

# Duties and potential liabilities of nominee directors and their appointors

**N**ominee directors are common in Malaysia. Section 217 of the Companies Act 2016 (CA 2016) expressly lays down that a nominee director is one who is appointed to the company by virtue of being an employee of the nominator, or as a representative of a member, employer or debenture holder, and he has a mandatory duty to act in the best interests of the company.

Implicit in the above is the legislative recognition that the nominee may be caught in a situation of dual loyalties, that is, to his nominator and also being a director of the company in which he now holds office.

When the Companies Commission of Malaysia (SSM) was framing this provision in the late 1990s, I remember being shown a draft, which read "... and in the event of any conflict between his duty to act in the best interest of the company and his duty to his nominator, he shall owe an exclusive duty to act in the best interest of the company to that to this nominator". Feedback to the SSM that this will be inimical to Permodalan Nasional Bhd, the Employees Provident Fund and Khazanah Nasional resulted in the current language that a nominee director shall not subordinate his duty to act in the best interests of the company to that of his nominator in the event of any conflict. S.217(2) provides penalties to the effect that if a director is convicted of the offence of contravening this proviso, he will be liable to imprisonment for a term not exceeding five years and/or a fine not exceeding RM3 million.



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BY PHILIP T N KOH

It is critical for a nominee director to be aware that his primary duty is to the company and not to his nominator. In a case in the UK, nominee directors gave complete precedence to the interests of their appointor. The holding appointor body adopted a policy of transferring the whole of the company's business to a new department within the group. The nominee directors assisted in this decision without any consideration for the interests of the company and the minority members. The court held that it was wrong to believe that as nominees, their duty is owed wholly to the appointor (*Scottish Co-operative Wholesale Society Ltd v Meyer* [1959]). In Malaysia there was a case in which James Foong J (as he then was) observed that nominee directors who took decisions merely at the behest of directions of their appointors are in breach of their duty to the company (*Industrial Concrete Products Bhd v Concrete Engineering Products Bhd* [2001]). The learned Justice found as a fact that Mr C, a nominee director of a group that embarked on a reverse takeover of the company "proceeded to run the entire company as if he owned it with total disregard for the board and all the other shareholders, except for the group he represented". Justice Foong tersely observed, "This is certainly in conflict with his duty to the company."

First of all, once a nominee director takes office, all the concomitant duties of care and skill and fiduciary duties of no-conflict are imposed upon the holder of the office.

In Australia, there is a rich vein of cases where

the reality of the dual loyalties of a nominee is recognised so that in decision-making, a nominee is not precluded from taking into consideration the interests of his appointor subject to such decision being not in conflict with that of the company. The nominee must hold a bona fide belief and may participate in board deliberations provided the belief is made in good faith. No director can be expected to approach the discharge of his duties in a vacuum free of concern for other interests.

Where there is actual conflict, the nominee directors must take steps to recuse themselves. In some instances, where harm is objectively clear, it would require them to even resign. However, in the case of an employee nominee director, this would be practically impossible. He or she should take steps to ensure that both sets of principals have their interests adequately taken care of.

There is some debate about whether one should excuse oneself from all deliberations. I think the rule has been made too absolute, although in the *1Malaysia Development Bhd-SRC International Sdn Bhd (1MDB-SRC)* case, there were public service protocols that require recusal and there is an argument that a company has the right to receive the advice of every director. So, for example, a nominee wearing the hat of an appointed director can give his views, drawing from his own skill and knowledge, and then recuse himself so that deliberations and decision-making can be made in an atmosphere where it can be construed as independent. The appointor-principal is of course not precluded from expressing a different view at a general meeting in the casting of the vote

for or against the resolution that may be recommended by the board to the general meeting.

Nominee directors in a group are also faced with a conundrum when they have to make a decision about whether they can take into consideration the group's interests. For example, if there is insolvency in one of the entities in a group, can a decision be made for financial restructuring to rescue that entity that involves an outlay from the company in which the nominee sits? There is a UK authority, also approved in Singapore/Malaysia, that the law permits directors to take along the group interest so long as an intelligent and honest man in the position of the director could reasonably believe that the transaction was for benefit of the subsidiary (*Charterbridge Corp Ltd v Lloyds Bank Ltd* [1969] 2 All ER 1185). However, when a company is in financial distress, directors need to be extra vigilant that their decisions are not mala fide or constitute unlawful trading or movement of assets to the insolvent entity which may be subject to challenge.

A nominee director must also take special care in the handling of price-sensitive information or knowledge and use of corporate opportu-

nity. He cannot pass price-sensitive information to the appointor if the information is not yet in the public domain. If financial information is such that it will influence share prices, he cannot pass the same to that part of his appointor organisation which makes decisions on trading of shares. Whether Chinese walls are in place at the appointor is a question of law and fact and questions can be raised as to their adequacy in protecting against allegations of insider trading.

As for the appointor's liability, there can be situations where the appointor may be held to be a shadow director. For example in the 1MDB-SRC case, the Court of Appeal (which was not overruled by the Federal Court) held the appellant (the former prime minister and minister of finance) to be a shadow director of 1MDB. Both the SRC constitution and the evidence demonstrated that the then minister of finance/PM and Advisor Emeritus (under the SRC constitution) gave instructions and directions to the 1MDB board and the de jure directors were accustomed to following them. So it is important that the appointor company desists in giving directions in such a manner that the majority of the company board becomes accustomed to act in accord-

ance to such directions or instructions if it is not to be found responsible to be a shadow director. The issue whether the appointor can be held vicariously liable for the torts (civil wrongs) of a nominee, where the nominee is an employee of the appointor, has received differing rulings in the common law. If there is evidence that the appointor has directed the act, the appointor could well be held to be a joint tortfeasor. In one Australian case, the court held that a director installed as such on the board of another company by his or her employer is in general presumed not to be subject to the employer's direction when performing functions as a director, so that no vicarious liability attaches to the employee's conduct in that capacity (*LM I Pty v Baudlerstone Pty Ltd* [2001] NSWSC 886).

A nominee director wears two hats and it is important that when he decides on transactions, he does so keeping in mind this fact so that he will not lose his head in the process. ■

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