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# Inconsistencies Between Theory and Practice: A Preliminary Study on the Concept of Directors' Duties Under The Companies Act 1965

Hasani Mohd Ali\*, Aishah Bidin and Jady@Zaidi Hasim

*Faculty of Law, Universiti Kebangsaan Malaysia, 43600 UKM Bangi, Malaysia*

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## Abstract

This paper is an early attempt at examining the concept of directors' duties with the aim to identify, to list and to analyse the laws which are incoherent or may suffer from practical problems due to inadequacies, or conceptual problems to the law. Such positions may be determined through case law studies, by commentators, experts and practitioners on the subject. The findings are useful in order to provide a list of inconsistencies between the teachings of the subject with problems in practices, for example by identifying why the good virtues as stipulated in theory may not be practical. The results obtained will be analysed and employed for teaching and learning practices in the form of mock trials, client counselling, mock board meetings, or topics for assignments, presentations, quizzes & tests etc. A more practical approach to the teaching of the concept of directors' duties specifically and the company law subject generally may be developed accordingly.

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## 1. Introduction

The original proposal of this project (with the reference no. UKM-PTS-024-2010) aims to incorporate practical and relevant inputs not only from the theoretical framework but also to integrate feedback and responses from the industry into the teaching and learning process of corporate law. The topic of directors' duties is selected because it is among the most important topic in corporate law. The objective of the research is the formulation of a teaching module which will be developed and applied by corporate law teachers at the faculty of law, and may be applicable for those which offer corporate law courses such as the faculty of economics, Graduate School of Business(GSB) UKM and generally the law schools in Malaysia. It will also enhance and integrate methodologies of problem-based learning (PBL) which are very relevant to achieve the program and course objective. The objective and aim is highly achievable as the faculty has already established collaborations with the relevant regulatory agencies and professional bodies including Companies Commission of Malaysia (CCM), Malaysian Institute of Chartered

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\* Corresponding author. Tel.: +603-8921-6364 fax: +603-8925-3217.

E-mail address: [hmohdali@ukm.my](mailto:hmohdali@ukm.my).

Secretaries (MAICSA), Securities Commission (SC), Practitioners (Azmi & Co), directors from various backgrounds etc.

## 2. Directors' duties: Problems identified

Imposing duties on directors through law mechanism is an effective means of monitoring directors while they are managing their companies. Mainly, there are two types of duties: fiduciary duty and the duty of care and skills. Breaches of each duty however carry different consequences in terms of liabilities or punishments. Fiduciary duty requires stricter observance by directors with almost zero tolerance; whilst, duty of skill and care, to a certain extent, may allow directors some flexibilities in its performance. Unfortunately, the boundary of each duty is not necessarily clear in a given situation.

Instances where the scope of directors' duties are not clear:-

- during a financial hardship, a high degree of care may be expected of a director so not to allow the company to continue trading at the expense of the creditors' interests. Failure of which may cause the director to be charged putting himself in a conflict of interests situation.

There are already a range of literature which highlight the problem in Malaysia. The only provision is concerning fraudulent trading prohibition. The provision is not practical as it requires a higher burden of proof both in a criminal or even in a civil action. As a result, if a company continues trading at times when its insolvency is at issue, the only action available is by proving that the directors have intent to defraud creditors. This is apparent when there is a transfer of asset or any similar act of misfeasance. For cases where directors simply choose not to stop trading, in the absence of intent to defraud, no action is possible against directors. The argument may be put forward by the complainant claiming that the directors in so doing putting his interests to continuously be paid fee which may constitute a fraud. Nonetheless, the proof of beyond reasonable doubt may be undermined by the argument that directors have a reasonable belief that a turnaround is possible. (Hasani, 2006)

Insolvent trading is not included in any proposal for reform by the Corporate Law Reform Committees (CLRC). As such, while directors may free to steer their companies without any strict prohibition in place, creditors' interests are arguably not well protected in this regard. The position by no means pro-directors because they are enjoying the benefit of non-clarity of the law. Directors are left with their discretion as yet without any clear law to be put in place. In the long run, there might be a growing perception that the law does not treat the related stakeholders fairly.

- Conflict of interests situation may present even though the director claims that his act is for proper purpose.

Duty to act for proper purpose may present another problem to directors. A director might be acting honestly in what he considers to be the company's interests and yet still be in breach of his fiduciary duty. The law requires that directors exercise their powers for the proper purposes as conferred on the directors. However, the exercise of directorial powers in what they believe for a proper purpose but acted out of a misguided sense in the company's interests may also amount as a breach of duty. See *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821 (Privy Council on appeal from New South Wales); *Whitehouse v Carlton Hotel Pty Ltd* (1987) 11 ACLR 715 (High Court of Australia).

Case law guidance as introduced by courts on this issue is quite unclear. The scope of purpose of a power is left for the court to determine. The aim of the exercise is to define 'as best can be done in the light of modern conditions, the, or some, limits within which [the power] may be exercised' as per Lord Wilberforce in *Ampol* case. Only then the court may 'examine [whether] the substantial purpose was proper or not'. In considering this 'substantial purpose', credit may be given to the bona fide opinion of the directors. As usual, the court will not interfere with their judgment in matters of management. The court's duty is to decide on which side of the line between proper use and abuse the case falls. The summary of the trend from cases suggests that, if there are two or more competing purposes underlying the exercise of a power, a breach of duty may be held if the impermissible purpose was causative in the sense that *but for* its presence the power would not have been exercised. Clearly, this development may pose a more critical problem in practice.

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