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1. **Assessing the Impact of Microcredit Programs on Participant's Entrepreneurial Behavior: A Conceptual Framework** 1
Zuraidah Mohamed Isa
Roslan Abdul Hakim
Russayani Ismail

2. **Writing Strategies Used by Malaysian ESL Undergraduates** 15
Lee Lai Fong
Teoh Sian Hoon
Geethanjali Narayanan
Gurnam Kaur Sidhu
Chan Yuen Fook

3. **Institutional Support for Postgraduate Study in Malaysia** 31
Gurnam Kaur Sidhu
Sarjit Kaur
Lim Peck Choo
Chan Yuen Fook
Lee Lai Fong
Leele Susana Jamian

4. **The Effect of Visual Display Unit (VDU) Near Task Under Two Different Surrounding Lightings on Accommodation Facility** 45
Azmir Ahmad
Ai-Hong Chen
Abd Rahim Ahmad

5. **Exploring Women's Work Decision in Malaysia** 53
Peck-Leong Tan
Ruzita Baah
Geetha Subramaniam
Hadijah Iberahim

6. **Enforcement of Foreign Judgment in E-Commerce Consumer Contracts in Malaysia: Issues and Challenges** 67
Shazanah Sarwar Khan
Sheela Jayabalan

7. **The Effect of Listening to Binaural Beats on Frontal EEG Alpha and Beta of Males and Females** 77
Norhazman H.
Mohamad Zaini N.
Tain M. N.
Kama Azura Othman
Jailani R.
Omar H. A.

8. **Corporate Governance: Nominee Director the Gatekeeper** 93
Yang Chik Adam

CORPORATE GOVERNANCE: NOMINEE DIRECTOR THE GATEKEEPER

Yang Chik Adam

Faculty of Law, Universiti Teknologi MARA,
40450 Shah Alam, Selangor, Malaysia
E-mail: yangchik_adam@yahoo.com; yangchik@salam.uitm.edu.my

ABSTRACT

The term corporate governance has been defined in the broad sense and is also referred to as the process through which shareholders induce management to act in their interest. A nominee director is usually appointed by the nominators to sit on the board of directors of a company to represent their interests. These nominators are usually the major shareholders or a class of shareholders or the creditors. Nominee directors are commonly found in companies such as in corporate groups, joint ventures and government-linked companies. It is a trite law that the board of directors act in the best interest of the company. A nominee director, in discharging his or her duties to the company will face the dual loyalty. Firstly, is his or her loyalty to the nominators who have nominated him or her to represent their interest in the company. Secondly, is the nominee director's duty to the company. Hence, the nominee director is in a delicate position in discharging his or her duty. Section 132(1E) of the Malaysian Companies Act 1965, stipulates the position of the nominee director under the strict approach that is to act in the best interest of the company and shall not subordinate the interest of the company to his or her nominators. Malaysian corporate ownership is in the concentrated category and the position of nominee directors is common. Companies in Malaysia are required to adhere to the Malaysian Code on Corporate Governance 2012. This paper aims to provide clearly the position of the nominee director as the gatekeeper and will assist the corporate regulators to improve and promote good corporate governance practice in the Malaysian corporate landscape.

Keywords: *Corporate Governance, Nominee Directors, Gatekeeper, Conflict of Interests.*

INTRODUCTION

A nominee director is usually appointed to the board of directors of a company to represent the interests of a specific group or class of persons such as a class of shareholders, a major creditor to the company or an employee group. In *Levin v Clark*, Jacobs J. noted that:

> *It is not uncommon for a director to be appointed to a board of directors in order to represent an interest outside the company: a mortgagee or other trader or a particular shareholder.*
> *It may be in the interests of the company that there be upon its board of directors one who will represent these other interests and who will be acting solely in the interests of such a party and who may in that way be properly regarded as acting in the interests of the company as a whole [1].*

It is common for the class of shareholders, debenture holders or a major creditor to have authority in the company by way of either an express provision in the company's Articles or in a supplementary agreement such as a shareholders' agreement, to appoint or remove a director. In a corporate group structure, it is common for the parent company to appoint nominee directors for its subsidiary companies.

The definition of corporate governance under the Malaysian Code on Corporate Governance 2012 [2] provides that:

> *The process and structure used to direct and manage the business and affairs of the company towards enhancing business prosperity and corporate accountability with the ultimate objective of realising long-term shareholder value, whilst taking into account the interests of other stakeholders.*

Section 132(1E) Malaysian Companies Act (CA) 1965 was the result of the Companies Amendment Act 2007 which codified the 'Responsibility of the nominee director' [3]. This further affirmed that the board of directors, especially the nominee director of a company is also in the position as a gatekeeper. This is because in the corporate context, directors and officers of a company are in a fiduciary relationship to the company.

Coffee Jr [4] is of the view that a gatekeeper within the corporate context means an independent professional who plays one of two distinct roles which tend to overlap in practice. Firstly, the gatekeeper may be a professional who is positioned so as to be able to prevent wrongdoing by withholding necessary cooperation or consent. For example, an investment banking firm can refuse to underwrite the issuer's securities if it finds that the issuer's disclosures are materially deficient, Secondly and the superior definition of a gatekeeper is an agent who acts as a reputational intermediary to assure investors as to the quality of the 'signal' sent by the corporate issuer.

In certain circumstances, nominee directors face difficulties when a conflict of interest and duty arises between the company on whose board they sit and the person who appointed them to the board. They are also subject to the duty not to fetter discretion. Thus, it can be seen that the nominee directors would be in a dilemma. In some common law jurisdictions, the nominee directors are relieved of the full force of the common law obligations when they are representing the interests of their appointor.

However, a relaxation of the nominee director's duties is accompanied by identification of the conditions that must be fulfilled before such relaxation takes effect, together with legal liability imposed on the nominator.

WHO IS A NOMINEE DIRECTOR?

The term nominee director is often used to describe a person who has been appointed as a director to represent the interests of a particular group of shareholders or class of shareholders. Under other circumstances, the appointment of the nominee director is to represent the interests of a group of employees, a lender or debenture holder or a participant in a corporate joint venture.

The phrase 'nominee director' has no legal definition.The term 'nominee director' is accepted as referring to individuals who are 'independent of the method of their appointment, in the performance of their office, act in accordance with some understanding, arrangement or status which gives rise to an obligation to the appointor' [5].

A nominee director is at law, a de jure director [6]. Keay [7] states that companies might have nominee directors, who are de jure directors owing their appointment due to some third person, often a member or members of the company who hold a strong position in relation to company affairs. This arrangement must be permitted by the articles of association. Ahern [8] opined that a nominee director is simply a species of the de jure director. However, a nominee director differs from a "normal" director in the sense that nominee directors were appointed at the behest of a third party rather than the company they serve. These directors may also be appointed by those holding a significant share interest in the company who had been given a contractual right [9], an expectation [10] or a right conferred by the company's articles [11] to appoint a director to the board [12].

As of 15 August, 2007, the Companies Act (Amendment) 2007, came into force and introduced the statutory provision on the duties and liabilities of company directors. Inter alia, by virtue of s.132 (IE), provides the responsibilities of a nominee director [13].

> *A director, who was appointed by virtue of his position as an employee of a company, or who was appointed by or as a representative of a shareholder, employer or debenture holder, shall act in the best interest of the company 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 not subordinate his duty to act in the best interest of the company to his duty to his nominator.*

Section 132(1E) CA 1965 demonstrates the 'special' status of nominee directors being recognised in the corporate board of directors and still treats the nominee director's liability similar to that of other directors.

THE CHALLENGES FACED BY NOMINEE DIRECTORS

In discharging the duty as nominee diectors, the dual loyalty owed by the nominee directors which was an issue peculiar to their fiduciary duties to the company as well as to their nominators. Austin [14] observed that 'some of the problems about nominee directorships are theoretical legal problems about the nature of fiduciary duties. In particular, can a director

accept a duty of loyalty to a nominator bearing in mind his or her duty to act in good faith for the benefit of the company as a whole? When an actual conflict arises between the director's duty to the nominator and the duty to the company, is the director ever free to prefer the former to the latter?' Such questions seem important because they imply tension between legal principle and commercial reality.

Ford *et. al.* [15] stated that there is a longstanding debate about the fiduciary duties of 'nominee' directors. These learned corporate law authors raised the issue, "when a director is appointed to the board to serve the interests of an identified appointor, is the director entitled to act as nominee of the appointor in disregard of his or her fiduciary duties as a director?"[16]. They explained that the answer to this question depends on a close analysis of the arrangements between the director, the appointor and the company.

Rachagan *et. al.* [17] described these challenges in reconciling the nominee's duty to the appointor with the corresponding fiduciary duty to act bona fide in the interests of the company as difficult. Aptly described by Lipton *et. al.* [18], the fiduciary and statutory duty to act good in the interests of the company as a whole requires directors to act in the best interests of the shareholders as a collective group. However, difficulties arise in situations where a nominee director is appointed to represent the interests of particular persons. In such cases, there may be problems reconciling the nominee's duty to act in the interests of those who appointed him or her and the duty to act in the interests of the company as a whole. In view of the rather serious consequences of breach of fiduciary duties, nominee directors are in an unenviable predicament when the time comes to make decisions and to choose a course of action [19].

CONCLUSION: NOMINEE DIRECTOR AS THE GATEKEEPER

Crutchfield identified that case law has adopted a strict view of nominee directors. The strict view was laid down in the English decisions [20] and adopted by Street J (as he then was) in Bennetts [21] is that once directors take their positions on the board they must act only in the interests of the company as a whole considering the interests of the members as a collective group in preference always to the wishes of their appointors.

Crutchfield [22] illustrates that the strict approach as irreconcilable with commercial reality, given that it is both unrealistic and unreasonable not to acknowledge that a nominee director shall always govern with his appointor's interests at heart whether or not his appointor's interests coincide with the best interests of the company. Crutchfield [23] further states that if this is the law, it imposes a standard which makes the position of nominee directors impossible. It ignores the commercial reality of the appointment of the nominee directors and the reality that in making their decisions they will often have regard to the interest and act upon the wishes of their appointors. Crutchfield further contend that the strict approach apart from lacking commercial realism, such a blanket prohibition also amounts to a lack of faith in equity's ability to apply its principles flexibly to the facts of a particular case [24].

He further stated that there are also cases that have allowed regard to be had in the interest of the appointor provided that this is in the best interests of the company. This view was derived from the case of Re: Broadcasting Station 2GB Ltd (1965). [25] Under this view the nominee directors are allowed to have regard to the interests of the appointor provided that in so doing the nominee director has an honest and reasonable belief that he or she is also acting in the best interest of the company.

Crutchfield also identified the test, that is, provided the director has a bona fide belief that promoting the interests of his or her appointor is consistent with his or her own appreciation of the interests of the company and provided that that belief is not totally unreasonable, the nominee will not be in breach of fiduciary duty. This test has been adopted by the court in deciding whether the board as a whole has acted bona fide and in the best interest of the company. This brings the law and commercial reality together.

Section 132(1E) [26] categorically states that a nominee director "shall act in the best interest of the company 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 not subordinate his duty to act in the best interest of the company to his duty to his nominator." In short, nominee directors have to tread carefully with prudence and discernment.

Balan et al [27] too are of the view that s.132(1E) lists the categories of nominee directors. This list is wide enough to cover the usual kind of nominee director. The duty imposed by the new provision is similar to the duty under the common law. A point to note is that the new provision makes no exception. The strict rule seemingly applies even in the case of the director of a wholly owned subsidiary. However a possible but limited escape route is the wording of the section which is that a nominee director "shall not subordinate his duty to act in the best interest of the company to his duty to his nominator". Thus, it is arguable that he may, act in the interest of his nominator provided that his act also advances the interest of the company or does not conflict with his duty to the company.

Lee [28] stated that the position of nominee director in Malaysia is that the phrase 'shall not subordinate his duty' under Section 132(1E) is worded in the negative. Therefore, as a final result, the company's best interest will prevail over the interest of the nominator.

It is submitted that these commentators have agreed that [29] s.132 (1E) CA 1965 places the position of nominee directors in Malaysia as illustrative of the strict or the traditional approach. The strict or traditional approach requires the nominee directors only to consider the best interest of the company and shall not subordinate his duty to act in the best interest of the company to his duty to his nominator. This strict or traditional approach has been discussed above as in the case of Industrial Concrete Products Bhd v Concrete Engineering Products Bhd [30].

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[3] Malaysian Companies (Amendment) Act 2007, s. 132(1E), A director, who was appointed by virtue of his position as an employee of a company, or who was appointed by or as a representative of a shareholder, employer or debenture holder, shall act in the best interest of the company 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 not subordinate his duty to act in the best interest of the company to his duty to his nominator.

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[6] Keay, A. (2007). Companies Directors' Responsibilities to Creditors, Routledge. Cavendish, p.5. Keay describe de jure directors – these directors are those who have been formally appointed by their consent, and according to the company's articles , see Table A, art.78. Such appointments will appear on the company records held by the Registrar of Companies.

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[11] See, for example, Cumbrian Newspapers Group. In John de Lacy, "The Concept of a Company Director: Time for a New Expanded and Unified Statutory Concept?" [2006] *Journal of Business Law*, p.284.

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[29] Philip T N Koh note 38; Sujata Balan and ST Lingam, note 39, p. 140; Lee Swee Seng note 40, p.29; Salim, note 41, p.1.

[30] [2001] 2 MLJ 332.