

Discerning the line when it comes to non-executive directors' duty of care

By Julie LY Huan

NON-EXECUTIVE directors (NEDs) owe a duty of care to the company to which they are appointed. In recent years, they have attracted greater scrutiny because of the increasing importance of their roles as watchdogs to monitor the conduct of management. Unfortunately, this has brought with it more litigation where NEDs have been sued for breaching their duty of care.

What responsibilities come under this duty of care? And what considerations – for example, risk versus reward – should prospective or incumbent NEDs take into account? Given that the NED typically has principal commitments outside the company, the dilemma is knowing how closely to monitor the activities of the company to properly discharge his or her duty. A recent legal case may help shed some light on this.

Late in December, the Singapore High Court had to rule on whether two nominee directors (a category of non-executive director) had breached their duty of care. It was undisputed that the two directors had not been aware of the terms of the company's business contracts and had not supervised its delegates. Notwithstanding this, the court ruled that they had not breached their duty of care.

While this judgement may be reassuring to NEDs, there are other cases where NEDs have been found guilty. Hence, the implications of this judgement on the duty of care should be seen in a broader context.

Unlike executive directors, NEDs do not have responsibilities for the day-to-day operations of the company. However, they are still required under the Companies Act to discharge a duty of care to the company.

Be that as it may, when applying this duty to any one director, Singapore's courts have shown an appreciation of the myriad functions that different directors perform. Indeed, while the statute does apply a broad sweep of general principles, it is in the spirit of the law that the courts have discretion to decide how one statutory provision should be applied in order to be fair in each individual case.

In December's High Court case, the two defendants were each the sole director of a company which was specifically set up to purchase and own merchant shipping vessels. Both directors were appointed solely to fulfil the regulatory requirement of having a Singapore resident director; real control lay with three other individuals who represented the shareholders and who had been granted powers of attorney (POA holders) to conduct the companies' business.

When the companies breached an agreement for the purchase of vessels, the seller sued the companies leading to their liquidation. The liquidator then sued the defendants, the two NEDs, alleging they had breached their duty of care as they were unaware of the terms of the agreement, and had delegated every function relating to the agreement to the POA holders without supervising them.

At the outset, the court noted that it is common practice to appoint persons as nominee directors solely to fulfil the resident director requirement, while business decisions are typically left to other more qualified persons. The court added that while "this does not mean that the defendants are relieved of their duties of care . . . it does impact the extent to which they are expected to be informed of the companies' affairs".

Applying that approach, the court concluded that it was entirely reasonable for the defendants to have left all matters pertaining to the purchase agreement to the POA holders. The defendants had not breached their duty of care.

This case can be compared with the saga surrounding Airocean Group Limited some years ago, where legal proceedings were instituted against the company's directors. Among them was the case of Ong Chow Hong, an independent director (a category of NEDs) who was convicted of breaching his duty of care because he neglected to review an announcement that the company made in response to an SGX query. Ong had instead relied on his co-director, a lawyer, to review the announcement.

DIFFERENT STANDARDS

Ong was convicted in the State Courts and, when he appealed against his sentence, not only did he fail – the High Court increased his sentence. In the 2011 High Court judgement, the court stated that "each director of a listed company has a solemn and non-delegable duty of due diligence to ensure compliance with market rules and practices". The court's strict approach in Ong's case has been lauded as setting the right standards for NEDs although his conviction was technically set aside in 2014 for other unrelated reasons.

Faced with these two contrasting cases, what should an incumbent or prospective NED do? Based on these two cases, there are at least two lessons that can be drawn. First, every NED is subject to a duty of care. However, the Singapore courts take a pragmatic view of the reality of the situation by looking carefully at the role that each NED has been given.

Second, the standard of care expected varies according to the nature of the activity. If it is about business decision-making, the standard of care expected may be lower, justifiably because the NED is not as familiar with the business of the company compared to management.

However, if it is about ensuring that the company complies with rules and regulations, the standard of care expected is higher. This is consistent with the corporate governance principle that independent directors fulfil an important role as watchdogs to ensure regulatory compliance. Hence, in this type of activity, the NED must watch out with more vigilance, probe deeper to the best of his ability and exercise his own independent judgement.

At the end of the day, NEDs cannot expect the Companies Act to prescribe all the different situations they may face and how they should act in each of them. Such an approach would be too rigid and constrained.

Nonetheless, by carefully monitoring court judgements, it is possible to draw specific principles to follow and see with greater clarity what is expected of them. Keeping abreast of case law developments is therefore vital. This will go a long way in helping NEDs perform their roles without undue fear of being sued for breaching their duty of care.

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