met. That is pursuant to Article 47 of Table A in the Fourth Schedule of Company Act 1965, which provides that:

'... two members present in person or by proxy (or as representative of a corporate member) shall be a quorum for general meetings. If the articles do not make any provision regarding quorum of meeting and Table A is excluded (which is unlikely) from the company's articles, the Company Act provides that two members of the company personally present shall be a quorum.',[§]

Thus, the narration shows that quorum was reached in the meeting for the decision on the acquisition within the board meeting.

However, the decision of the board on the issues of acquisition of property on its own, without the approval of the shareholders is a fundamental legal flaw. That is to say, the decision of the board to go ahead with the business of acquisition without the prior consent of the shareholder is *ultra vires*'. That is, it is 'beyond the legal power and authority' of the board. The action violates the provision of the Listing Requirements of Bursa Malaysia Securities Berhad ('LR BMSB') which give shareholders of listed companies a role in significant management decisions. Thus, according to the, Listing Requirement 10.06,^{**} it requires informed shareholder approval if a listed company proposes to enter into a transaction which involves the acquisition or disposal of assets with a value exceeding twenty five per cent of the company's equity share capital.

Therefore, a listed company must seek the informed approval of shareholders in general meeting for any transaction or business arrangement involving the diversion of twenty five per cent or more of its assets to an operation, which differs widely from its previous activities. The Listing Requirement 10.08^{††} requires shareholder approval for transactions between a listed company and related parties, such as directors and their associates. Transactions include the provision of loans or other financial benefits, which exceed five per cent of the company's equity share capital. Thus, in all, the shareholders (AGM) are statutorily empowered upon the directors in four areas:

1. **Disposal or acquisition of company's main undertaking:** Section 132C states thus; the directors shall not enter into any transaction for the acquisition of an undertaking or property of substantial value, or the disposal of a substantial portion of the company's assets, which may materially and adversely affect the company's financial position, unless the proposal has been approved by the general meeting.
2. **Acquisition or disposal of substantial non-cash assets:** Section 132E states thus; certain property transaction of a substantial value between directors and their companies are voidable at the instance of the company, unless the company in general meeting ratifies the transactions within a reasonable time. Transactions entered into in breach of s 132E are voidable at the instance of the company and the directors are liable for severe criminal penalties.
3. **Issues of Shares by directors:** Section 132 D states that; with the exception of share issued as consideration for the acquisition of shares or assets by the company, any share issue by directors requires the prior approval of the general meeting.
4. **Payment made to directors upon retirement or resignation:** Section 137 states that; Proposed benefited to directors by way of compensation for the loss of office or retirement from office must be disclosed to the members. The payment of such benefits is unlawful unless approved by the general meeting.

Thus, pursuant to the provision of the items 1&2 (Section 132C and Section 132E) in the above, the action of the board to go ahead with the acquisition of the property is voidable, if the shareholders/general meeting so wish, since it contravene the applicable laws. This also buttressed by **Section 132C of the Company Act** which states that;

(1) Not with standing anything in a company's memorandum or article, the directors shall not carry into effect any proposal or execute any transaction for –

[§] Article 47 of Table A in the Fourth Schedule of Company Act 1965.

^{**} LR BMSB' 10.06

^{††} LR BMSB 10.08.

(a) The acquisition of an undertaking or property of a substantial values; ...

In fact a severe penalty is imposed on such action in the same **Section 132C of the Company Act which states that**

(5) Any director who contravenes the provision of this section shall be guilty of an offence against the Act.

Penalty: Imprisonment for five years or thirty thousand ringgit or both.^{††}

Notwithstanding the above provisions, the directors appear to be more powerful than the shareholders/general meeting, except in the above stated circumstances. Articles usually confer wide powers of management of a company's affairs on the board of directors. For example, Table A, art 73 specifies that the directors manage the company's business. The management power in art 73 is very broad. It gives directors the right to exercise all the company's powers except those specifically given to the company in general meeting. Therefore, it is the articles and not the general meeting, which gives the board the necessary authority to act as the company's agent.

More so, the case law seems to favor the directors more than the shareholders in issues of management as well as the areas that are related to the scope of the power of the AGM. Instances of such cases are as follow:

In the case of *Baldev Singh v Mahima Singh* [1974] 2 MLJ 206^{§§}, one of the company's articles vested the power of allotment of shares in both the directors and the members in general meeting, as primary organs of the company. The court held, by virtue of the article, that the general meeting had power to pass a resolution with respect to the manner of allotment of shares and it was not open to the directors to act contrary to the resolution. However, in construing the meaning of this article, Hashim Y. A. Sani J refused in *Automatic Self-Cleansing Filter Syndicate Co v Cuninghame* [1906] 2 Ch 34^{***}, which made clear that the division of powers between the board and the company in general meeting depended on the construction of the articles of association.

Moreover, it was even held that the decision of the shareholders/general meeting cannot override the decision of the board of directors. Thus, in *Automatic Self-Cleansing Filter Syndicate Co v Cuninghame* [1906] 2 Ch 34^{†††} the directors were ordered by a general meeting to sell the company's property. The directors refused to do this, relying on a provision in the articles similar to Table A, art 73. The members argued that the articles were subject to the overriding rule that the directors, as agents of the company, were obliged to follow the instructions of their principal, the company, the will of the company being a resolution of the general meeting. *The Court of Appeal* rejected this argument and held that the directions of the general meeting were a nullity, which could be ignored by the directors. The articles gave management powers to the board of directors, which included the power to sell the company's property. The English Court of Appeal held that members could not interfere with the directors in this respect because they were contractually bound by the articles.

Members in general meeting cannot override management decisions about whether the company should commence legal proceedings.

Thus, in *John Shaw & Sons (Salford) Ltd v Shaw* [1935] 2 KB 113^{†††}, Peter, John and Percy Shaw had a company together. They had an argument over owing the company money, and the result was a settlement. Peter and John would resign as governing directors, promised they would not take part in financial affairs, and independent directors would be appointed and given control over the company's financial affairs. When the independent directors required John and Peter to pay money to the company, John and Peter refused. The independent directors resolved to bring a claim against them. Just before the hearing, an extraordinary general meeting was called, where as the majority shareholders Peter and John procured a resolution to discontinue the litigation. The company, and Percy, contended the resolution was ineffective because it.

At first instance Du Parcq J disregarded the resolution and gave judgment for the company. John appealed.

The Court of Appeal upheld the judge, so that the shareholders could not circumvent the company's constitution and order the directors to discontinue litigation. Greer LJ said the following.

I am therefore of opinion that the learned judge was right in refusing to dismiss the action on the plea that it was commenced without the authority of the plaintiff company. I think the judge was also right in refusing to give effect to the resolution of the meeting of the shareholders requiring the chairman to instruct the company's solicitors not to proceed further with the action. A company is an entity distinct alike from its shareholders and its directors. Some of its powers may, according to its articles, be exercised by directors; certain other powers may be reserved for the shareholders in general meeting. If powers of management are vested in the directors, and they alone can exercise these powers. The only way in which the general body of the shareholders can control the exercise of the powers vested by the articles in the directors is by altering their articles, or, if opportunity arises under the articles,

^{††} Section 132C of the Company Act 1965 (1)(a) and (5).

^{§§} *Baldev Singh v Mahima Singh* [1974] 2 MLJ 206.

^{***} *Automatic Self-Cleansing Filter Syndicate Co v Cuninghame* [1906] 2 Ch 34.

^{†††} *Automatic Self-Cleansing Filter Syndicate Co v Cuninghame* [1906] 2 Ch 34

^{†††} *John Shaw & Sons (Salford) Ltd v Shaw* [1935] 2 KB 113

by refusing to re-elect the directors of whose actions they disapprove. They cannot themselves usurp the powers which by the articles are vested in the directors any more than the directors can usurp the powers vested by the articles in the general body of shareholders.

The law on this subject is, I think, accurately stated in Buckley on Companies as the effect of the decisions there mentioned. For these reasons I am of opinion that the Court ought not to dismiss the action on the ground that it was instituted and carried on without the authority of the plaintiff company.

In addition, the powers of the shareholders/general meeting was also limited by articles in *Re Chi Liung & Son Ltd; Tong Chong Fah v Tong Lee Hwa* [1968] 1 MLJ 97^{§§§}. The founding governing director of a company had, by power of attorney, appointed her son as managing director and empowered him to exercise the very wide powers of a governing director on her behalf. Upon her death, a family power struggle ensued. At an extraordinary general meeting of the company a resolution was passed appointing two other family members of managing director and assistant managing director respectively. The son was removed from his position as managing director. The resolution conferred upon the newly appointed managing director powers equivalent to those exercisable only by the governing director as specified by the company's articles of association. The son petitioned the court claiming that the actions of the other family members were oppressive and sought orders to set aside the resolution. **Gill J held** that the actions at the general meeting were oppressive. He considered the effect of the company's constitution and held that if the articles of association of a company contain no power to remove directors before the expiration of their period of office, but authorize the shareholders by special resolution to alter any of the articles, there must be a separate special resolution altering the articles so as to give power to remove directors before a resolution can be passed to remove any of them. No special resolution had been passed and Gill J ordered that the petitioner remain as managing director until disputes in the will regarding control of the company had been dealt with by the probate court.

However, balance of power and authority between the decisions of the share/holders general meeting and the directors is created in the case of *Baldev Singh v Mahima Singh* [1974] 2 MLJ 206^{****}.

The fact of the case was whether the shareholders have such authority over the board of directors since the board and the general meeting of shareholders are the two organs of a company. It was decided that both have authority to bind the company in relation to matters within its authority. The starting point is to ascertain what matters within each organ's authority are. Where the company legislation clearly stipulates the authority of the respective organs, there would not be any difficulty or dispute. However, where there are lacunae, then the company's internal governance rules will have to be relied on to provide the solution to the division of authority.^{††††}

Thus, the decision of the shareholder can stand in only the areas that are statutorily mention, while that of the board covers all management affairs.

In short all the above itemized actions of the CEO violate the company's regulations. The meeting of the board ought to be convened to decide whether or not the company will enter in the transaction.

In *Chan Choon Ming v Low Poh Choon* [1995] CLJ 812^{††††} VC Goege JCA said: 'the directors are the primary organ of a company. They have powers conferred on them to manage the company. These powers are conferred upon the directors collectively as a board. Prima facie, they can be exercised only at a board meeting of which due notice has been given and at which a quorum is present. And although majority decision prevails, it is trite that a meeting of the majority without notice to the minority is ineffective.'

This action violates the **Section 132C** which states that;

'...the directors shall not enter into any transaction for the acquisition of an undertaking or property of substantial value, or the disposal of a substantial portion of the company's assets, which may materially and adversely affect the company's financial position, unless the proposal has been approved by the general meeting.'^{§§§§}

The action violates Section 199 (2A), which provides that;

Every public company and its subsidiary must devise and maintain a system of internal accounting sufficient to provide a reasonable assurance that:-

- (a) Assets are safeguard against loss from unauthorized used or disposition, and
- (b) Transaction are properly authorized and that they are recorded as necessary to permit the preparation of true and fair profit and loss accounts and balance sheets and to maintain accountability of assets.

^{§§§} *Re Chi Liung & Son Ltd; Tong Chong Fah v Tong Lee Hwa* [1968] 1 MLJ 97.

^{****} *Baldev Singh v Mahima Singh* [1974] 2 MLJ 206.

^{††††} Aiman Nariman Mohd Sulaiman, "CORPORATE GOVERNANCE ISSUES AND ENFORCEMENT ACTIVITIES OF THE MALAYSIAN CORPORATE REGULATORS," Corporate Law Teachers' Association Conference "Corporate Law and Corporate Governance: Stocktaking on Compliance and Enforcement" 4-6 February 2007, at 12.

^{††††} *Chan Choon Ming v Low Poh Choon* [1995] CLJ 812

^{§§§§} Section 132C.

And 132 C which provides that 'the approval of company required for disposal by directors of company's undertaking or property. It states that;

(2) Not with standing anything in a company's memorandum or article, the directors shall not carry into effect any proposal or execute any transaction for

(b) The disposal of a substantial portion of the company's undertaking or property, which would materially and adversely affect the performance of financial position of the company, unless the proposal of transaction has been approved by the company in general meeting.

(5) Any director who contravenes the provision of this section shall be guilty of an offence against the Act.

Penalty: Imprisonment for five years or thirty thousand ringgit or both.

In **Industrial concrete Products Bhd v Contrete Engineering Products Bhd [2001] MLJ 332**^{*****}, A nominee director proceeded to run the entire company as if he owned it, with total disregard for the board and all other shareholders, except for the group he represented. The court held that this conduct was in conflict with his duty to the company and that of the interest of his principal. The court accepted that the primary duty of a director is his or her allegiance to the company. Only when there is no conflict of interest can he or she take into account the interest of the principal.

The issue of concealing of financial information which both the CEO Frank and CFO Abubak were trying to embark on was decided in *Danies v Anderson (1995) 13 ACLC 614*^{†††††}

In the case, AWA Ltd, a large listed company, engaged in foreign exchange dealings to hedge against its potential losses caused by foreign currency fluctuation. An employee, Koval, managed these dealings. AWA's senior executives did not put in place adequate internal control to monitor Koval's activities, nor were proper record kept. During 198 and 198 Koval unsupervised activities generate larger losses. For a time Koval was able to conceal this from his superiors by unauthorized currency borrowing from a number of banks. During this time AWA's auditors, Deloitte Haskins and Sells, carried out two audits. Daniels, the audit partner warned AWA management in the of the inadequacies of internal controls. However, notwithstanding the fact that Daniels know that the management had not acted on his warning, he failed to inform AWA's board of directors of the full extent of the inadequacies of the internal control and accounting records, instead, in December 1986, he wrote a letter to the board suggesting improvement to the company's internal audit procedures without specifically mentioning the problem with the foreign exchange operation stressing the urgency of the matter. The board did not become aware of the full extent of Koval's foreign exchange dealings and the unauthorized loans until the end of March 1987.

AWA sued its auditors for negligence. The auditors claimed contributory negligence on the part of AWA and instituted a cross-claim against the directors seeking contribution. In the cross-claim, the auditors alleged that AWA's directors had been negligent. The New South Wales Court of Appeal held that the auditors were negligent but that AWA's contributory negligence arose because both its senior executives and chief executive officer CEO were held to have been negligent and this was attributed to AWA.

The court held that AWA's no-executive directors did not breach their duty of care because no the facts they had made inquiries and requested information about the foreign exchange dealings from senior management and the auditor, but the full details were concealed from them. Hooke, AWA's chairman and chief executive officer, was in a different position. He breached his duty to act with reasonable care because he failed to make inquiries of senior management which would have led to a better appreciation of the risks and dangers of the foreign exchange dealings. As the company's chief executive officer, he was under a continuing obligation to supervise management and seek satisfactory explanation regarding the deficiency of the foreign exchange trading system and procedures.

The punishment of director in corporate governance accordance whit commercial cod of Iran

In commercial law of Iran, Authority of director is not explained obviously. The duty of director under article 118 commercial cod of Iran (amend bill of commercial cod 1347 or 1969) Company directors have all necessary power to corporate governance; except, concerning issues which, Pursuant to the provisions of this Act, Decisions and act on them is under the capability of AGM; Contingent on that, their power limited.

This Article is intended the great power of corporate's director. Subsection 4 of Art 258 amend bill of commercial cod 1347 stated regulatory element; if the power of chairman, board of director and CEO used against the interest of company for personal purpose or for other company directly, indirectly whit malic is supposed to be as a crime. Committed of this offence are chairman, board of director and CEO but legislation does not exactly specify which actions or behaviors include in the scope of Abuse of authority. Thus, according to the phrase of 'whit malice' in the top paragraph of Article 258 amend bill of commercial cod 1347, to accomplish this offence it has to

^{*****} *Industrial concrete Products Bhd v Contrete Engineering Products Bhd [2001] MLJ 332.*

^{†††††} *Danies v Anderson (1995) 13 ACLC 614*

exist the specific malic and general malic. The punishment of this offence intended correctional imprisonment from one year to three years.

Conclusion

The majority judgment considered the directors' duties of care and stated several propositions:

- Directors owe a common law duty of care to their company which overlaps with their equitable duty of care;
- Directors are under a duty to familiarize themselves the company's business and how it is run. The court approve the following principle from the United States case *Francis v United Jersey Bank 432 A 2d 814 (1981)*^{####}, 'A director is not an ornament, but an essential component of corporate governance. Consequently, a director cannot protect himself behind a paper shield bearing the motto dummy director';
- Even though director may have a variety of different skills and experience, they must do more than merely represent their particular field of experience, they must ensure that the board has the means to monitor management so as to satisfy themselves that the company is being properly run;
- While directors need not have equal knowledge and experience of every aspect of the company's activities, they are required to make inquiries and keep themselves informed about all aspects of the company's business operation;
- Directors must be allowed to make business judgment and take commercial risks. However, they cannot safely proceed on the basis that ignorance and a failure to inquire are protection against liability for negligence; and
- Director cannot short their eyes to corporate misconduct and then claim that they did not see the misconduct and did not have a duty to look '*The sentinel asleep at his post contributes nothing to the enterprise he is charged to protect*'.

In a nutshell, each director has a duty to act, in the best interests of the company and he has to responsible to manage in the best way. But sometimes the director may do something against the company or shareholders, in matter director is the agent of the company and have to behave the same as behavior of a lawyer with his client. So, if the transaction be agents the interest or object of company and shareholders it will be void. Director must administer the company according whit memorandum and article or every things which are under his intra various. If the transaction is outside the company's object the director is responsible.

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