

Forum on the New Companies Ordinance –What Directors Need to Know

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Panel Discussion by Professionals

Directors' care, skill and diligence

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公司註冊處
COMPANIES REGISTRY

Directors' Duty of Care, Skill and Diligence

Re City Equitable Fire Insurance Co Ltd [1923] Ch 407

Subjective test

..... such degree of skill as may reasonably be expected from a person of his knowledge and experience

By 1980 that was considered too low a standard in HK

1980 Companies White Bill included statutory statement of director's duty

But it did not survive into Companies (Amendment) Ordinance 1984 (one of the casualties of that White Bill)

Another attempt in 1991 failed

The UK Insolvency Act 1986 s 214

wrongful trading, ie continuing to trade when there is no reasonable prospect of avoiding insolvent trading

s 214(4) director's conduct to be judged against the conduct that might be expected of a reasonably diligent person having both –

- (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as are carried out by the director whose conduct is being impugned (OBJECTIVE), and
- (b) the general knowledge, skill and experience that that director has (SUBJECTIVE)

This test was applied by analogy to directors' duty generally in UK

Few relevant cases in Hong Kong, but generally assumed HK would follow minimum objective standards

PART 10

Division 2

Directors' Duty of Care, Skill and Diligence

465. Duty to exercise reasonable care, skill and diligence

- (1) A director of a company must exercise reasonable care, skill and diligence
- (2) Reasonable care, skill and diligence mean the care, skill and diligence that would be exercised by a reasonably diligent person with –
 - (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company; and
 - (b) the general knowledge, skill and experience that the director has.

- (3) The duty specified in subsection (1) is owed by a director of a company to the company.
- (4) The duty specified in subsection (1) has effect in place of the common law rules and equitable principles as regards the duty to exercise reasonable care, skill and diligence, owed by a director of a company to the company.
- (5) This section applies to a shadow director as it applies to a director.
- (6) For the purposes of subsection (5), a body corporate is not to be regarded as a shadow director of any of its subsidiaries by reason only that the directors, or a majority of the directors, of the subsidiary are accustomed to act in accordance with its direction or instructions.

466. Civil consequences of breach of duty to exercise reasonable care, skill and diligence

Without affecting other provisions of this Ordinance or the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap 32), the consequences of breach (or threatened breach) of the duty specified in section 465(1) are the same as would apply if the common law rules or equitable principles that section 465(1) replaces applied.

The statutory duty replaces the Common Law: subs (4) but Common Law case authorities relevant in interpreting s 465 despite no equivalent of UK s 170(4)

The objective standard in subs (2)(a) depends on the functions carried out by the director in relation to the company, ie the position of the director in the company, his responsibilities and the nature and type of the company concerned see *Brumder v Motornet Service and Repairs Ltd* [2013] EWCA Civ 195, para 55: “section 174 of the 2006 Act recognises that there will be variations between different types of directors and between different types and sizes of company. Directors are permitted to engage in substantial delegation of management functions to non-Board employees, just as they were at common law: see *Re City Equitable* at page 429. Directors are not, however, permitted to escape from being in a position to guide and

monitor management and from “the duty to supervise the discharge of the delegated functions”: *Re Barings plc* (No. 5) [2000] BCLC 433, 489 approved by the Court of Appeal at 536, and *Equitable Life Assurance Society v Bowley* [2003] EWHC 2263 (Comm) at [41].... One factor may be the ‘quality of internal controls’” (Mr Brumder, sole director, injured by defective vehicle ramp; Mr B had made no attempt to ensure company observed Health and Safety Regulations, or made a risk assessment or service of the ramp; therefore in breach of s172) Note oversight and monitoring duty; may delegate, but must then monitor

There may be differences between what is expected of executive and non-executive directors see *Daniels v Anderson* (1995) 16 ACSR 607 NSWCA (foreign exchange frauds – CEO liable – but not NEDs), though they are still required to monitor management

S 465(b) with a subjective standard of care, raises the level, so specialists (eg accountants, lawyers, engineers) appointed for their expertise, will be required to give care, in matters within their expertise, of the reasonably diligent person with their knowledge, skill and experience

Remedies for breach of duty under s 465 the same as for breach under Common Law: s 466

473. Ratification of conduct by director involving negligence, etc

- (1) This section applies to the ratification by a company of conduct by a director involving negligence, default, breach of duty or breach of trust in relation to the company.
- (2) A decision of the company to ratify the conduct may only be made by resolution of the members of the company.
- (3) If such a resolution is proposed at a meeting, every vote in favour of the resolution by a member who –
 - (a) is a director in respect of whose conduct the ratification is sought;
 - (b) is an entity connected with that director; or
 - (c) holds any shares in the company in trust for that director or entity,is to be disregarded.
- (4) Subsection (3) does not prevent a member specified in that subsection from attending, being counted towards the quorum for, or taking part in the proceedings at, any meeting at which the decision is considered.

- (5) For the purposes of this section –
- (a) **conduct** (行為) includes acts and omissions;
 - (b) **director** (董事) includes a former director;
 - (c) a shadow director is to be regarded as a director; and
 - (d) a reference to an entity connected with a director has the meaning given by section 486.
- (6) Nothing in this section affects –
- (a) the validity of a decision taken by unanimous consent of the members of the company; or
 - (b) any power of the directors to agree not to sue, or to settle or release a claim made by them on behalf of the company.
- (7) This section does not affect –
- (a) any other Ordinance or rule of law imposing additional requirements for valid ratification; or
 - (b) any rule of law as to acts that are incapable of being ratified by the company.

S 473 a useful addition (derived from UKCA 2006 s 239)

in requiring votes of interested parties to be disregarded and ratification only by members (rather than directors),

but does not help on other relevant issues, ie applies only to ratification of existing breaches, does not deal with authorisation in advance of breach

and seems to preserve by subs (7)(b) in particular Common Law rule that some serious breaches, eg misappropriation of company's property *Cook v Deeks* (1916), were not ratifiable

And note subs (6), nothing in s 473 shall affect (a) the validity of a decision or taken by unanimous consent of members or (b) any power of the directors to agree not to sue or to settle or release a claim