The Companies Act, 2004
Directors Duties and Responsibilities

In keeping with the growing international trend the Companies Act, 2004 has incorporated provisions that seek to make Directors personally accountable for a wider range of matters and to make them liable to heavier penalties for breaches of the Act.

In Countries such as:

United Kingdom – The Cadbury Report;
United States of America – COSO- Treadway Commission;
Canada – Toronto Stock Exchange Commission;
South Africa – King Report; and
Australia – Australian Stock Exchange.

Corporate governance guidelines have been developed which seek to put greater emphasis on the duties and responsibilities of Directors.

Prior to the new legislation, directors already owed fiduciary duties and duties of skill and care to their companies under the 1967 Companies Act. However, those duties were not clearly set out in the 1967 Act. The result was a whole slew of court cases that sought to delineate what the directors' duties were. This meant that any person who was appointed to be a director of a company prior to this new legislation had to glean his/her responsibilities from the myriad of court decisions.

The new legislation codifies these duties:

Section 174 (1) of the Act states that every director and officer of a company in exercising his powers and discharging his duties shall:

(a) act honestly and in good faith with a view to the best interest of the company, and

(b) exercise the care, diligence and skill that a reasonably prudent person would exercise in ***comparable*** circumstances (the objective test), including, but not limited to the general knowledge, skill and experience of a director or officer (the subjective test).

Directors' Duties under the Companies Act, 2004 (hereinafter referred to as the Act) fall under two broad categories:

- Duties owed in respect of shareholders; and
- General duties to the Company.

GENERAL DUTIES

The Act imposes general duties in relation to all actions of the directors. It clarifies and reforms the general duties of directors as it relates to company confidential information, dealing in company shares, and transactions in which they may have or have an interest

The Act describes the overriding fiduciary duty of directors as being to act honestly and in good faith and in the best interest of the company. A breach of this duty usually involves the director doing something that he should not have done at all. The Act also requires a director to exercise the degree of prudence and skill that a normally prudent person would exercise in comparable circumstances. A breach of duty in this regard typically involves the director doing badly something that he may legitimately do.

As directors have a fiduciary duty to the company and have a fiduciary obligation to act bona fide in the best interest of the company, directors must not place themselves in positions of conflict of interest. The Courts have long recognized that directors occupy a position of trust and accordingly should not place themselves in a position where the interest if the company conflicts either with their own interests or those of any other person with whom they are associated.

DISCLOSURE

To this end Section 193 of the Act makes provision for directors (and officers) to make certain disclosures to the Company.

A Director is now required to disclose in writing to the company or request to have entered in the minutes of the meetings of directors the nature and extent of his interest in any contracts/proposed contracts entered into by the Company.

The contracts themselves are subject to approval of the Board of Directors and the director concerned ought not to be present during any proceedings of the board in connection with that approval.

Disclosure should be made by a director at:

- The meeting at which the proposed contract is first considered;
- If he is not interested at that time then at the first meeting after he becomes interested; or
- If a person who is interested in a contract later becomes a director then at the first meeting after he assumes the office of director.

Section 193 (4)

Where a director does not disclose his interest in a contract made by the company, that contract may be set aside by the Court on the application of the company.

Records of all contracts entered into by the company must be kept at the Company's registered Office.

The director must also now disclose his Shareholdings (and that of the director's spouse or child) in the company, the company's subsidiary, or holding company or subsidiary of the company's holding company including the number of shares of each classes and the amount of debentures of each class. (Section 196)

In addition, Directors' service contracts are to be open for inspection by virtue of Section 195 of the Act.

The Company is obligated to keep at an appropriate place:

(a) in the case of each director whose contract of service with the company is in writing, a copy of that contract;

(b) in the case of each director whose contract of service with the company is not in writing, a written memorandum setting out its terms; and

(c) in the case of each director who is employed under a contract of service with a subsidiary of the company, a copy of that contract or, if it is not in writing, a written memorandum setting out its terms.

An appropriate place has been deemed by the Act to include any of the following:

(a) the company's registered office;

(b) the place where its register of members is kept (if other than it` registered office);

(c) its principal place of business in Jamaica.

The Registrar is to be given notice of the location of service contracts or any change within fourteen (14) days. Failure to notify the Registrar, or to keep copies of the documents or allow inspection will attract a fine of **Two Hundred Thousand Dollars ($200,000.00)**

A director must notify the company in when as a director he:

- He becomes or ceases to be interested in shares/debentures of the company;
- He enters into a contract to sell his shares/debentures;
- He assigns a right that the company has granted to subscribe for shares/debentures in the company;

- A specified company grants him a right to subscribe for shares/debentures in that company; or he exercises or assigns that right granted to him

Section 196 (2) (3)

DUTY TO ACT WITH CARE

At common law a director's duty of care and skill was unduly fettered in favour of directors. In contrast to the heavy duties of good faith owed to the company, the duties of care and skill are light.

Until recently, the possession of a title or retirement from high office often gained board seats ahead of qualities of business acumen and drive. The courts expected a part-time director to display only such skill as was actually possessed and such duty to office as was actually offered. This contrasted with the duty of full-time employees who are bound to devote their full-time attention and skill to the running of the company. However, with the changing standards, and the greater degree of care and skill required in what appear to be more complicated business decisions, it would be expected that the duties of care and skill would correspondingly increase. The classic statement of the duties of care and skill required of directors was stated by Romer J in ***Re City Equitable Fire Insurance Co. (1925) UK.*** His Lordship said:

Directors need not exhibit in the performance of their duties a greater degree of skill than may reasonably be expected from a person of their knowledge and experience.
Directors are not bound to give continuous attention to the affairs of their company. Their duties are of an intermittent nature to be performed at periodical board meetings and at meetings of any committee of the board upon which they happen to be placed. They are not, however, bound to attend all such meetings, though they ought to attend whenever in the circumstances they are reasonably able to do so.
In respect of all duties that, having regard to the exigencies of business and the articles of association, may properly be left to some other official, directors are, in the absence of grounds for suspicion, justified in trusting that official to perform such duties honestly.

Section 174 is an attempt to overcome the deficiencies in the common law by imposing duties of care, diligence and skill. These duties are to be measured against what can reasonably be expected of a director acting in like circumstances.

It is reasonable to expect a certain level of competence of directors although the level of competence will vary markedly according to the nature of the company.

The Act does not impose a higher standard of skills on directors who hold professional qualifications, and in that respect departs from the common law position established in the City Equitable case. Where a director has special skills, the Courts will expect the director to exercise those special skills. This, it has been argued, crates a dual standard of care. One standard will be appropriate for directors who have no specialist skills and another for specialist directors such as Attorneys-at-Law or Accountants.

In judging each case, the following must be taken into account:

- the nature of the company;
- the nature of the decision
- the position of the director and the nature of the responsibilities undertaken by the director

in determining whether or not the director exercised reasonable care, diligence and skill in the circumstances.

The standard is therefore now one of the reasonably competent director but the Act recognizes that circumstances differ widely from company to company.

It should be noted that whilst a director's duty of care is owed to the company alone (Section 174(5) the interest of third parties may be taken into account

Section 174 (4) of the Act states that in determining what are the best interests of the company "a director or officer may have regard to the interests of the company's shareholders and employees and the community in which the company operates".

DEFENCES

A director will not have breached his duty of care where he believed in the existence of certain facts which, if true, would have rendered his conduct reasonably prudent.

A director would also have met his statutory obligation where he relied in good faith on documents relating to the company's affairs such as:

- financial statements represented to him or her by an officer of the corporation or in a written report of the corporation's auditor to reflect fairly the financial position of the corporation; or

- a report of a lawyer, accountant, engineer, appraiser or other person whose profession lends credibility to a statement made by him or her.

DISQUALIFICATION OF DIRECTORS

Section 180

The Court is now empowered to disqualify a director for a period of up to five (5) years. Directors can be disqualified where it appears to the Court that the director is unfit to be concerned in the management of the company or for persistent breaches of the Companies Act.

DISQUALIFICATION - UNFIT TO MANAGE

To begin the process of Court Disqualification a written complaint is made to the Registrar that a person is unfit to be concerned with the management of a company. A complaint of that nature can be made by :

- Shareholders of the company;
- Other directors of the company;
- Creditors of the company;
- Liquidator of the company; or
- Trustee in Bankruptcy.

Upon the receipt of the written complaint the Registrar must:

- Conduct an investigation of the complaint;
- Hold a hearing to provide the complainant with an opportunity to be heard; and if satisfied that there are sufficient grounds for the matter to be heard in Court,
- Issue a certificate to that effect to the complainant who will then have a right to make an application to the Supreme Court as it relates to the director and his conduct or actions.

Any decision by the Registrar to refuse to issue a certificate may be appealed to the Master in Chambers of the Supreme Court.

The Registrar is also empowered to make an application in her own right where she is satisfied that a person is unfit to be concerned with the management of a company. It is a requirement of the Act that any person who intends to make an application for disqualification of a director (including the Registrar) must notify the director concerned at least ten (10) days prior to the application.

Where an application is made to the Supreme Court pursuant to the issuance of a certificate from the Registrar the Court may order that the director may not, without the Court's permission, be a director of the company or be in any way involved with the management of the company from the date of the Court's Order or from the date of the completion of term of imprisonment. As previously stated the period of disqualification cannot exceed five (5) years.

Applicants in respect of an action for disqualification may appear before the Court in person or be represented by an Attorney-at-Law.

The Court in determining whether to make an Order for disqualification must take into account the following:

- Any misfeasance/breach of fiduciary or other duty that he owes in relation to the company.

- Any misapplication/retention of funds or property of the company or any conduct which results in an obligation to account for the said funds or property;
- The extent of the director's responsibility for any Failure to keep or maintain proper accounting records as prescribed by the Act.
- Where the Director has knowingly been a party to carrying on business in a manner akin to fraudulent trading; and
- Any other circumstances which may be prescribed.

Section 180 (7)

Where an application is made to the Supreme Court pursuant to the issuance of a certificate from the Registrar the Court may order that the director may not, without the Court's permission, be a director of the company or be in any way involved with the management of the company from the date of the Court's Order or from the date of the completion of term of imprisonment. As previously stated the period of disqualification cannot exceed five (5) years.

Applicants in respect of an action for disqualification may appear before the Court in person or be represented by an Attorney-at-Law.

DISQUALIFICATION FOR PERSISTENT BREACHES

Section 182 (1), (5).

Directors may also be disqualified by the Court for persistent breaches of the Companies Act in failing to file statutory returns (Annual Returns, Particulars of Directors, Notice of Situation of Registered and or Notice of Appointment of Secretary), accounts or other documents required to be delivered, sent or notices of matter to be given to the Registrar.

Conclusive proof of persistent breaches may be provided by producing evidence that a person has been adjudged guilty of **three (3)** or more defaults within a period of five (5) years from the date of application. A person is considered to be guilty of default if he is convicted of an offence consisting of contravention of or failure to comply with that

provision or a default order is made under any provisions of the Act requiring submission of returns, notices, or other documents to the Registrar.

Research conducted on the effect of the similar U.K. provisions regarding the disqualification of directors which is covered by the **Company Directors Disqualification Act 1986** made the following findings:

- Most disqualification orders made under the Act involve directors who are, effectively, owner-managers of small businesses and as such operate within what is essentially a self-employed culture. Unfortunately, disqualification tends to be least effective against this type of director since, once disqualified, they are more likely to be able to find new work or to set up in business again in their own name than are career executives and professionally-qualified directors, for whom disqualification is a major threat to their reputation and professional or business status.

- Due to the ease with which companies may be incorporated, and the fact that no qualification is required to act as a director, disqualifying a few thousand small company directors constitutes a limited control on the access of the potentially unfit to the privilege of trading with limited liability.

- For these reasons, Government policy needs to avoid concentrating its resources on increasing the crude number of disqualifications. It should, rather, focus its efforts on investigating and, if necessary disqualifying, directors of larger companies whose unfit conduct has the potential to cause the greatest damage within the commercial world and for whom the consequences of disqualification are likely to have the greater impact. Further, the legislation needs to be reformed so as to allow longer, even indefinite, periods of disqualification in appropriate cases. Overall, the emphasis should be on the quality and not the number of disqualifications achieved.

- The ease with which companies may be set up in the UK, and the absence of any qualification criteria for acting as a director, combine to limit the potential impact of

the law on disqualification as a tool of control over who may have access to the privilege of limited liability.

- The overall effectiveness of disqualification is limited. Given a current population of perhaps two million directors, with millions more who could easily become directors, the direct protective benefit of even a thousand short-term disqualifications annually is restricted. The deterrent effect of disqualification is also weak (although, as has already been said, it is more effective in relation to the more 'professional' executives). The threat of disqualification is also relatively ineffective in terms of encouraging directors to act properly towards their company's creditors: this weakness is not helped by the absence of any clear and authoritative statement of the principles which have been developed by the courts with regard to directors' duties to creditors.
- When companies fail or are struck off, the level of investigation of their directors' past conduct varies. In some cases, there is no real investigation at all, and whether or not in-depth investigation takes place usually depends on the availability to the insolvency practitioner of sufficient assets within the company or of pro-active creditors who are willing to provide funding for proper investigative work to be done. As an alternative to liquidation, directors can now apply for their company's existence to be brought to an end by having it simply struck off the companies register, thereby avoiding any investigation of their conduct: the validity of this procedure needs to be reviewed in order to assess whether it is being used to the detriment of creditors.

- Where a director who has been disqualified takes part in the management of a company, in breach of the terms of the order, he commits a criminal offence and is liable to prosecution. Unfortunately, infringements of this kind are difficult to detect, and this constitutes an intrinsic limitation on the effectiveness of disqualification. In recent years, while huge efforts have gone into achieving disqualifications, there have been only a handful of prosecutions of individuals who breach the terms of their disqualification orders. Thought needs to be given to ways in which information on individuals acting in this way can be communicated to the authorities and acted

upon. Publicity for disqualification orders on the Companies House website and the recent introduction of a disqualified directors 'hotline', on which members of the public can report those they believe to be acting in breach of a disqualification order, should be of value in this regard.

Disqualification of Directors: No Hiding Place for the Unfit?
ACCA Research Report No. 59

We will have to wait to see if the provisions as it relates to disqualification will have the desired effect.

DIRECTORS' INDEMNIFICATION & INSURANCE

Section 201

Provisions are made for the company to indemnify directors, and to obtain insurance for them, but only in circumstances where they have acted honestly and in good faith and in the best interest of the company. The indemnification would operate to cover charges, legal costs and expenses reasonably incurred in respect of any criminal, civil/administrative action/proceedings to which he is made a party by virtue of his being a director

Indemnification is also available in the case of criminal/administrative proceedings where a fine is imposed and where the director would have had reasonable grounds for believing the Generally speaking the new Companies Act merely allows a company to indemnify a director or officer against personal liabilities but does not require the company to do so.
For a director or officer to require an indemnity to be given to him there must be some positive obligation

In Canada it is normal for a company's by-laws to provide that it must indemnify directors and officers if the requirements of the by-laws are met. This practice should usually be followed when incorporating a new company.

A director or officer should never assume the existence of the appropriate by-law, but should look into it and ensure that it is as broad as possible. This should be done as part of accepting an appointment and when any important change occurs. If a director or officer is

not satisfied he should consider resigning. Directors and officers should also take the extra step of getting an express contractual right to an indemnity. This eliminates technical hurdles about enforcing the non-contractual by-laws. It also ensures that the company cannot unilaterally change the right to the indemnity.Although insurance coverage is only available subject to the same "good faith" requirements as apply to indemnities, it is advisable that it be obtained. The reason for this is that an indemnity is of little value if the company that is to provide it has become insolvent. Insurance cover is particularly useful because many instances of director's liability arise in circumstances where a company is insolvent.

It is also important to note that the coverage and exclusions under a policy of insurance must be carefully reviewed, as there may be restrictions in the policy beyond the "good faith" requirements imposed by the Act.

If a Company's rights have been infringed, the only proper Plaintiff is the Company itself. This is the rule in **Foss v. Harbottle**.

As a general principle this is correct because it avoids the problems of many actions being commenced simultaneously by members who felt aggrieved by a particular action of the management of the Company. However, a problem arises when the alleged perpetrators of the wrong against the Company also control the Company

The Act attempts to temper the strictness of this position by allowing Derivative actions.

Where the directors fail to have a company commence action in order to enforce its corporate rights as a result of a wrong done to the company, a complainant may seek leave of the Court to either bring the action in the name of the company or any of its subsidiaries or to intervene in an existing action to which the company or its subsidiaries are a party.

Examples of the type of wrongs alleged to have been done to the company for which a derivative action has been considered appropriate include:

- an allegation by minority shareholders that the directors had sold company assets at a price far below their true value; and
- an allegation by minority shareholders that certain directors were in breach of their fiduciary duty to the company.

The Court will grant leave to commence a derivative action if it is satisfied of the following:

- The complainant has given reasonable notice to the directors of the intention to seek leave;
- The complainant is acting in good faith;
- It appears to be in the interest of the company or its subsidiary that the action be brought, prosecuted, defended or discontinued.

The persons included in the category of complainants upon whom a right to commence a derivative action may be conferred, include

- Shareholders and creditors (past and present);
- Directors and officers (past and present),
- the Registrar and any other person the Court considers to be proper.

The Court is given a broad discretion to make any order it thinks fit in a derivative action, including orders:

- Authorizing the complainant to control the conduct of the action;
- Giving directions for the conduct of the action;
- Directing that any amount adjudged payable by a defendant be paid in whole or in part to former and present shareholders or debenture holders instead of the company; and
- Requiring the company to pay reasonable legal fees incurred by the complainant.

SHADOW DIRECTOR

A shadow director has now been defined by the Act as person in accordance with whose directions or instructions the directors of the company are accustomed to act, so, however, that a person is not deemed a shadow director by reason only that the directors act on advice given by him in a professional capacity.

Section 183(7) of the Act states that a shadow director must be included on the Register of Directors.

CONCLUSION

Since the issue of the Cadbury Report in December 1993 in the United Kingdom, corporate governance - the system by which companies are directed and controlled - has become a focus of attention for both regulatory authorities and the responsible business community. There is now a far greater expectation by the courts that all directors must have a reasonable understanding of their legal responsibilities and of the company's accounting requirements. Anyone becoming a director for the first time should appreciate that claiming ignorance of a director's duties and responsibilities because one is new to the job may well not be an acceptable defence should things go wrong and thus should adequately inform himself of his duties and responsibilities as a director and familiarise himself with the business of the company on whose board he will be sitting.

Prepared by:
Edward G. Brightly
Manager, Trade Marks, Designs & Geographical Indications Directorate.
Jamaica Intellectual Property Office.