Corporate Responsibilities of Company Executives

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This article explores the notion of corporate governance and outlines the legal rules applicable to directors' duties in the governance of the 21st century company.

Many a philosopher, scholar and legal analyst has posed the question on whether entities, being corporate or otherwise, should be driven by self regulation or by strict rules and regulations. The same question has often been posed in matters related to the very basic rules of governance of corporations.

By way of definition, corporate governance is the set of internal and regulatory laws and regulations, processes, customs and policies affecting the way a corporation is directed, administered or controlled. The Cadbury Committee in the UK on the Financial Aspects of Corporate Governance in December 1992 defined the term as "the system by which companies are directed and controlled".
There are various principal actors on the corporate governance stage including shareholders, management and the board of directors. Other stakeholders include employees, suppliers, customers, banks and other lenders, regulators, the environment and the community at large.

After expounding on the larger notions of corporate governance in general, this article will then focus on the role of one of the main actors in the corporate arena – the director.
The question begs... "What is the *raison d'être* behind the institute of corporate governance and why has it taken such a prime role in today's business era?" Indeed, corporate governance, the unwieldy name given to the systems which guide the control and management of corporations, is a relatively recent term that came into being in the 1970s. However, in the last decade or so, it has positioned itself more and more in the centre of the corporate boardroom.
Since the late 1970's, there has been a drive of bold, broad efforts to reform corporate governance, partly due to the drive of shareowners to exercise their possession rights and to augment the value of their shares and, hence, wealth. Over the past three decades, indeed corporate directors' duties have expanded greatly beyond the traditional legal responsibility of duty of loyalty to the corporation and to its shareowners.

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- *Corporate directors' duties have expanded greatly beyond the traditional legal responsibility of duty of loyalty to the corporation and to its shareowners.*
- *It is very interesting to note that the Maltese Company's Act does not provide for the directors to act in the best interests of the shareholders but of the company itself, thereby stressing the separate legal personality of the shareholders from the company per se.*
- *The Court is evidently actively analysing both the provision of wrongful trading, as well as the notion of fraudulent trading.*

THE DIRECTOR

A company's corporate governance—whether good or bad—is established by its board of directors (BOD). The duty of the board is to

safeguard the company's wellbeing. Ideally, in some situations, the BOD should not consist of company employees who work under the Chief Executive Officer's (CEO) direction. This is because the BOD's role is the hiring and supervision of the company's CEO and other top-officers of the company such as the Chief Financial Officer (CFO), Chief Marketing Officer (CMO) and the Chief Technical Officer (CTO). Hence, the BOD should be independent of the company's management. When independent directors know how to work effectively with the company's senior management team, they are likely to produce a corporate climate which accelerates the growth of long-term shareholder value.

The Maltese Company's Act (CA) spells out clearly that the duty of the BOD is to act honestly and in good faith in the best interests of the company. It is very interesting to note that the law does not provide for the directors to act in the best interests of the shareholders but of the company itself, thereby stressing the separate legal personality of the shareholders from the company per se. However it is the directors' main responsibility to promote the success of the company by directing and supervising the company's affairs and management, hence enhancing shareholders' value.

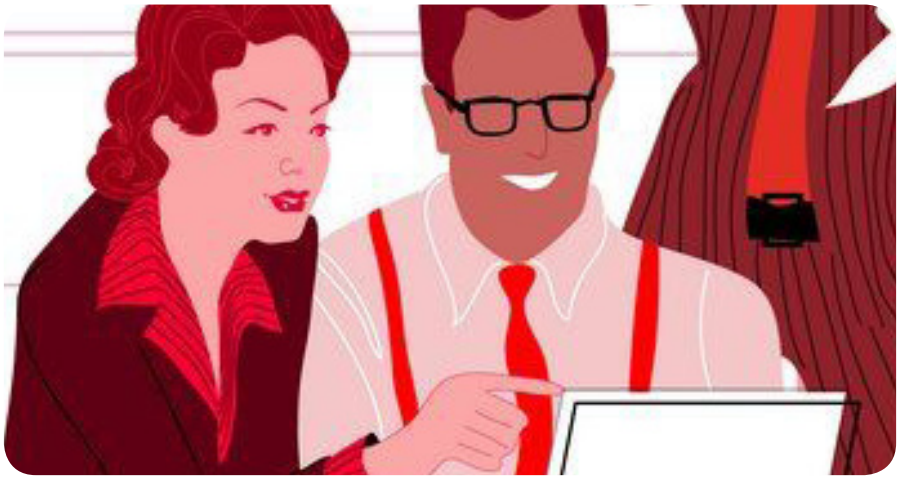
The same principle is outlined in The Corporate Governance Guidelines for Public Interest Companies (the Guidelines) issued by the Malta Financial Services Authority (MFSA) These guidelines emphasise the importance of the board of directors being composed of persons who are fit and proper to direct the business of the company. Indeed the Guidelines explain that the concept of fit and proper requires directors to be honest, competent and solvent persons.

The MFSA Guidelines also present a number of obligatory clauses, such as having a separate chairman and CEO, non-executive directors on the board and a remuneration committee. The guidelines also stipulate an annual review of the board's performance.

THE NOTION OF WRONGFUL TRADING

The CA scrutinises the role of a director in a situation where the company has been dissolved and is in a state of insolvency. It regulates a director's failure to take every step to minimise potential loss to creditors when the said director knew, or ought to have known prior to the dissolution of the company that there was no reasonable prospect that the company would avoid being dissolved due to its insolvency, a situation referred to as "wrongful trading". In such case the court, on the application by the company's liquidator, may declare the director liable to contribute towards the company's assets as the court thinks fit.

The law lays down that the facts which a director of a company ought to know or ascertain, the conclusions which s/he ought to reach, the steps which ought to be taken, are those which would be known, ascertained, reached or taken, by a reasonably diligent person having both: -



(a) the knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as are carried out by or entrusted to that director in relation to the company; and

(b) the specific knowledge, skill and experience that the director has.

The law also catches 'shadow directors', that is persons in accordance with whose directions or instructions the directors of the company are accustomed to act. The law therefore lays down a two-fold test: -

(a) the Objective Test
under which the director is judged according to what a reasonable director should have done in the same situation, and

(b) the Subjective Test
under which the actual knowledge, skill and experience of that particular director is taken into account. If the director is particularly qualified, then the Court will take his qualifications into account and the director will be held liable for a higher degree of responsibility.

The law further provides for joint and several personal liability of the directors in damages for any breach of duty. By way of exception to this general rule of joint and several liability, a director shall not be liable for the acts of his co-directors if s/he proves either that s/he did not know of the breach of duty before or at the time of its occurrence and that on becoming aware of it after its occurrence s/he signified forthwith to the co-directors his dissent in writing; or that, knowing that the co-directors intended to commit a breach of duty, s/he took all reasonable steps to prevent it.

It would be most prudent for all directors to take heed of the above, particularly when bearing in mind the fact that the Maltese Courts have recently given landmark judgements on Corporate Responsibility pertaining to personal liability of Directors.
The Court is evidently actively analysing both the provision of wrongful trading, as well as the notion of fraudulent trading.

CONCLUSION

During the past decades, companies have progressively enjoyed increasing freedom of business activity, creating new opportunities for entrepreneurs using the corporate form. However, this newfound freedom carries with it increased responsibilities, and the reactions of the various schools of thought to this have ranged from a move in favour of increased legal regulation, to a drive in the direction of self-regulation.

Enterprises must show respect for their shareholders as well as for other stakeholders, including creditors and indeed society as a whole. The manner in which company directors promote and control their company's operations, that is, the way in which they put into effect their stewardship, is not just a matter of interest to their shareholders, but is moreover a matter of public interest. Mutual trust between the community and the business society is the key to improved competitiveness. Many a code of conduct has been promulgated by different regulatory bodies. The aim of most of these guidelines has generally been the advancement of best practices, making it easier for directors and managers to fulfil their duties and assisting them in advancing the growth and development of their companies; ensuring public confidence in enterprises and business activities in general; and strengthening trust between investors, directors and managers.

At the end of the day, healthy corporate governance levels are instrumental in securing a stronger economy based on a mature corporate business environment which is ripe for the internal and foreign direct investment opportunities that Malta has to offer.

References:

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[2] *Crawford, Curtis J. (2007). The Reform of Corporate Governance: Major Trends in the U.S. Corporate Boardroom, 1977-1997 (Capella University)*

[3] *Article 136, Companies Act, Chapter 386 of the Laws of Malta*

[4] *MFSA, The Corporate Governance Guidelines for Public Interest Companies*

[5] *Article 316 , Companies Act, Chapter 386 of the Laws of Malta*

[6] *Article 147 ibid*

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