



## CORPORATE MANAGEMENT & DIRECTORS

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This paper begins with an overview of corporate management *inter alia* by identifying at the outset who a director is. Thereafter, it seeks to discuss the relationship between a director of a company and the articles of association therein. In doing so, it informs the reader about the different types of labels hooked onto directors in practice, a distinction not to be found within the provisions of the Companies Act, No. 7 of 2007 (the 'Act'). Thereafter, Part 2 of this paper delves into a discussion of the various responsibilities of directors identified both within the Act and in other statutes. This Part also deals with corporate liability and personal liability of directors touching upon on corporate and personal guarantees. Finally discussed in this paper is on the protection afforded to directors. This Part deals with *inter alia* on the statutory framework of protection afforded to directors and otherwise. It also sets out several 'golden tips' a sitting and an aspiring director ought to follow.

### 1. CORPORATE MANAGEMENT

#### 1.1 *The Company & its management*

Every corporation must have a board of directors. Most also have officers. The position of directors tends to be defined, or at least commented on, in every corporations statute, whereas the statutory coverage of officers tends to be somewhat haphazard. Understanding the roles and obligations of both is

key to understanding how corporations actually work. (...)¹

The Directors of a company have control of the day-to-day management functions of the company with which the members/shareholders cannot interfere. This is a basic company law principle established more than a hundred years ago in the House of Lords in England.<sup>2</sup> The shareholders cannot usurp the powers granted by the Articles of Association to the Directors and similarly the Directors cannot usurp the powers granted by the Articles of Association to the general body of shareholders.<sup>3</sup> The Directors and the Directors alone are responsible for the management of the company with the exception of matters specifically allocated to the company in general meeting or the shareholder/members meeting.<sup>4</sup>

Several jurisdictions which have followed modern corporate law mechanisms have built into their corporate statutes this common law principle that the powers of management of the company are vested in the Board of Directors. Sri Lanka too following New Zealand<sup>5</sup> and several other developed jurisdictions has given statutory effect to the same. A company shall have at least one Director, except a public company which should have at least two Directors.<sup>6</sup> The Articles of Association in its discretion can spell out the minimum number of directors and the maximum number of directors the company must have and the quorum for its meetings. The Articles of Association of the company shall govern the proceedings of the board of a company – The Board Meetings.<sup>7</sup>

1 Bruce Welling, *Canadian Corporate Law* (Butterworths, 1996) 189.

2 *Quin & Axtens Vs Salmon* (1909) AC 442.

3 *John Shaw & Sons (Salford) Ltd Vs Shaw* (1935) AER 456.

4 *Alexander Ward & Co Vs Samyang Navigation Co* (1975) 2 AER 424.

5 New Zealand Companies Act (1993), Section 128.

6 See, Section 201 of the Companies Act No 07 of 2007.

7 See, Section 215 of the Companies Act No 07 of 2007.

The management function of the company in Sri Lanka is set-out clinically in Section 184 of the Act. This provision of the Act says it all. It is a basic principle in Company Law that members or shareholders of companies do not run companies but appoint a Board of Directors to manage the company. Shareholders too if they so wish and if they can muster adequate support at the shareholders meeting, can get themselves appointed to the Board to manage the company. The Companies Act also permit some functions of the Board to be delegated and some not to be delegated. Section 186 of the Act read with Schedule 6 therein spells out the same.

## 1.2 *The Director*

Who is a Director? It is important to note that if the definition<sup>8</sup> fits the individual, then he or she becomes a Director under the law, may be with whatever name tag – Executive Director, Non-Executive Director, Independent Director, Nominee Director, Alternate Director, Shadow Director, Chairman, President etc. In addition to being a Director appointed by the shareholders, the same individual can be contracted by the company for employment. Eg. As the Managing Director or Chief Executive Officer (CEO). In such a situation he will be a Director on the Board appointed by the shareholders and also an employee/executive by contract with the company. Then he will be wearing two hats at the same time - as a Director of the Board and also as an employee/executive of the company.<sup>9</sup> Section 529 of the Act specifically provides therein by way of a proviso that the Provisions of paragraphs (b) and (c) shall not apply to a person to the extent that the person acts only in a professional capacity. Advisors to the Board and/or to the company providing professional services for a fee or otherwise cannot be treated as Directors. However, they must ensure that their actions do not fall to the Director category as specified therein.

8 See, Section 529 of the Companies Act 07 of 2007.

9 See, *Collettes Ltd. Vs. Commissioner of Labour & others* (1989) 2 SLR 06. See, *Ceylon Meat Products Ltd. Vs. Mrs. C. Fernando* (1989) 2 SLR 304.



Of necessity, as the complexities of commercial life have intensified the community has come to expect more than formerly from directors whose task is to indeed govern the affairs of companies to which large sums of money are committed by way of equity, capital or loan. The affairs of the company with a large annual turnover, large stake in assets and liabilities, the use of very substantial resources and hundreds, if not thousand employees demand an appreciable degree of diligent application by its directors if they are to attempt to do their duty. To some extent this has been recognised by the fact that the compensation paid to non-executive directors has changed from a modest honorarium to a sum which bears a measurable relationship to the work expected of the director. Indeed it has led to a number of professional non-executive directors.

One of the most striking features of the law concerning directors' 'duties' is the insistence that directors accept more and more responsibility for the oversight of the company's affairs at the same time as the affairs of the company become more and more complex and diverse.<sup>10</sup>

The director's duties are catalogued in a statutory form for the first time in Sri Lanka in the Companies Act No. 07 of 2007. This is a revolutionary step forward in the corporate arena. Hitherto, the duties of directors had to be ascertained from the common law (ie. case law) on the issue. If the directors are to be held responsible for their acts there should be a clear identification of their responsibilities and duties. The provisions of the Act provides it now.<sup>11</sup> To have a directors charter of duties and responsibilities and also to provide the directors to rely on information and advice on experts to enable them to act in good faith are features of modern corporate law. The provisions relating to directors also provide for indemnity and insurance

in given circumstances as set-out therein.<sup>12</sup> It is pertinent to note that the provisions in the Act provide a clear set of guidelines to directors in particular and to the commercial world at large. There was much debate on this inclusion and the provisions were finally adapted to the Act as they compliment the other new provisions in the Act as well. Thus, the provisions of the Act provide a basic code of ethics for the Board. This has become essential as the qualifications to become a director is not very rigid.<sup>13</sup> The fate of the company depends largely on its performance of the Board. If the shareholders appoint competent Directors to the Board, then eventually the competence of the Directors will be reflected on the performance of the company. On the contrary if the shareholders appoint idiotic Directors to the Board, the repercussions will be the same on the performance of the company *vis-à-vis* unwise management.

The idea that the shareholders were ultimately responsible for the unwise appointments of directors led to the duty of care, skill and diligence which a director owed to a company being characterised as remarkably low (...) However ridiculous or absurd the conduct of directors, it was the company's misfortune that such unwise directors were chosen.<sup>14</sup>

(...) To put up with foolish directors is one thing; to put up with directors who are so foolish that they make a profit of £115,000 odd at the expense of the company is something entirely different (...)

*Templeman J in Daniels Vs Daniels.*<sup>15</sup>

It is essential that the Board of Directors ought to be aware of the civil and criminal liabilities under the Companies Act. They must also be aware of the other relevant statutes when the company is listed.<sup>16</sup> There may be other

12 In the United States & several developed countries Insurance Policies are tailor-made for such situations.

13 See, Section 202 of the Companies Act No. 07 of 2007.

14 *Daniels Vs Anderson* (1995) 16 ACSR 607, 658-659.

15 (1978) Ch 406.

16 See, Eg. Sections 224, 225, (Oppression &

10 *AWA Limited Vs Daniel (trading as Deloitte Haskins & Sells)* (1992) 10 ACLR 933, 1013.

11 It is of importance to keep the directors expressly informed.

statutes too that will impact on the conduct of the Directors depending on the functions of the company. Eg. Banking etc. However, the Directors can rely on the mechanisms of protection referred to in the Act and also rely on protection from Courts in given circumstances.<sup>17</sup>

### 1.3 *The Director & The Articles*

Articles of Association is the document which provides the internal management mechanism of the company. In New Zealand this is now referred to as the Constitution of the company. This in effect contains a contract between the company and each shareholder, and between the company and each director and company secretary and between and each other shareholder of the company, under which each party agrees to observe and perform the functions set out in the Articles.<sup>18</sup> The doctrine of *ultra vires* in company law is not available under the Companies Act No. 07 of 2007.<sup>19</sup> However, under the provisions of the Companies Act No. 07 of 2007, the company can adopt a statement of objects if it so wishes in the Articles of Association.<sup>20</sup> An act of such company is not however invalid merely because the said act is contrary to or beyond the said objects in the Articles. The Directors however can be liable for acting in breach of the provisions of Section 188 of the Act as referred to in Section 17 internally.

The Articles of Association of a company may provide for any matter not inconsistent with the provisions of the Companies Act other than the First Schedule thereto, and in particular may provide for –

#### (a) the objects of the company;

mismanagement) Section 234 (Derivative Action) of the Companies Act No. 07 of 2007/ SEC Act etc.

<sup>17</sup> See, Section 526 of the Companies Act No. 07 of 2007 (Power of Court to grant relief in certain cases.)

<sup>18</sup> See, Schedule One – Model Articles – Companies Act No. 07 of 2007.

<sup>19</sup> The doctrine of *ultra vires* was available under the Companies Act No 17 of 1982 via the Objects Clause in the Memorandum of Association.

<sup>20</sup> See, Section 13 & Section 17 of the Companies Act No. 07 of 2007.

(b) the rights and obligations of shareholders of the company; and

(c) the management and administration of the company.<sup>21</sup>

A director of a company shall 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 Association of the company.<sup>22</sup>

### 1.4 *Independent Non-Executive Directors*

Executive and non-executive directors on boards of companies have been the norm in company law for several years. Executive directors are full time employees of the company with specific functions assigned to them by the company with properly defined contracts. Non-executive directors on the other hand do not carry-out executive functions for the company but serve on the board as non-executive directors. The Cadbury Report in 1992 highlighted the importance of the non-executive director bringing into the board ‘independent judgement’. Pursuant thereto the Corporate Governance mechanisms have encouraged the introduction of independent non-executive directors on the boards of listed companies.

In the last several decades there has been a dramatic shift away from boards dominated by inside directors towards boards dominated by outside directors (...) A principal reason for this change has been the growing concern that inside directors (i.e. corporate employees) tend to be self-serving.<sup>23</sup>

The mandatory rules on Corporate Governance in Sri Lanka for listed companies indicate *inter-alia* that the board of directors of a listed company shall include at least, two non-executive directors or such number of non-executive directors equivalent to one third

<sup>21</sup> See, Section 13 of the Companies Act No. 07 of 2007.

<sup>22</sup> See, Section 188 of the Companies Act No. 07 of 2007.

<sup>23</sup> See, Robert I Tricker, International Corporate Governance (London Prentice-Hall 1994) 15.



of the total number of directors, whichever is higher. It states further that where the constitution of the board of directors includes only two non-executive directors as referred to above, both such non-executive directors shall be ‘independent’. In all other instances two or 1/3 of non-executive directors appointed to the board of directors, whichever is higher shall be ‘independent’. Further, the board shall require each non-executive director to submit a signed and dated declaration annually of his/her independence or non-independence against the specified criteria. The said mandatory code deals with Non-Executive Directors, Independent Directors, Disclosures relating to directors and Criteria for defining “Independence” in detail.<sup>24</sup>

Whether the novel corporate governance concept of having a fair number of persons on the board as ‘Independent Non-Executive Directors’ is productive or counter-productive to the growth of the company is not really tested in Sri Lanka yet. Several international jurists however are of the view that the role and effectiveness of Independent Non-Executive Directors has been over emphasized in recent times. Since the Independent Non-Executive Director is also treated the same way as all the other directors on the board *vis-à-vis* duties, responsibilities and liabilities, may be at times such an Independent Non-Executive Director will be over cautious in decision making which can be a detriment to the growth of the company. However, it is an accepted norm today that Independent Non-Executive Directors bring into the board room, a broader perspective of much needed expertise in particular fields, wealth of experience and a wide range of expertise and skills on particular issues to strengthen the management functions of the company. When in fact Independent Non-Executive Directors are appointed to boards, the said criteria should be considered seriously. Apart from the valuable expertise they carry with them on board, they ought to ensure that their independent view point is focal on management decision making. The Independent Non-Executive Directors must also be aware that they

<sup>24</sup> See, the Colombo Stock Exchange Mandatory Code.

are also kept as gate keepers or watch dogs of the company to check on self-interest and other abuses within the corporate management. They must be bold enough to voice their dissent when needed with gusto.

## 2. THE RESPONSIBILITIES OF DIRECTORS

### 2.1 *The Basic Duties of Directors*

The duty of directors to act in good faith and in the interests of the company is set out with clarity in the current law.<sup>25</sup> What the director believes to be in the interests of the company is subject to further qualifications such as the standard of care and *bona fides*.<sup>26</sup> Even a nominee director of a subsidiary company ought to act in the best interests of that subsidiary company and not in the best interest of the parent company which nominated him. However, if the Articles of that subsidiary company permit, the director can act otherwise.<sup>27</sup> A Director should know what good faith or *bona fides* means as against bad faith and *mala fides* and also he should know well, that the interests of the company means best interests of the company and none other. Thus, the duty of Directors to act in good faith and in the interests of the company is the primary golden rule to be observed by every Director.

The directors are bound to comply with the provisions of the Companies Act and the Articles of Association of the company.<sup>28</sup> This is a simple golden rule for Directors across the board all and sundry.

A director of a company shall not act in any manner which is reckless or grossly negligent and shall exercise the degree of skill and care that may be reasonably expected of a person of

<sup>25</sup> See, Section 187 of the Companies Act No. 07 of 2007. See, also New Zealand Companies Act (1993) Section 131(1).

<sup>26</sup> See, Cassidy, “Has the “sleeping” director finally been laid to rest?” (1997) 25 ABLR 102.

<sup>27</sup> See, Section 187(2) of the Companies Act No. 07 of 2007.

<sup>28</sup> See, Section 188 of the Companies Act No. 07 of 2007.

his knowledge and experience.<sup>29</sup> For example an Attorney-At-Law on a Board cannot be heard to say that he did not know the law or an Accountant on a Board cannot be heard to say that he did not understand accounts. This again is a simple rule to be followed by all Directors. This provision says it all about the ‘care’ aspect of a Director on the company. This is simply similar to the parental care of a father towards his family. This again is a simple rule to be followed by all Directors.<sup>30</sup>

Duty of directors on insolvency and the duty of directors on serious loss of capital are detailed out in the Act with the penal provisions attached thereto in particular.<sup>31</sup> Sections 219 and 220 provide additional stringent responsibilities civil and criminal both on the Director to be awake all the time. The shareholders and the creditors may not know the actual financial situation of the company at any given moment. Therefore, it is the duty of the Board to arrest such drastic situations of financial crisis and act forthwith. These are two provisions of the Act the Directors should take serious note of. When the going is bad for the company and the Directors simply ignore and carry on as everything is perfectly normal, they are liable for the serious consequences set-out in the said provisions.

Transactions in which a director is interested, disclosure of directors’ interests in shares are set out clinically under the provisions.<sup>32</sup> The said provisions *ex facie* set out the stand every Director should take when it comes to ‘conflict of interests’ in contracts and ‘conflict of interests’ in shares. This is the minimal threshold and provides how best a Director should act in such circumstances. The principle that the Directors must not place themselves in a position where their duties towards the company and their personal interests conflict is again

29 See, Section 189 of the Companies Act No. 07 of 2007.

30 See also, New Zealand Companies Act (1993) Section 137.

31 See, Sections 219 & 220 of the Companies Act No. 07 of 2007.

32 See, Sections 191 to 200 of the Companies Act No. 07 of 2007.

related to Directors’ good faith, best interests of the company and the standard of care referred to above. These areas commonly fall under the categories under conflict of interests in contracts and conflict of interests in share transactions and their own gain on the same.

The law expressly states that the provisions contained in the Companies Act are in addition to and not in derogation of any provisions contained in any other written law relating to the duty or liability of directors or officers of a company.<sup>33</sup>

## 2.2 Corporate liability Vs. Personal liability<sup>34</sup>

The company can be held liable (civil & criminal both) under certain provisions of the Companies Act. Eg. A minority shareholder can sue the company under Section 224 (Mismanagement) and obtain orders against the company. Civil actions against the company under the provisions of the Companies Act have to be instituted in the High Court of the Western Province exercising civil jurisdiction commonly referred to as the ‘Commercial High Court’.<sup>35</sup> In addition to civil liabilities, there are several provisions in the Companies Act which attract criminal liability on the company. All these fall under the category of ‘corporate liability’. However, there are specific provisions in the Companies Act which attract ‘personal liability’ of the directors/officers as set out therein which include civil liability and criminal liability separately. Thus, ‘personal liability’ (civil & criminal both) of directors/officers as against ‘corporate liability’ is an important matter all directors/officers should be aware of and be conscious of *vis-à-vis* in all the actions taken by

33 See, Section 190(3) of the Companies Act No. 07 of 2007. (Eg. Laws governing the Securities and Exchange Commission, the Colombo Stock Exchange etc).

34 See, Section 529 of the of the Companies Act No. 07 of 2007 (Interpretation) ‘Officer’ in relation to a body corporate, includes a director, manager or secretary.

35 See, Section Section 529 of the Companies Act No. 07 of 2007.



them in the company. Corporate behaviour is thus, under these specific control mechanics.<sup>36</sup>

The threshold becomes higher when the organization is a Bank which is governed under the Banking Act. The said provisions are very detailed and meticulous and every director of a Bank ought to read them carefully and understand every bit of it for proper compliance.<sup>37</sup> There are certain statutes which may add several other liabilities if that particular organization is governed under that statute too. Eg. Finance Companies, Leasing Companies etc. The Board of Directors of each company ought to know and understand their respective roles and liabilities *vis-à-vis* that particular company. However, all companies that come under the purview of the Companies Act are bound by the provisions (civil & criminal both) referred to above. All listed companies are bound further under the provisions of the Securities & Exchange Commission Act and the Rules of the Colombo Stock Exchange.

<sup>36</sup> For provisions governing civil liability, see, Sections 17(3), 31(5), 41(4), 45(2), 46(2), 61(2), 78(3), 134(5), 188, 216(5), 217(3), 217(4), 218(7), 219(2), 219(3), 224, 225, 228, 233(1), 234, 236, 314, 375(2), 376(1), 394(5), 423(2), 481(1), 499(1), 499(2), 499(3), 500(6), 504, 526 of the Companies Act No. 07 of 2007.

For provisions governing criminal liability, see, Sections 8(5), 9(3), 11(6), 12(3), 15(3), 18(3), 37(4), 38(2), 39(4), 40(4), 42(1), 47(3), 51(5), 55(2), 56(5), 59(6), 63(5), 70(5), 76(2), 78(2), 81(5), 102(11), 104(3), 106(3), 110(2), 111(4), 115(4), 116(5), 117(3), 119(2), 120(2), 122(2), 123(2), 124(6), 126(4), 128(5), 133(6), 137(3), 139(3), 142(7), 144(6), 147(5), 148(3), 149(3), 150(2), 152(3), 154(5), 161(5), 164(3)(4), 165(2), 166(2), 167(2), 173(1), 174, 175, 176, 177, 181(3), 182(5)(6), 192(4), 212(3), 213(4), 214(6), 217(5), 220(4), 223(4), 229(4), 231(2), 241(7), 242(7), 256(5), 257(4), 283(5), 310(4), 313, 314, 320(2), 334(6), 374(3), 375(1), 376(2), 380(1), 381(1), 382(1), 383(3), 384, 386(2), 393(2), 394(5), 411(3), 441(4), 480(6), 484(2), 493(8), 498, 499(3), 500(4)(6), 503, 511, 512(1), 513, 515, 516, 517 and 526 of the Companies Act No. 07 of 2007.

<sup>37</sup> See, Provisions of the Banking Act – *vis-à-vis* Director's Duties & Management. See, Supervision by the Director, Bank Supervision of the Central Bank. See, also, Corporate Governance for Banks.

### 2.3 Corporate Guarantees Vs Personal Guarantees

It is a fact that lending institutions including banks obtain collateral for funding the company. In most instances corporate guarantees and/or collateral from the company is adequate. However, in certain cases in addition to corporate guarantees, the lending institutions request for personal guarantees of Directors which can be stronger and easily encashable. This function is by voluntary contract and if a Director has given a personal guarantee, he is bound by the terms of the said contract when the company is in default. This is a serious situation wherein the lending institution can easily go against the Director's personal wealth as per the contract. Thus, any Director providing personal guarantees for corporate gain must consider the consequences of default. It may be normal if that Director holds a large stake in the company or a similar situation where the only collateral that can be offered to the lending institution is his personal property as the company has none. In most of the personal guarantee contracts it is common to see that the Director providing same gives an undertaking that any property in his name on that date, mentioned or otherwise shall not be alienated thereafter without the express permission of the lender. Thus, once it is pledged, the Director is prevented from selling or alienating the same or part of it without the permission of the lender. Directors providing personal guarantees for the benefit of the company ought to take note of the consequences thereof. Independent Non-Executive Directors should not provide personal guarantees on behalf of the company to lending institutions and all other Directors should act with care and diligence when they give personal guarantees on behalf of the company to lending institutions.

### 2.4 EPF, ETF & Gratuity Liabilities

The personal liability of Directors for non-payment of EPF, ETF and Gratuity has been in the statute books for a considerable period of time. In Sri Lanka this has been a perennial complaint

by the corporates as they hate to be called up in the Magistrate Courts on Criminal charges. These are however safeguards guaranteed to the employees of companies and the Directors at all times must ensure that all the said statutory payments are made on time by the company.<sup>38</sup>

### **2.5 Government Nominee Directors**

The Secretary to the Treasury's ownership in shares in companies and the special role played by such holding is expressly recognised in the Companies Act No. 07 of 2007. This is to ensure that the State ownership of shares is adequately protected. The Government Nominee Directors, where such Directors are nominee Directors of the State are *vis-à-vis* nominees of the Secretary to the Treasury.<sup>39</sup> They can be nominated and be removed by the Secretary to the Treasury alone and none other. However, the Government Nominee Directors must be aware that there is no immunity from liability by being Government Nominees on the Board. Under Section 4(2) of the Act the Secretary to the Treasury is also permitted to incorporate a Single Shareholder Company.<sup>40</sup> Under the provisions of the Companies Act with regard to attending and voting on proxies it is stated as follows:

Notwithstanding anything in this Act, where the Secretary to the Treasury is the holder of more than ten per centum of the shares, the Secretary to the Treasury shall be entitled to appoint another person as his proxy for every ten per centum or part thereof of the shares held by the Secretary to the Treasury:

Provided where the Secretary to the Treasury is a holder of a golden share in a company in

<sup>38</sup> In this regard, see, Sections 9, 34, 35, 36, 37, 38, 40 and 47 of the Employee's Provident Fund – Act No 15 of 1958 (as amended). Also, see, Sections 5 of the Employee's Provident Fund (Special Provisions) Act No. 6 of 1975 (as amended). Further, see, Section 39, 40 and 44 of the Employee's Trust Fund Act No 46 of 1980 (as amended). See, Sections 15, 16 and 20 of the Payment of Gratuity Act No 12 of 1983.

<sup>39</sup> See, Sri Lanka Insurance, where 99% shares are held by the State via the Secretary to the Treasury.

<sup>40</sup> See, Section 4(2) of the Companies Act No. 07 of 2007.

terms of its articles, notwithstanding anything in this Act, the Secretary to the Treasury as the golden shareholder thereof shall be entitled to appoint not more than three other persons as his proxies to attend on the same occasion.<sup>41</sup>

Under the provisions of the Companies Act with regard to Resolution in lieu of meeting it is stated as follows:

Notwithstanding any provision in this Act, where the Secretary to the Treasury is the holder of a share of a company, any resolution referred to in this section shall not be valid unless the consent in writing of the Secretary to the Treasury as a holder of the share is also obtained in favour of such resolution.<sup>42</sup>

Though such special beneficial provisions are available for the shareholding of the Secretary Treasury / State, the Nominee Directors on the Board are treated equally with all other Directors when the question of duties, responsibilities and liabilities are concerned. The Government Nominee Directors of such companies therefore have no immunity from liability. The Government Nominee Directors of such companies ought to be aware of this fact and act with responsibility, especially at a time when the State has become a visible shareholder in large corporate bodies. The other categories of State institutions include Corporations created by their own Statutes and public enterprises.<sup>43</sup>

## **3. THE PROTECTION FOR DIRECTORS**

### **3.1 The Provisions to Protect Directors**

Under the provisions of the Companies Act a Director can rely on information and advice<sup>44</sup>

<sup>41</sup> See, Section 139(2) of the Companies Act No. 07 of 2007.

<sup>42</sup> See, Section 144(8) of the Companies Act No. 07 of 2007.

<sup>43</sup> See, A Guide – For the Treasury Representatives, Ministry of Finance & Planning – Sri Lanka, July 2010; See also, Public Enterprise Guidelines for Good Governance (www.treasury.gov.lk).

<sup>44</sup> See, Section 190 of the Companies Act No. 07 of 2007.



as set out more fully in Section 190. A Director acting on advice given by a professional on the matter in issue can fall under this category. Eg. A tax expert's opinion, a legal expert's opinion, a financial expert's opinion etc. The persons who can be relied upon for such advice and information are listed therein. However, such reliance is subject to the Director in question acting in good faith, making proper inquiries if necessary and has no knowledge that such reliance is unwarranted.<sup>45</sup>

### **3.2 Indemnity & Insurance for Directors**

Furthermore, indemnity and insurance for director's actions on given circumstances may be allowed by companies if the articles permit same.<sup>46</sup> However, the Articles of Association of the company must expressly authorize same.<sup>47</sup>

It is however, best if the company can have relevant and appropriate articles to that effect, to obtain the best situation. The provision set out in the Model Articles is not adequate. D & O (Directors & Officers) Insurance Policies are tailor-made and are on offer by several reputed Insurance Companies.

### **3.3 Interim Orders**

Directors may obtain relief from the courts in appropriate circumstances.<sup>48</sup>

### **3.4 Maintenance of the Interests Register**

The Board of Directors and the Directors individually must ensure that the company maintains a due and proper Interests Register. This forms part of the annual report for the shareholders to peruse. The particulars of entries made in the Interests Register during the accounting period is stated in the annual report.<sup>49</sup>

<sup>45</sup> See also, New Zealand Companies Act (1993), Section 138.

<sup>46</sup> See, Section 218 of the Companies Act No. 07 of 2007.

<sup>47</sup> See, First Schedule – Model Articles, Article 40 on Insurance and indemnity.

<sup>48</sup> See, Section 526 of the Companies Act No. 07 of 2007.

<sup>49</sup> See, Sections 192, 193, 194, 196, 197, 200 and 216 of the Companies Act No. 07 of 2007.

### **3.5 Business Judgement**

In the Companies Act No. 07 of 2007 it is seen very clearly that in Section 187 (Duty of directors to act in good faith and in the interests of company) and in Section 189 (Directors standard of care) the centuries old 'duty of care' concept of Directors has been embedded into the statute expressly. In Section 187 it is stated that 'A person exercising powers or performing duties as a director of a company shall act in good faith (...) in what that person believes to be in the interests of the company.' In Section 189 it is stated that '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.' The 'duty of care' concept thus narrows down to the individual in question. Thus far however courts in Sri Lanka have not interpreted these new provisions of the law and the corporate community in Sri Lanka is yet to see how the courts will look at these provisions in action. Jurisdictions such as New Zealand and Australia too have followed the same path and have made the 'duty of care' concept statutory. The courts in the said jurisdictions have interpreted these statutory provisions in the backdrop of the Business Judgement Rule of the United States. Infact Australia was one of the first countries in the British Commonwealth to make this statutory. The Victoria Companies Act 1958 in Section 107 contained the statutory duty of a director.<sup>50</sup> Later New Zealand too introduced the same influenced by the Canadian Business Corporation Act and the Australian Act but narrowing it to the person in issue – "(...) must exercise the care, diligence and skill that a reasonable director would exercise in the same circumstances taking into account, but without limitation, (...)".<sup>51</sup> It is indeed based on the commercial reality. In New Zealand and

<sup>50</sup> See, J.H.Farrar, 'Corporate Governance, Business Judgment and the Professionalism of Directors' (1993) 6 Corporate and Business Law Journal 1.

<sup>51</sup> See, Section 137, New Zealand Companies Act (1993).

Australia the courts have taken a very balanced view taking into consideration the commercial reality but there are several outstanding issues to this test as different schools of thought still exist.

### 3.6 Some Golden Tips for Directors

The following are some valuable tips for any director.

- Be mindful of accepting directorships. (Eg. Do not take over past sins of others, do not join rogue clubs).

- Check the history of the company before joining the board.

- Act in the best interests of the company at all times.

- Always act in good faith, where your *bona-fides* can be established easily when in doubt.

- Never act in a reckless manner whilst on the board.

- Never act in a grossly negligent manner whilst on the board.

- Always rely on your experience and knowledge in business judgement.

- Do not let your personal interest conflict with the interests of the company.

- Familiarize yourself with the important provisions of the Companies Act which can have an impact on your actions on the board.

- Familiarize yourself with the provisions of the Articles of Association of the company.

- Note that in the Companies Act it is specifically stated that the provisions set out therein are in addition to and not in derogation of any provisions contained in any other law relating to the duty or liability of directors or officers of a company.<sup>52</sup>

<sup>52</sup> See, Section 190(3) of the Companies Act No. 07 of 2007.

- Ensure that all statutory obligations of the company (Eg. EPF, ETF, Taxes etc) are complied with forthwith. (Compliance check either monthly or quarterly).

- Ensure that all banks and other lending institutions are serviced accordingly. (Compliance check either monthly or quarterly).

- Regularly check whether the risk management techniques of the company are in operation. (Eg: Enterprise risks, strategic risks etc.).

- Note the significance of several other important provisions of the Companies Act that deals with *vis-à-vis* Company Name and Company Number,<sup>53</sup> special provisions applicable to Private Companies,<sup>54</sup> the Solvency Test,<sup>55</sup> Distributions,<sup>56</sup> the Stated Capital and Capital Maintenance,<sup>57</sup> Reduction of Stated Capital,<sup>58</sup> Dividends,<sup>59</sup> Acquisition of shares,<sup>60</sup> Minority buy-out right,<sup>61</sup> Meetings, Proceedings and Resolutions,<sup>62</sup> Major transactions,<sup>63</sup> etc.<sup>64</sup>

- Check whether the financial reporting is done in a professional manner under the provisions of the law. (Eg: Dimo PLC - Annual Report 2019).

- If the company is listed on the Stock Exchange, make sure that you are aware of the provisions of the Securities & Exchange Commissions Act and the SEC Rules which can have an impact on your actions.

<sup>53</sup> See, Section 12 of the Companies Act No. 07 of 2007.

<sup>54</sup> See, Section 170 of the Companies Act No. 07 of 2007, Part II and Second Schedule of the Act.

<sup>55</sup> See, Section 57 of the Companies Act No. 07 of 2007.

<sup>56</sup> See, Section 56 of the Companies Act No. 07 of 2007.

<sup>57</sup> See, Section 58 of the Companies Act No. 07 of 2007.

<sup>58</sup> See, Section 59 of the Companies Act No. 07 of 2007.

<sup>59</sup> See, Section 60 of the Companies Act No. 07 of 2007.

<sup>60</sup> See, Section 63 of the Companies Act No. 07 of 2007.

<sup>61</sup> See, Section 93 of the Companies Act No. 07 of 2007.

<sup>62</sup> See, Sections 133 to 147 of the Companies Act No. 07 of 2007.

<sup>63</sup> See, Section 185 of the Companies Act No. 07 of 2007.

<sup>64</sup> For an elaborated discussion see, Cabral H., *Companies Act No. 07 of 2007 and the Corporate Law of Sri Lanka* (updated 2nd edition, 2019).



- If the company is listed on the Stock Exchange, make sure that you are aware of the provisions of the Listing Rules of the Colombo Stock Exchange which can have an impact on your actions.

- If the company is listed on the Stock Exchange, make sure that you are aware of the mandatory code on Corporate Governance and also the voluntary code on Corporate Governance.

- Even if the company is not listed try to follow the Corporate Governance mechanisms in place for good governance.

- Consider the mechanisms of CSR (Corporate Social Responsibility) for the company.

- If the company is a Licensed Commercial Bank or a Licensed Specialised Bank, make sure that you are aware of the provisions of the Banking Act which can have an impact on your actions.

- If the company is a Licensed Commercial Bank or a Licensed Specialised Bank, make sure that you are aware of the provisions of the Directions made under the Banking Act which can have an impact on your actions.(Eg. Corporate Governance etc.).

- If the company is a Licensed Commercial Bank or a Licensed Specialised Bank, make sure that you are aware of the Guidelines for Internal Controls published by the Institute of Chartered Accountants of Sri Lanka (2010).

- If the company is a Registered Finance Company, make sure that you are aware of the provisions of the Finance Companies Act and Directions made under the said Act which can have an impact on your actions.(Eg. Corporate Governance etc.).

- If the company is a Registered Finance Leasing Company, make sure that you are aware of the provisions of the Finance Leasing Act and

Directions made under the said Act which can have an impact on your actions.(Eg. Corporate Governance etc.).

- If the company is a specialised entity, make sure that you are aware of the provisions of the Statute or Statutes which can have an impact on your actions in addition to the provisions of the Companies Act referred to above.

- Be mindful of your actions that can be impeached by the company, directors, shareholders, creditors and other stakeholders under the provisions of the Companies Act.

- Be mindful of oppression and mismanagement actions and derivative actions that can be instituted by minority shareholders impeaching actions of directors.<sup>65</sup>

- If the company is a conglomerate or a group entity, ensure that you have a fair knowledge on Holding Companies, Subsidiary Companies and Associate Companies and their respective roles under the law.

- Check whether the Consolidated Accounts or Group accounts are done accordingly if it is a group entity. (Eg: Avoid any Ceylinco Consolidated scenarios).

- Be mindful of related party transactions of the company. (Eg. Avoid any Golden Key scenarios.).

- Ensure that all disclosures are made under the law.

- Use your conscience when taking decisions at board level.

- Make use of your own expertise when you have a superior knowledge on the subject.

- Never let others who are lesser knowledgeable on the subject matter in issue pressurize you to change your decision.

<sup>65</sup> See, Sections 224, 225, & 234 of the Companies Act No. 07 of 2007.

- Always ensure that the independent directors are truly independent.
- Always ensure that the board recognize the views of independent directors.
- Do not be under any obligation to the Chairman or any other member on the board.
- Have an independent mind of your own.
- Ensure that your dissent on any matter is recorded correctly at meetings.
- Check the Board Minutes and Minutes of other committees where you are a party, with care.
- Read the Board Minutes with absolute care before they are confirmed.
- See that Board Minutes and other Minutes of committees are corrected accordingly.
- Know that Board Minutes are treated as a contemporaneous record of events and matters.
- If you are not an expert on the matter in issue, ensure that you rely on third party expertise on the matter either at Board level or externally. Keep records of same.<sup>66</sup>
- Use of information and advice of third parties is permitted under Section 190 of the Companies Act with clarity.
- Any individual on the Board can rely on third party expertise in given circumstances.
- Always remember to keep such advice on record to be used as evidence when needed later. (Eg. Legal Opinions, Emails etc.).
- Be aware of the provisions of the Companies Act and other relevant statutes which attract personal liability including criminal liability which again is personal in nature.
- Make use of the Directors & Officers Insurance cover. (D & O Insurance Cover).<sup>67</sup>
- Ensure that a proper 'Interests Register' is maintained by the company and all relevant interests of directors including yours are duly entered in the said register.
- Make use of Section 526 of the Companies Act (Power of Court to grant relief in certain cases) when needed to obtain appropriate relief from court.
- Make note of actions that attract personal liability (civil and criminal both) as set out in any other statute or statutes that impact on the company.
- Ensure that all your actions are carried out in a professional manner reasonably with dignity and honesty.
- Independent Non-Executive Directors are invited to Boards mainly due to their expertise. (Eg. Expert in Finance, Expert in Law, Expert in Marketing etc.) Ensure that such expertise is made use of by the Board and not ignored.
- If you feel uncomfortable on the board exit forthwith.
- Independent Directors should resign no sooner they feel their independence is eroded.
- Do not accept Board appointments if you cannot dedicate sufficient time for board matters.
- Do not accept too many directorships if you cannot dedicate sufficient time for each directorship.
- Be aware of your rights as a Director under the Companies Act. (Eg. Privy to Board Minutes etc.).
- Check whether the CEO (Chief Executive Officer) is performing his obligations correctly.

<sup>66</sup> See, Section 190 of the Companies Act No. 07 of 2007.

<sup>67</sup> See, Section 218 of the Companies Act No. 07 of 2007.



- Check whether the Sub-Committees of the Board (Eg. Audit Committee, Remuneration Committee, Nomination Committee etc.) are in operation in the correct manner.

- Check whether the company external auditor is performing his rights professionally.

- Check whether the Company Secretary is performing his rights professionally.

- Ensure that the internal audit mechanisms of the company are in order.

- Be familiar with the SLAS (Sri Lanka Accounting Standards) that may have an impact on your company. Also note that Sri Lanka will be following the IFRS (International Financial Reporting Standards) from 1<sup>st</sup> January 2012.

- Avoid being a mere passenger on the board endorsing all decisions of the board in a passive manner.

- Be cautious when giving personal guarantees for corporate benefit.

- Remember that ignorance is no excuse.

- Remember that accepting a directorship is not joining a cocktail circuit.

- Never discuss board room matters with family members.

- Never discuss board room matters with friends or associates.

- Do not disseminate price sensitive corporate information to any third party who is not entitled to know them.

- Do not trade your principles for money.

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