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Nominee Directors Face Difficult Balancing Act

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It is a truism that a director is required to act in the company's best interests, but a shareholder need only look after his own.

For the nominee director, this raises a troubling conundrum. After all, he is appointed to the board by specific shareholder(s) – usually a parent company, a major shareholder, or joint venture or institutional investor – with the aim of safeguarding their interests. Yet, he must nevertheless ensure that he is acting in the best interests of the company, no different from any other director of the company.

Despite the potential conflict of interest, the law has long accepted the existence of the nominee director. The challenge lies in how a nominee director, his appointer and the company that he serves as director address these conflicts.

NOMINEE DIRECTORS

Notwithstanding the nature of his appointment, a nominee director owes the company the same fiduciary duties as any other director. He must act in the collective interests of all the company's shareholders.

This does not mean he is not entitled to take into account his appointer's interests - indeed, he may do so as long as those interests do not conflict with the company's. When an actual conflict arises, he must, as a matter of law, prefer the interests of the company. If a situation arises in which there is a question about whether he can apply an independent mind to the issue at hand, he should abstain from making any decision about it.

Where a director represents the interests of the holding company on the board of a wholly owned subsidiary, there will normally be a considerable coincidence of interests. In fact, the constitution of the subsidiary may expressly allow the director to take into account the interests of the holding company, save in the situation where the subsidiary is insolvent or will become insolvent because of the director's acts.

The Companies Act goes further. It allows a nominee director to disclose the company's information to his appointer if he is authorised by the board to do so. However, he has to ensure that such disclosure is not likely to prejudice the company. The disclosure may be in respect of all or any class of information, or only such information as may be specified in the authorisation.

If the company is listed on the SGX, a nominee director has to consider whether any disclosure is in breach of the SGX Listing Rules which prohibit selective disclosure of "material information".

The extent to which a nominee director may "serve two masters", as it were, depends on the circumstances of each company or transaction.

For that reason, there are advantages to spelling out his mandate – to the extent that it is relevant to his role as a nominee director – in a written instrument and disclosing the terms of his appointment to the board. This would help to identify and define what the company and the nominee director regard as being in the best interests of the company.

A formal instrument will also provide guidance about the extent to which the nominee director may share the company's information with his appointer, and whether he is allowed to seek independent legal advice in carrying out his duties, particularly when there is an actual conflict of interests, and who bears the legal costs of that advice.

In view of the invidious position that a nominee director may face, a nominee director may consider asking the appointer to provide additional directors and officers liability insurance coverage for him.

COMPANIES WITH NOMINEE DIRECTORS

A company that has nominee directors should have a policy that articulates its expectations with regard to their conduct.

Matters that should be addressed include the scope and extent of the company's information that may be disclosed by the nominee director to his appointer, requiring the disclosure of any potential conflict of interests between the company and the appointer, and the procedures to be taken when an actual conflict of interests arises.

APPOINTERS

Appointers should also be clear on the arrangements for how it wishes the nominee director to function and their own risk of exerting too much control over such a director.

The Companies Act imposes directors' duties and responsibilities on a de facto director, namely a person who is not formally appointed as a director, but, in fact, acts as a director by exercising the same powers of, and discharging the same functions as, a director.

An appointer who exercises too much control over a nominee director may be imputed with the status of a director himself if a majority of the directors are found to be accustomed to act in accordance with his instructions or directions.

In summary, the uncertainties and tensions surrounding the issue of when a nominee director can duly advance the interests of his appointer without being seen to be undermining the interests of the company may be avoided by establishing certain guiding principles as to the conduct of the nominee director at the time of his appointment.

At the same time, the nominee director should also disclose the mandate between him and his appointer. Such best practices will help all parties to be cognisant of their respective expectations. ■