STAKEHOLDER SAFEGUARD AGAINST UNFIT DIRECTORS: A WAY FORWARD FOR GOOD GOVERNANCE UNDER THE COMPANY LAW OF SRI LANKA

Shanthi Segarajasingham[1]

ABSTRACT

Companies Act No.07 of 2007of Sri Lanka imposes a variety of duties on officers/directors of companies. These duties include procedural duties of filing of returns or sending notifications to the Registrar of Companies as well as important duties of compliance which includes satisfying solvency test, duty to act in good faith, duty of care etc. The second category of the duties has serious repercussion that affects every stakeholder. The Registrar of companies is empowered to take action by obtaining a court order. Unfortunately, neither the Registrar enforces his powers nor the sanctions are enforced and it seems that non-compliance is ignored. S. 213 provides for prohibitions while s.214 provide for directors' disqualification which may be enforced by court order. This too is never enforced in Sri Lanka and therefore non compliant directors do not get caught. Sri Lankan experience of failed companies in the recent past taught many lessons and the time is ripe to bring the errent directors to light. The contemporary law in the United Kingdom, Company Directors Disqualification Act of 1986 (CDDA 1986) is advanced and codified disqualification regime. The provisions amplify the directors' traditional common law duties as well. The Insolvency Services handle the enforcement of the provisions. Enormous number of disqualification cases was heard from the time this Act was enacted and the disqualification orders are indicative of the effectiveness of the law. Companies Act 2013 of India too contains some remarkable provisions. This paper will deal with a comparative analysis of the three jurisdictions mentioned and the write envisages suggesting reforms to the Companies Act of Sri Lanka to bring about a more effective mechanism relating to directors' disqualifications which will pave way for good governance.

Key Words: Company Directors, Disqualification/Unfitness

1. Introduction

Companies are a creation of the law for economic development. During the early days companies were known as mere business entities for the benefit of its shareholders. The ambit of those who enjoy the fruits of companies expanded over the years. It resulted in the creation of the concept of stakeholders. Every stakeholder contributes in some way towards the business of companies resulting in the companies becoming accountable to its stakeholders. The stakeholders would benefit only when their companies do well. On the other hand, if the companies suffer losses or collapse suddenly, the stakeholders would suffer. Therefore, it is essential to ascertain the root cause/causes of the downfall of the companies. Although there may be many reasons for the downfall, every possible reason is centred on one cause which would be the failure of directors to perform their duties. Though directors are collectively called as 'board', in reality every director cannot be responsible for the failure of a company. A few unfit directors conduct themselves in unacceptable manner and cause hardship to companies. It is time that stern steps are taken against such directors and safeguard the stakeholders of companies.

2. **Stakeholder Safeguard**

While shareholder value is treasured and retained, an expanded notion of stakeholder value[2] is given prominence and wide publicity as well. Companies owe a duty not only to shareholders but also to its employees, consumers, suppliers, society and the State. This is because of the fact that all these stake holders are directly or indirectly connected with the companies' affairs. It may be argued that if these stakeholders enjoy the fruits of earnings, or in other words get benefit out of companies' profits, why shouldn't they be part of losses also. The answer to this is that most stakeholders are innocent and in no way connected to the losses and therefore should not be held responsible. The good governance of a company would mean and include safeguard of stakeholders and they should be protected. This is applicable to every stakeholder.

Employees are stakeholders, but they are not part of internal management of the company. They will learn about the downfall only when the financial year-end bonus is not paid after finalising the profit and loss accounts. Even in such a situation the employees have no right to interfere in the management of the company. It is the moral duty of companies that they earn profits and share a portion of profits with the employees. It is to be noted at this juncture that s.172(1)(b) of Companies Act 2006 of the UK (hereinafter referred as CA 2006 - UK) provides that the directors of a company must have regard to the interests of the

[1] LL.B (Hons), M.Phil, Attorney-at-Law, Senior Lecturer, Department of Commercial Law, Faculty of Law, University of Colombo, Sri Lanka, email: shanthisegha@yahoo.com

[2] Stakeholder value has the broad objectives of minimize cost and waste while improving the quality of its products, enhance the skills and satisfaction of its employees, and contribute to the development of the community from which it draws its resources and sustenance. Objectives of shareholder value is limited to enhance the firm's earnings, increase the market value of its shares, and increase the amount or frequency of the dividend paid. See: http://www.businessdictionary.com/definition/shareholder-value-approach.html#ixzz3VZbVijrG

employees.[3] Unfortunately the Companies Act No.7 of 2007 of Sri Lanka (hereinafter referred to as CA 2007 - SL) does not have a provision similar to the above mentioned provision.

Consumers and suppliers who are also stakeholders are in no better position than the employees and they neither have any special information as to the company's financial position nor about the conduct of directors. Suppliers may be alert when their bills are not settled, but their rights are limited to that of a creditor. The CA 2007 - SL has not provided for any right to the creditor during the life of the company. In the recent Australian case of *McCracken v. Phoenix Constructions (Qld) Pty Ltd*[4], the Queensland Court of Appeal reaffirmed the orthodox position that creditors (or other persons whose interests are affected) are not entitled to claim damages against a director personally for contravention of s. 182 of the Corporations Act of Australia[5] and unanimously held that s.1324(10) of the Corporations Act of Australia[6] does not confer a right to creditors to claim damages for loss suffered by the contravention of s.182. It was held that the Act did not empower the trial judge to award damages to Phoenix Constructions (the creditor) and to do so was contrary to the intent of the statutory provisions. This results in a situation that creditors requires to be safeguard. The UK statute provides for the safeguard of creditors in their s.172(3) which may be a lesson for the other jurisdiction.[7] The statute of the UK provide for creditor safeguard in their Companies Act 2006 which may be a lesson for other jurisdictions.[8]

The recipients of the benefits of the company is the society or the public at large and this category consists of large amount of stakeholders. The CA 2007 - SL allows public inspection of certain records[9] and in addition, financial statements of all PLCs are published in the newspapers. The requirements of the law are sufficient for any learned person to become aware of a company's plight. However, the general public are too busy in this competitive world and have very little time to spend on something in which they are not directly connected. As a result, the unfit directors who cause the companies to suffer losses are neither detected nor reprimanded.

Every company is a contributor to the GDP whether big or small and thereby the State become a stakeholder. The State has given, by law, freedom for companies to do any business or activity or enter into any transaction,[10] but States do not interfere unless there is a crisis.[11] It is the expectation of the State that the companies perform well, so that the State is benefitted. However, in situations of turmoil the State intervenes, in the interest of the public ,through its agencies such as Central Bank or Securities and Exchange Commission. The recent *Seylan Bank* financial crisis in Sri Lanka is a good example of State intervention preventing the fall of a licensed commercial bank.[12] Nevertheless it will not be practically possible for the State, (whether through the Central Bank or through other agencies) to revive every company when they face difficulties. Therefore, the State has a stern interest over the well-being of companies. Unfit directors causing detriment to companies are therefore a concern of the State.

The last category of stakeholders are shareholders who are important in the life of a company. Shareholders take part in the profits of the company by way of distribution, scrip dividend and capital gain. They have the right to obtain copies of annual

[3] Section 172- Duty to promote the success of the company
(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to— (b) the interests of the company's employees;

[4] [2012] QCA 129

[5] Under s.182(1) a director must not use their position to gain an advantage for themselves or for someone else.

[6] Section 1324(10) S gives the Court power to grant an injunction against a person and also "*either in addition to or in substitution for the grant of the injunction, order that person to pay damages to any other person*"., This provision empowers the award of damages to "*anyone whose interests have been affected*". The original decision interpreted this provision broadly, expanding directors' possible exposure. Subject to any possible appeal to the High Court, the appeal decision lays these concerns to rest and reiterates that, in general, directors owe duties to the company, and not to the creditors. See: http://www.arita.com.au/news-view/2011/08/02/corporations-act-s-1324%2810%29---appeal-proceedings-1057

[7] S.172(3) - "The duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company".

[8] S.172(3) provides that - The duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company.

[9] S.120

[10] See section 2 (2) SLCA 2007

[11] For Example, the Central Bank of Sri Lanka intervened when Seylan Bank PLC was is financial turbulent during 2009. Similarly, the Government intervened when National Savings Bank was in crisis during 2011 relating to their investment very much above the market value in loss making *The Finance PLC*. See: http://www.sundaytimes.lk/120520/News/nws_06.html, http://www.cseleaks.com/2012_05_01_archive.html

[12] Seylan Bank is a member of Ceylinco Group that faced crisis in 2009 due to the sudden collapses of one of the sister companies, Golden Key Credit Card Company Ltd. Public investment in Golden Key amounting to nearly 300 million Sri Lanka rupees was at stake and cases were filed by depositors in every court in Sri Lanka using different laws and grounds. This resulted in customers of Seylan Bank becoming alarmed and they wanted to pull their money from Seylan Bank. Many malpractices of Directors of these two entities and the Chairman was brought to light. Central Bank intervened, the board of Seylan Bank was dissolved and new directors were appointed. On a planned restructure Seylan Bank was revived and it is now back as a profit earning commercial bank.

reports[13] and inspect minutes and resolutions.[14] Hence, they are privy to information relating to company's financial status. Although remedies are available under ss.224, 225 and 234 of the CA 2007 - SL,[15] the general trend in Sri Lanka is that the shareholders are not vigorous and is rare to find active shareholders. There is only one reported case so far that ended up in the highest court of Sri Lanka.[16]At the same time courts are also mindful of costly shareholder actions that do not produce any benefit to any party.[17] Whether there is shareholder activism or not shareholder needs are fulfilled by proper corporate governance by proper board in place in companies. Unfit directors are therefore causing hardship to the shareholders as well by way of poor management.

3. Unfitness In The Board

Generally the law does not provide for any special qualifications for directors. It is the basic contractual capacity the directors are expected to possess.[18] Therefore, anyone who satisfies the age requirement, not convicted for any offence under the Companies Act or otherwise or not an undischarged bankrupt may become a director unless there is a court order to disqualify him/her. However, the expectations of the stakeholders are heavy. In addition, there are requirements from enforcement authorities and that is compliance of the law and regulations or rules. Although the expectations of different stakeholders vary, those are connected on one aspect and it is the duty of directors to take the company towards financial stability. When the company fails in making profits, it is the directors who are responsible and the members of the board can be possibly be branded as 'unfit'. The sudden collapse of companies around the world taught many lessons and the most important out of it is to identify the reason of such collapses. A common feature in every collapse is mismanagement of finances by directors who are not fit and proper persons to manage the affairs of a company. For example, Enron, an American energy company based in Houston, Texas was formed in 1985. Though a profitable concern at the beginning, the company collapsed in 2001. Enron's $63.4 billion in assets made it the largest corporate bankruptcy in U.S. history until WorldCom's bankruptcy the following year. By poor financial reporting, the officers were able to hide billions of dollars in debt from failed deals and projects. The Chief Financial Officer and other executives not only misled Enron's board of directors and audit committee on high-risk accounting practices, but also pressured to ignore the issues. Enron shareholders filed a $40 billion lawsuit after the company's stock price, which achieved a high of US$90.75 per share in mid-2000, plummeted to less than $1 by the end of November 2001. The U.S. Securities and Exchange Commission began an investigation but it was too late and could not prevent the fall of Enron. Many executives at Enron were indicted for a variety of charges and some were sentenced to imprisonment. Enron's auditor, Arthur Andersen, was found guilty of illegally destroying documents relevant to the SEC investigation which voided its license to audit public companies. Employees and shareholders received little when compared to losses in billions in pensions and stock prices. The only virtuous aspect of the Enron collapse is that it gave rise to a new regulation by way of a new legislation, called the Sarbanes-Oxley Act.[19]

It is clear therefore improper management converts a director as 'unfit'. The term 'unfit' is not defined in the statutes. However, the government of UK describes it in their official website as follows[20]:

'Unfit conduct' includes:

- allowing a company to continue trading when it can't pay its debts (a similar requirement is found under ss.219 and 220 of CA 2007 – SL)
- not keeping proper company accounting records a similar requirement is found under s.148 of CA 2007 – SL)
- not sending accounts and returns to Companies House (there is no single similr provision in Sri Lanka, but requirement is founds all over the Act)
- not paying tax owed by the company (comes under the tax statute)
- using company money or assets for personal benefit (misapplication of funds is available under s.376 in Sri Lanka, but not exactly similarilar)

4. Unfit Directors Under The Law Of Sri Lanka

The Registrar of Companies is empowered to give notice to the companies to comply with the requirement in the Companies Act relating to filing of returns or delivering of any documents. If a companies fail to make good the default in 10 days, the Registrar may obtain a court order by virtue of s.481 Companies Act 2007 of Sri Lanka. This provision is enacted with the objective of transparency of company affairs because the stakeholders ought to know the activities and performance of companies. However,

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[13] S.167 of SLCA 2007

[14] S.119 of SLCA 2007

[15] Sections 224, 225 and 234 provide for shareholder remedies of oppression, mismanagement and derivative action respectively.

[16] *Amarasekera v. Mitsui & Co. Ltd* [1993] 1 Sri L.R 22 is a case on derivative action by a minority shareholder.

[17] *Prudential Assurance Co v. Newman Industries[No.2]* [1982] 2 AER 841

[18] For example see s.202 CA 2007 – SL ; s.57 CA 2006 – UK provides only for the minimum age of directors. It is because, under the law of the UK body corporates can act as directors

[19] Source: http://en.wikipedia.org/wiki/Enron_scandal

[20] https://www.gov.uk/company-director-disqualification

the Registrar never enforces the said provision and non-compliance is never taken for task. Incompetent individuals accept positions as directors for financial benefit at the cost of shareholders and never concerned about compliance since they are aware that they will not be trapped. It is necessary therefore, in the interest of stakeholders, that errant directors are punished by way of disqualification orders.

4.1 Directors' Duties In Brief

The duties of directors are multifaceted. No single legislation can provide comprehensively all the duties. Companies legislation, securities legislation, articles of association of each company and stock exchange rules generally provided for duties of directors. In addition, directors are considered as fiduciaries or equivalent to trustees and the common law duties which are called fiduciary duties are never disputed. Moreover, there are other pieces of legislation imposing duties on directors. The EPF Act, ETF Act, Inland Revenue Act are some of those. The whole responsibility of taking the company towards success, by adhering to the duties, rests on the board of the company. The Companies Act No.07 of 2007 imposes a variety of duties on officers and directors of companies. Out of these, one part of the duties are procedural in nature such as notifying the Registrar of Companies of various changes takeing place in companies, filing of returns and preparing annual report. Duties falling under this category of procedural nature are generally backed by criminal sanction such as fine and / or imprisonment. Unfortunately these sanctions are never enforced in Sri Lanka. In addition there are important duties of making disclosure of interest in transactions, age etc. There are disclosure requirements under the listing rules of the stock exchange and the board is duty bound by those too. Sections.187, 188,189 of SLCA 2007 contain very important statutory duties of directors in Sri Lanka. Out of these, s.187 is restatement of fiduciary duty of 'acting in the best interests of the company' which is very wide and could hold any director responsible for *mala fide* activities. S.188 provides that a director should not act in contravention of the provisions of the articles of the respective company and the Companies Act. S.189 cast the duties of care and skill in their performances. However, there are no penal provisions by way of a sub-sections to these three sections of 187 to 189.

Moreover, ss.219 and 220 of CA 2007 are also paramount duties of directors when they come to know that the company is financially instable. S. 219 is a novel provision introduced in Sri Lanka in 2007 and provides for steps the directors should take when they come to know that the company is unable to pay debts as they fall due. Section 220 too is a novel one providing for duties of directors when the assets of the company fall below half of its stated capital. Both these sections of 219 and 220 contain sanctions. Moreover, the Solvency Test is another important mechanism introduced in the CA 2007 to curb situations of financial crisis. Civil and criminal liabilities are provided in the Act for non-compliance/contravention and these are also mechanisms to urge directors to comply. It is regretted that the liability provisions are rarely enforced or it will be more accurate if said that those are never enforced in Sri Lanka. Public listed companies are under a further stringent obligation to adopt Corporate Governance. Nevertheless, the Sri Lankan statute lacks a provision similar to s, 172 of CA 2006 of UK which provides that the directors owe a duty to promote the success of the company.[21] This is referred as one of the interesting innovations by authors who, at the same time raise doubts as to the interpretation of this requirement, as in *Item Software (UK) Ltd v. Fassihi*. [22]

4.2 Disqualification Regime Under The Law Of Sri Lanka

All the duties of directors mentioned above have serious repercussion that affect every stakeholder. The Part on 'Directors' Duties' under the Companies Act provides for disqualification of directors under sections 213 and 214. A person is prohibited from managing the companies if he falls under any of the grounds stated in s.213. The grounds for such prohibition are conviction of any offence under the same Companies Act, conviction of any offence involving dishonesty or fraudulent acts, adjudged insolvent or adjudged to be of unsound mind. A person shall not be a director and cannot take part in the management of the company directly or indirectly for a period of five years from conviction or adjudication unless leave of court is obtained. A person intend applying leave of court shall give notice to the Registrar of Companies who may attend and be heard at the hearing of any application Any other persons are also permitted to attend and be heard if the court thinks. It is not clear who those other persons are. Other persons interested may be either shareholders or creditors in the opinion of the writer.

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[21] 172 Duty to promote the success of the company
(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and …….

[22] [2004] EWCA Civ 1244 In this case the defendant was a salaried director of the claimant company, which dealt with software products. When the company was renegotiating a contract with a customer the defendant secretly approached the customer and proposed to divert the contract to a company of his own. As a result, the negotiations with the company failed and the customer terminated its contract with the company. The company discovered the defendant's misconduct, and brought proceedings against him for compensation alleging that he was in breach of duty as a director seeking to divert the company's contract to his own company. The Court of Appeal held that a director of a company was subject to a fundamental duty of loyalty requiring him to act in what he, in good faith, considered to be the best interests of the company. As, on the facts, there was no basis on which the defendant could reasonably have concluded that it was not in the claimant's interests to know of his breach of duty, he could not fulfill his duty of loyalty except by telling the claimant about his setting up a new company to acquire the contract for himself.

S.214 provides four grounds under which a person may be disqualified to manage the company by an order of the court. It is to be noted that s.213 provides grounds for prohibition to manage the affairs of the company and those who fall under any of the grounds cannot function as a director unless court permits. It means, if a person still wishes to function as a director despite the fact that he is prohibited under s.213, may seek court permission to do so and it is very unlikely that the court will grant permission. Under s.214, court order will have to be obtained when a person falls under any of the grounds stated, in order to declare him as disqualified. The maximum period for which a court order can be given is 10 years and such person against whom the order has been given shall not directly or indirectly connected or take part in the management of the company during the period of such disqualification. The statutory provision is carefully drafted taking into consideration the natural justice principle of *audi alteram partem.* S.214(2) provides that a person intending to apply for a court order shall give not less than ten working days' notice of such intention to the person against whom the court order is sought and he is entitled to appear before court, give evidence or call witnesses on the day of hearing. Under s.214, disqualification orders may be given, if a person is prohibited under s.213, or persistently fails to comply with the provisions of the Act, or convicted of any offence or had caused a company to become insolvent. Although the Registrar of Companies, liquidator, administrator, shareholder and creditors are given the right to file an application to court for a disqualification order, this right too has never been enforced in Sri Lanka. This tend anyone to come to a conclusion that provisions of the Companies Act are mere directives and not mandatory and a director may comply with the requirements or not and even in the event of non-compliance, he is hardly noticed. He has easy avenues to escape even when his unfitness is brought to light. Sri Lankan experience of failed companies in the recent past is evident for this.

5. Unfit Directors Under The Law Of The United Kingdom

The contemporary law in the United Kingdom is entirely different and advanced. Company Directors Disqualification Act of 1986 (CDDA 1986 - UK) was enacted for the purpose of codifying disqualification regime. Though it is a small piece of legislation it is a comprehensive one. Number of directors who are disqualified are on the increase in the UK. In the year ended on 31st March 2011, 1437 directors were disqualified for various grounds under the CDDA 1986 - UK.[23] S.1 of the Act, headed as 'preliminary' deals with the scope of the Act in general. Under the circumstances specified in the Act a court may, make against a person a disqualification order, and thereby he shall not, without leave of the court be a director of a company, or be a liquidator/ administrator, or be a receiver/ manager of a company's property, or in any way, directly or indirectly, be concerned or take part in the promotion, formation or management of a company, for a specified period from the date of the order. The period of order may vary and the maximum period is provided under each provision that sets out the grounds for disqualification. The minimum period of disqualification being is two years.

5.1 Disqualification By Court

The court may make a disqualification order against a person under sections 2-8 of CDDA 1986 - UK. Such an order may be made where he is convicted of an indictable offence in connection with the promotion, formation, management or liquidation of a company, or with the receivership or management of a company's property.[24] This is similar to s.213 of CA 2007 -SL. The court may make a disqualification order against a person who has been persistently in default in relation to provisions of the companies legislation requiring any return, account or other document to be filed with, delivered or sent, or notice of any matter to be given, to the Registrar of Companies.[25] This is similar to s.214(1)(b) of CA 2007 -SL. The maximum period of disqualification under the above mentioned provision is 5 years. The court may make a disqualification order against a person if, in the course of the winding up of a company, it appears that he has been guilty of an offence for which he is liable under s.458 of the Companies Act (fraudulent trading), or has otherwise been guilty, while an officer or liquidator of the company or receiver or manager of its property, of any fraud in relation to the company or of any breach of his duty as such officer, liquidator, receiver or manager.[26] This is similar to s. 376 of CA 2007 – SL. However, the Sri Lankan provision provides for repayment of money misapplied, and not for any disqualification order. It is not hard for directors to pay money as it will not affect them. In most situations however a disqualification will be an attck on their reputation.

The court is empowered to make a disqualification order where a person is convicted of a summary offence in consequence of a contravention of, or failure to comply with any provision of the companies legislation requiring a return, account or other document to be filed with, or notice of any matter to be given, to the Registrar of Companies and during the 5 years ending with the date of the conviction, the person has been convicted of, in total not less than 3 default orders and offences counting for the purposes of this section.[27] Sri Lankan s.381 provides similar, but again it is a lapse as there is no provision for disqualification. A disqualification order is a deterrence to the would be ofenders and that is one of the reasons of the writer to support it.

Further, the court is empowered to make a disqualification order against a person where it is satisfied that he is or has been a director of a company which has at any time become, and that his conduct as a director of that company makes him unfit to be concerned in the management of a company.[28] This is similar to s.214(1)(d) of CA 2007 - SL. The case of *Re Sevenoaks*

[23] http://www.tcii.co.uk/wp-content/uploads/2012/03/Disqualification-of-company-directors.pdf
[24] S.2 CDDA 1986
[25] S.3 CDDA 1986
[26] S.4 CDDA 1986
[27] S.5 CDDA 1986
[28] S.6 CDDA 1986

Stationers (Retail) Ltd [29]illustrates an order under this provision. In this case Mr Cruddas was a chartered accountant and director of five insolvent companies which had debt amounting to £600,000. There were never any audited accounts of any of the five companies. He failed to keep proper accounting records and failed to ensure annual returns were filed. He did not pay crown debts (PAYE, NIC and VAT) and traded while insolvent. He only paid creditors who pressed for payment. It was held that he was unfit to be concerned with management under the CDDA 1986 section 6. In deciding how much out of the maximum of 15 years to disqualify him, he was disqualified for 5 years. This was because only serious cases where someone who was already disqualified should be given ten years and above, while six to ten years are for those who do not merit the top bracket and two to five years for not very serious cases. Dillion LJ was very clear in pronouncing, " I have no doubt at all that it is amply proved that Mr. Cruddas is unfit to be concerned in the management of a company. His trouble is not dishonesty, but incompetence or negligence in a very marked degree and that is enough to render him unfit." In *Secretary of State for Trade and Industry v Swan*,[30] a senior non-executive who was the deputy chairman of the board and chairman of the audit and remuneration committees of a company and the CEO of the company were disqualified using s.6. The trend for bringing non-executives to account for corporate failings has continued with the disqualification of a non-executive director of a listed company who failed to deal properly with serious allegations about financial irregularities and about misconduct by the company's finance director says Page and Bateman. The case also gave some guidance on the extent to which chief executives are entitled to rely on the other directors and managers of the business to do their job and the extent to which they ought to be aware of what their managers are doing. It also offered some welcome clarification of the steps that a director must take to verify the contents of a circular for which he has accepted responsibility.[31]

An application under s.6 may be made to the court by the Secretary of State if it appears to the Secretary of State that it is expedient, in the public interest, that a disqualification should be made against any such person.[32] *Re Barings plc (No 5)* [33] is said to be the best example for a case concerning directors' duties of care and skill. Unfitness was determined by the objective standard that should ordinarily be expected of people fit to be directors of companies. Directors must inform company affairs to the board and join in with other members of the board to supervise those affairs. Having no adequate system of monitoring was therefore held as a breach of this standard. Directors may delegate functions, but they nevertheless remain responsible for those functions being carried. This will apply even if the work is in a foreign land. The Secretary of State sought director disqualification orders under the CDDA 1986 against three directors of Barings for their failure to supervise his activities. They were held to be incompetent, and therefore "unfit to be concerned in the management of a company" under ss 6-8.

If it appears to the Secretary of State from a report made by inspectors under section 437 of the Companies Act, or from information or documents obtained under section 447 or 448 of that Act, that it is expedient in the public interest that a disqualification order should be made against any person who is or has been a director or shadow director of any company, he may apply to the court for such an order to be made against that person. The court 'may' make a disqualification order against a person where, on an application under this section, it is satisfied that his conduct in relation to the company makes him unfit to be concerned in the management of a company.[34] Under the CA 2007 – SL, similar procedure of requesting the Registrar of Companies to investigate company's affairs is available. In this regard the power of the Registrar of Companies in Sri Lanka based on the report of the inspector is referring the matter to the Attorney General for further action, apply to court for an appointment of a liquidator (s.177(3)) or file a petition for winding-up (s.272 proviso (c). *Re JA Chapmn & Co Ltd* [35] is a case where an application was made under s.8 following a report from the inspectors after an investigation under s. 447 of Companies Act 1985 of the UK. The court may make a disqualification order under the circumstances and the relevant provision gives discretion to court. It is to be noted that, under s.6, the court is under a obligation to make a disqualification order which is evident from the word 'shall ' used in the provision. Sealy opines that the test under both section 6 and 8 is the same and that is unfitness though there are differences between the two provisions. Sealy quotes the case of *Re Atlantic Computers PLc*[36]and states that it would be unusual for courts to use discretion. The differences between s.6 and s.8 include *inter alia* minimum disqualification period which is 2 years under s.6 while s.8 is silent as to the same.[37]

S.9 of CDDA 1986 – UK along with Schedule 1 of the Act provides for certain criteria the court must pay attention in determining unfitness of directors or shadow directors. Where the court makes a declaration under section 213 or 214 of the Insolvency Act 1986 of the UK,[38] that a person is liable to make a contribution to a company's assets, then, whether or not an

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[29] [1991] Ch 164

[30] [2005] All ER (D) 102 (Apr)

[31] Page Tom and Bateman Peter, Disqualification of non-executive director of listed company, 3 May 2005, http://www.mondaq.com/x/32301/Corporate+Crime/Disqualification+of+nonexecutive+director+of+listed+company

[32] S.7 CDDA 1986

[33] [2000] 1 BCLC 523

[34] S.8 CDDA 1986. S.447 of Companies Act 1985 is still in force and it is under PART XIV WHICH IS ON INVESTIGATION OF COMPANIES AND THEIR AFFAIRS. S. 437 PROVIDES THAT The inspectors appointed to investigate companies affairs may, and if so directed by the Secretary of State shall, make interim reports to the Secretary of State, and on the conclusion of their investigation shall make a final report to him. S.447 empowers the Secretary of State to require documents or information while s.448 provides that a person authorized by the Secretary of State may enter and search premises of a company under investigation.

[35] [2003] 2 BCLC 206

[36] Unreported, 15 June 1998

[37] Sealy LS and Sarah Worthington, Cases and Material in Company Law, p.266

[38] S.213 is on fraudulent trading while s.214 is on wrongful trading.

application for such an order is made by any person, the court may, if it thinks fit, also make a disqualification order against the person to whom the declaration relates.[39]

5.2 AUTOMATIC DISQUALIFICATION

Section 11 of CDDA 1986 – UK provides that it is an offence for a person who is an undischarged bankrupt to act as director of, or directly or indirectly to take part in or be concerned in the promotion, formation or management of a company except with the leave of court. The person will have to get the permission of court if he wishes to function as a director. For this reason this provision is considered as an automatic disqualification since this section applies without a need for a court order. S.213(1)(c) of CA 2007 - SL provides similar. In addition to bankruptcy, a person convicted or involved in fraudulent act or an adjudged unsound mind person are also falling under automatic disqualification under the Sri Lankan law.

The consequences of contravention of the CDDA 1986 – UK is rather severe. The CDDA 1986 – UK imposes civil as well as criminal sanction for both disqualifications by court order and for automatic disqualification. It is a criminal offence under s. 11(1) for an undischarged bankrupt to act as a director during a time the ban is in force. Likewise section 13 imposes criminal penalties against persons who breach disqualification order by court.

A body corporate can function as a director under the Companies Act of the UK[40] and therefore a body corporate can be subjected to a disqualification order. Where a body corporate is guilty of an offence of acting in contravention of a disqualification order, and it is proved that the offence occurred with the consent or connivance of, or was attributable to any neglect on the part of any director, manager, secretary or other similar officer of the body corporate, he is guilty of the offence.[41] This situation is not applicable to Sri Lanka since Sri Lankan law does not permit body corporate to act as directors.[42]

Section 15 CDDA goes further and imposes personal liability which is to be welcomeed. The writer is of the opinion that it is a message of retribution. A person is personally responsible for all the relevant debts of a company if at any time in contravention of a disqualification order or of section 11 of the Act he is involved in the management of the company, or is willing to act on instructions given, without the leave of the court, by a person whom he knows at that time to be the subject of a disqualification order or to be an undischarged bankrupt.

S.18 CDDA 1986 is an important provision relating to the enforcement of the orders. The Secretary of State may make regulations requiring officers of court to furnish him with particulars relating to disqualification orders made, any action taken by a court in consequence of which such an order is varied or ceases to be in force, or leave is granted by a court for a person subject to such an order to do anything which otherwise the order prohibits him from doing. It is a duty of the Secretary of State to maintain the register of orders, and of cases in which leave has been granted from the particulars so furnished. Such register shall be updated when a subsequent order is given. It adds more value by the provision that the register shall be open to inspection on payment of such fee as may be specified by the Secretary of State in regulations. Thereby the interested public may inspect the Register and obtain information relating to any orders the court has made against any director under the CDDA 1986. It is possible for anyone dealing with a company to take precautions by inspecting the register.

Enormous numbers of disqualification cases were heard and reported from the time the said Act was enacted. The provisions amplify the directors' traditional common law duties as well. The Insolvency Services handle the enforcement of the provisions. This is because most of the disqualification orders are coupled with insolvent winding-up of companies. The procedure adopted in England does not allow the directors to plead guilty. Therefore, the charges were contested and trials took place which caused delay. As a result, the CDDA 1986 was amended in 2000 to allow the Secretary of State to accept disqualification undertaking from directors that they will not handle matters that are prohibited by a disqualification order.[43] This change further enhanced the legal regime that existed. The disqualification orders were divided into 3. The third and the extreme order of 10 years or more was given for a director who already had another disqualification order. The second one of 2 to five years was for serious cases which do not merit the third category while the first is for relatively not very serious matters. In *Secretary for State for Trade and Industry v. Carr,*[44] C, a director of a quoted company settled a large amount of compensation claim by one F against the company for US$ 18 million. He concealed the company's real financial position from its creditors, shareholders and possible investors. They were not isolated acts, in the opinion of the court, instead it amounted to a sustained attempt over a long period to conceal and misrepresent the true position. He involved in concealing information which C knew should be disclosed to the board. This deliberate dishonest conduct on the part of C in the performance of his duties as a director of a listed company warranted a disqualification order for 9 1/2 years.

The decision of *Re Landhurst Leasing Plc*[45] is a lesson for those who leave the work for the others to do. The company involved in this case was engaged in the business of lease financing. Two of the company directors (B and A), were sentenced to imprisonment for committing the offences of corruption and dishonesty after the sudden collapse. The Secretary for State filed a

[39] S.9 CDDA 1986
[40] The position is same under both 1985 and 2006 Acts. See s. 155 of CA 2006 - UK
[41] S.14 CDDA 1986
[42] S. 202 (2) (f) CA 2007 - SL
[43] It was by the Insolvency Act 2000 and the Insolvency Act 2000 (Company Directors Disqualification Undertakings) Order 2004.
[44] [2006] EWHA 2110
[45] [1999] 1 BCLC 286

case later against three other employees/directors who played minor role and joined the company at a later stage. Even after the appointment of these three new directors, B and A continued to control the business and affairs. It was held that the three new employee/directors could not accept office as directors without assuming corresponding responsibilities. They cannot possibly argue that they should not be held liable in the event of leaving the others in the board to handle and the board as a whole had to accept responsibity. Two out of the three directors were disqualified.

The courts have been considering various factors in imposing disqualification orders. In *Secretary for State for Trade and Industry v. Reynard*[46] a director's conduct during the disqualification proceedings were taken into consideration for sentencing purposes. Similarly, in *Ghassemlan v. Secretary for State for Trade and Industry*[47] it was held that a director's lack of co-operation with the Secretary for State constituted a ground for unfitness for being a director. This makes us to accept that attitude is part of the duty.

However, one should not consider that the Secretary for State for Trade and Industry to be harsh when it comes to disqualification orders. In *Secretary for State for Trade and Industry v. Jonkler*[48] the Secretary of State released, on the basis of public interest, a former director who has previously agreed for a disqualification undertaking. *Official Receiver v. Jupe*[49][2011], are some of the recent examples for the development of law in the area of disqualifications.

6. Certain Remarkable Aspects From The Companies Act 2013 Of India

The Companies Act 2013 of India has detail novel provisions relating to appointment, qualifications and disqualifications of directors including independent directors. India too experienced sudden collapse of companies and the new provisions must be learning from the history. The Central Government of India allocates a Director Identification Number on applications made and no person shall be appointed as a director of a company unless he has been allotted the Director Identification Number.[50]This allows the government to keep a record of all those who may hold the position of director. S.164 is on directors disqualification. It contains many detailed grounds for disqualification than the UK and Sri Lankan law. For example, no person who is or has been a director of a company which has not filed financial statements or annual returns for any continuous period of three financial years; or has failed to repay the deposits accepted by it or pay interest thereon or to redeem any debentures on the due date or pay interest due thereon or pay any dividend declared and such failure to pay or redeem continues for one year or more. In addition, the Indian law limits the number of companies in which a person can hold the position of director. S.165 provides that no person, after the commencement of this Act, shall hold office as a director, including any alternate directorship, in more than twenty companies at the same time, provided that the maximum number of public companies in which a person can be appointed as a director shall not exceed ten. Sections 152, 164 and 165 may be lessons for Sri Lanka.

7. Conclusion

Incompetent individuals accept positions as directors for financial benefit and are never concerned about compliance since they are aware that they will not be trapped. It is necessary therefore, in the interest of stakeholders, that errant directors are punished by way of disqualification orders. Disqualification regime focuses on individual directors who are found to be unfit and not collectively on the board. It is a correct approach since 'board' is not a legal person and the acts are done by individuals. Unfit directors who deserve punishment are misusing the golden concept of limited liability to evade. It is also in the public interest because the directors are custodians of company funds. The courts have not made a disqualification order in case concerning the collapsa of companies. Reforms to the Companies Act of Sri Lanka is necessary in order to bring about a more effective mechanism relating to directors' disqualifications. Public awareness programmes have to be carried out to educate the stakeholders. A meaningful mechanism may be possible through the Securities and Exchange Commission which reviews the Annual Reports of all public quoted companies, although it is not a statutory duty. The courts have wide discretion under the CDDA 1986 - UK and the terminologies such as 'unfitness', 'commercial immorality' etc were interpreted. The Disqualified Director Database maintained by the Insolvency Services of the UK also may be followed in Sri Lanka.Provisions of CDDA 1986 – UK and sections 152, 164 and 165 of Companies Act 2013 of India may be lessons for Sri Lanka.

46 [2002] EWCA Civ 497
47 [2006] EWHC 1715
48 [2006] EWHC 135
49 [2011] 1 BCLC 191
50 S.152