

A Guide on Directors' Duties



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A blue-tinted photograph of a group of people in a modern office setting, looking out a large window at a city skyline. The image is used as a background for the title.

■ A Guide on Directors' Duties



■ Introduction ■

In general the responsibilities and liabilities of directors derive from various sources, including the constitution of the company, case law and statute law. If a person does not comply with his duties as a director he may be liable to civil or criminal proceedings and may be disqualified from acting as a director.

Although case law sets out and elaborates on most of these significant principles, it tends to be complex and inaccessible. The objective of this Guide is to outline the general principles for a director in the performance of his functions and exercise of his powers.

All directors are advised to read this Guide and acquaint themselves with the general duties of directors outlined in the Guide. Companies should give copies of the Guide to their directors for information and reference. This Guide is readily accessible on the websites of the Companies Registry (www.cr.gov.hk), the Hong Kong Exchanges and Clearing Limited (www.hkex.com.hk), the Securities and Futures Commission (www.sfc.hk), the Official Receiver's Office (www.oro.gov.hk) and the Hong Kong Monetary Authority (www.hkma.gov.hk). Hard copies are also available at their offices.

In addition, directors are also encouraged to refer to more detailed reviews of the role and duties of directors in law. For example, the Hong Kong Institute of Directors (www.hkiod.com) has issued the Guidelines for Directors and the Guide for Independent Non-Executive Directors. Directors should also refer to the Corporate Governance

Code issued by the Hong Kong Exchanges and Clearing Limited (www.hkex.com.hk) to improve the manner in which listed companies are managed.

It is important to note that all the general principles of directors' duties in this Guide are of equal importance. The statements are principles only and are **not** intended to be exhaustive statements of the law. Furthermore, statute or case law could require certain forms of conduct under specified circumstances. If directors are at all in doubt about the nature of their responsibilities and obligations, they should seek legal advice.


■ The general principles of directors' duties ■

Principle 1: Duty to act in good faith for the benefit of the company as a whole

A director of a company must act in good faith in the best interests of the company. This means that a director owes a duty to act in the interests of all its shareholders, present and future. In carrying out this duty, a director must (as far as practicable) have regard to the need to achieve outcomes that are fair as between its members.

Principle 2: Duty to use powers for a proper purpose for the benefit of members as a whole

A director of a company must exercise his powers for a "proper purpose". This means that he must not exercise his powers for purposes that are different from purposes for which they were conferred. The primary and substantial purpose of the exercise of a director's powers must be for the benefit of the company. If the

A close-up photograph of a hand moving a light-colored chess piece (a pawn) on a chessboard. The board has alternating light and dark squares. Other chess pieces are visible in the background, slightly out of focus.

primary motive is found to be for some other reasons (e.g. to benefit one or more directors and to gain control of the company), then the effects of his exercise of his power may be set aside. This duty can be breached even if he has acted in good faith.

Principle 3: *Duty not to delegate powers except with proper authorisation and duty to exercise independent judgement*

Except where authorised to do so by the company's articles of association (the "constitution") or any resolution, a director of a company must not delegate any of his powers. He must exercise independent judgement in relation to any exercise of his powers.

Principle 4: *Duty to exercise care, skill and diligence*

Section 465 of the Companies Ordinance (Cap. 622) provides that a director of a company must exercise reasonable care, skill and diligence. This means the care, skill and diligence that would be exercised by a reasonably diligent person with —

- (i) 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
- (ii) the general knowledge, skill and experience that the director has.

Principle 5: *Duty to avoid conflicts between personal interests and interests of the company*

A director of a company must not allow personal interests to conflict with the interests of the company.

Principle 6: *Duty not to enter into transactions in which the directors have an interest except in compliance with the requirements of the law*

A director of a company has certain duties where he has a material interest in any transaction to which the company is, or may be, a party. Until he has complied with these duties, he must not, in the performance of his functions as a director, authorise, procure or permit the company to enter into a transaction. Furthermore, he must not enter into a transaction with the company, unless he has complied with the requirements of the law.

The law requires a director to disclose the nature and extent of his interest in respect of such transactions. Under certain circumstances the constitution may



prescribe procedures to secure the approval of directors or members in respect of proposed transactions. A director must disclose the relevant interest to the extent required. Where applicable, he must secure the requisite approval of other directors or members.

Principle 7: *Duty not to gain advantage from use of position as a director*

A director of a company must not use his position as a director to gain (directly or indirectly) an advantage for himself, or someone else, or which causes detriment to the company.

Principle 8: *Duty not to make unauthorised use of company's property or information*

A director of a company must not use the company's property or information, or any opportunity that presents itself to the company, of which he becomes aware as a director of the company. This is except where the use or benefit has been disclosed to the company in general meeting and the company has consented to it.

Principle 9: *Duty not to accept personal benefit from third parties conferred because of position as a director*

A director or former director of a company must not accept any benefit from a third party, which is conferred because of the powers he has as director or by way of reward for any exercise of his powers as a director. This is unless the company itself confers the benefit, or the company has consented to it by ordinary resolution, or where the benefit is necessarily incidental to the proper performance of any of his functions as director.

Principle 10: *Duty to observe the company's constitution and resolutions*

A director of a company must act in accordance with the company's constitution. He must also comply with resolutions that are made in accordance with the company's constitution.

Principle 11: *Duty to keep accounting records*

A director of a company must take all reasonable steps to secure that the company keeps accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy the company's financial position and financial performance. To avoid breaching the fraudulent trading provisions in section 275 of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32), a director must not allow the company to incur further credit knowing that there is no reasonable prospect of avoiding insolvency.

Companies Registry
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