

Confidentiality of Company Information: Challenges for Nominee Directors

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ABSTRACT

Company directors are subject to certain fiduciary duties discussed under common law and in statutory provisions. Directors' fiduciary duties include duty to protect the confidentiality of company information. Any information that belongs to the company is to be used only by the company for the company. Such information is considered the property of the company and it must be used to the advantage of the company. The objective of this paper is to discuss the duty of nominee directors concerning the confidentiality of company information. Nominee directors who actually represent their nominators on a board of directors will find their duty challenging as they might be expected by their nominators to provide them with certain company information. The study is based on doctrinal and statutory analysis of selected jurisdiction as well as cases based on various jurisdiction. It is argued that nominee directors are in a vulnerable position as directors who are representing their nominators at the same time. Though it has been clearly legislated that their loyalty is to the company they should to a certain extent be allowed to disclose information that would not jeopardise their companies.

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INTRODUCTION

Directors, as responsible persons who manage their company, are subject to certain fiduciary duties provided by the Companies Act as well as Common law. One of directors' fiduciary duties is the duty of avoiding conflict of interests. Under this broad duty, directors are responsible for

protecting the confidentiality of company information. This article discusses the exercise of this duty by nominee directors. Despite the fact that nominee directors are appointed as directors to represent the interest of their nominators, they are subject to the same duties as other types of director i.e. to act in the best interest of the company/ shareholders as a whole (*Greenhalgh v Arderne Cinemas Ltd [1951] Ch 286*).

Nominee directors definitely are duty-bound to protect the interests of the company; however, at the same time they are expected to safeguard the interests of their nominators. They are constantly confronted by the dilemma of whether they should disclose information of interest to their nominators if their nominators were to request such information. Their nominators, of course, would believe that they are entitled to such information. As directors who manage the company they have easy access to all company information, including highly confidential information. The statutory provisions provide that company directors are entitled to certain company information such as the records of the company. Thus, the duty of protecting the confidentiality of company information is crucial for nominee directors, given their dual position.

Nominee Directors

In today's corporate world the existence of nominee director/s on a company's board of directors is inevitable. Nominee directors are those who are nominated to the board by an individual or class of

shareholders or by certain groups such as major creditors or employees of the company (Companies and Securities Law Review Committee, 1987). It is common practice for major shareholders, holding companies, institutional shareholders and joint ventures to have a director as their representative on the board. Lord Denning M. R. referred to a nominee director as a director who is nominated by a large shareholder to represent his interests (*Boulting v Association of Cinematograph, Television and Allied Technicians [1963] 2 QB 606*, pp. 626-7). Since they are representing an individual or a group of persons, they can be described as a trustee of their nominators (*Re Syed Ahmad Alsagoff (1960) 1 MLJ 147*) or as a watchdog of their nominators, appointed to ensure that the nominators' rights are properly safeguarded.

Duty of Nominee Directors

Nominee directors do not act in their own capacity; thus, they may in a way think that they owe a certain extent of loyalty to their nominators, who were responsible for putting them in their present position. However, the chief duty of a director is to act in the best interests of the company. Winslow J. in his dicta said, "A company is entitled to the undivided loyalty of its director. A director who is the nominee of someone else should be left free to exercise his best judgement in the interest of the company he serves and not in accordance of his patron" (*Raffles Hotel Ltd v Rayner [1965] 1 MLJ 60*). Lord Denning mentioned that it would be unlawful for nominee directors to act in

the affairs of their company in accordance with the directions of his nominators (Boulting's at 626).

Section 132(1E) of the Malaysian Companies Act 1965 provides that the 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. This provision explains the general duty of nominee directors, that their loyalty and allegiance are to the company and not to their nominators.

The Court of Appeal in *Re Neath Rugby Ltd* ([2009] EWCA Civ 291) in referring to nominee directors held that the fact a director of a company has been nominated to that office does not impose any duty owed to his nominator unless provided otherwise by any formal or informal agreement that he has with his nominators. The court conceded that it is normal for nominee directors to act according to the wishes of their nominators who had put them in that position provided they would not be in breach of their duties to act in the best interest of the company.

Street J (at p.310) in *Bennetts v Board of Fire Commissioners of New South Wales* ((1967) 87 WN (Pt 1) (NSW) 307) said that the nominee director should not use his position as an opportunity to serve the group that nominated him. The nominee director should not allow himself to be a mere channel of communication or listening post for his nominators. In this

case, Bennetts had been elected to the Board of Fire Commissioners by the Firemen's Union. Later, the Union was involved in an industrial dispute with the Board. The Chairman of the Board obtained legal advice that he would not disclose to Bennetts unless Bennetts gave an undertaking that he would not disclose it to the Union. Bennetts disagreed and commenced a proceeding for a declaration that he was entitled to the information.

The decision in *Bennetts* was followed in *Harkness v Commonwealth Bank of Australia Ltd* ((1993)32 NSW 543 at 555), where the court held on the same point that "... whether a person is elected by a special interest group, considered to be a representative of one group for another group, or a nominee director, does not alter the fact that the person owes the duty of confidence to the board to which he or she has been appointed." This has been described as a strict rule imposed upon nominee directors. It would be unrealistic to prescribe such a blanket prohibition on all nominee directors because nominee directors are actually the representatives of their nominators and it would be impractical not to expect them to have any regards at all to the interests of their nominators (Crutchfield, 1992). Jacobs J (at p.1663) in *Re Broadcasting Station 2GB Ltd* ([1964-65] NSW 1648) viewed that such a rule would make the position of a nominee director impossible. Jacobs J. observed that nominee directors should be allowed to consider the nominators' interests provided that it would be in the best interests of the

company as well (*Levin v Clark [1962] NSW 686*).

It is worth noting that in a recent case, *Central Bank of Ecuador and others v Conticorp SA and others ([2015] UKPC 11)*, the Privy Council agreed with the lower court decision that a director must act bona fide in the best interests of the company; he must positively apply his mind to the question of what the company's interests are; he must exercise independent judgement and not fetter his discretion; and the same is expected from the nominee director (citing Lord Denning's in *Boulting's*). The court, therefore, in this case asserted that Mr Taylor as sole director and nominee investment adviser of IAMF (the second Appellant) had breached his fiduciary duty by acting on the instructions of the Respondents. Mr. Taylor had a duty to understand IAMF's affairs and to apply his own mind to act in the best interests of IAMF.

Duty to protect confidentiality of information. One of the important duties of a director is to avoid conflict of interest. Under this duty, directors must not put themselves in a position of conflict where he has direct or indirect interest. This duty refers to the exploitation of any property, information or opportunity irrespective of whether the company could gain benefit out of it or not. Section 132(2)(b) of the Malaysian Companies Act 1965 states that a director is not allowed to use any information that he acquired in his position as a director of a company for his own benefit or for the benefit of any other

person or cause detrimental to the company. Though the provision does not elaborate on the meaning of 'information', the meaning may include trade secrets, list of customers and other information that could be deemed confidential (Abd & Samsar, 2007). In *Electro Cad University Australia Pty Ltd v Mejati RCS Sdn. Bhd & Ors ([1998] 3 MLJ 422)*, the defendant (director), without the company's knowledge, had used information about the company's product. The information here refers to technical and marketing data. Subsequently, the defendant manufactured an identical product in direct competition with the plaintiff's product. The High Court issued an injunction to restrain further breach and divulging of any confidential information. The court had also declared that the plaintiff was the true owner of the confidential information and trade secrets. The court further ordered the defendant to relinquish any documents or materials related to the products and to pay damages to the plaintiff. The court agreed that the first and second defendants owed an equitable obligation to the second plaintiff in relation of the confidential information they received in their capacity as consultant and director, respectively. The confidential information had been used by the defendants in designing, manufacturing, marketing and promoting their product 'Stopcar', which was in competition with the product belong to the plaintiffs, 'Stopcard'.

In defining what is confidential, Kalamathan J (at p. 441) perceived that confidential information refers to information that is the object of an obligation

of confidence and is used to cover all information of confidential character, for example, trade secrets. The judge further explained that it is not necessary for the confidential information to be patentable; it was simply necessary to show that the information was confidential and could not be found in the public domain.

Goulding J (at pp117-8) stated that information that was gained while in the course of employment was characterised by three identifiers: first, it is information that is easily accessible to the public and thus, an employee would be at liberty to impart it during or after his employment; second, it is confidential information that cannot be used or disclosed during the nominee director's employment but in the absence of an express restriction, the nominee director is free to use the information, once his employment has ended; and third, it is information regarding specific trade secrets that a nominee director should not use or disclose either during or after his employment (*Faccenda Chicken Ltd v Fowler* [1987] 1 Ch. 117).

According to Young J. in *Harkness v Commonwealth Bank of Australia Ltd* ([1993]32 NSW 543 at 553),

What is confidential is not to be found merely by looking to see whether someone has marked 'confidential' against an item. The obligation of directors is to keep secret any matter which is discussed, the communication of which might detrimentally affect the company, indeed, even the issuing of information as to who

voted in what way on a particular resolution may detrimentally affect the working of a company if it is breezed abroad.

Confidential information has been further specified in *Canterbury-Hurlstone Park RSL Club Ltd v Roberts* ([2008] NSWSC 845), where the court considered the discussion at Board meetings concerning the sale of particular assets, a review on the performance of the Chief Executive Officer and views of the Board members to be confidential as they were not known to the public. Thus, confidential information can be construed as material corporate information, and the disclosure of such information would be detrimental to the company. As emphasised by the Corporate Director's Guidebook (2007), the disclosure of non-public information by directors would damage the trust among directors and management and jeopardise boardroom effectiveness and directors' collaboration. It is deduced that whether a piece of information is confidential or not would depend on whether it is available to the public or not as well as whether its disclosure would be detrimental to the company or not.

Nominee Directors and Confidential Company Information

To avoid conflict of interest a director is bound by the duty of protecting the confidentiality of company information. With regards to nominee directors, their loyalty or priority is to the company; they cannot disclose confidential company

information to anybody, even their nominators (who might be the majority shareholders) who have put them in their present position. Nominee directors would be in breach of duty if they disclosed information that would affect the company's interests. In most circumstances, it would be expected that the nominee director would report back to their nominators, which is the primary purpose of putting nominee directors in their position. The nominee directors are given the task of controlling or supervising the company on behalf of its nominators. The duty of directors not to disclose company information or use confidential information without the consent of the company is incompatible with the nominee directors' position (Thomas, 1997, pp. 149-150).

In comparison to other jurisdiction, New Zealand has taken a liberal approach concerning the duties of nominee directors. Section 145(2) (a) of the New Zealand Companies Act 1993 deals with the disclosure of information by nominee directors. It allows a director of company to disclose company information to his nominator, unless prohibited by the board of directors. In addition to this, a director of a company that is carrying out a joint venture between the shareholders may act in the best interests of the shareholders even though it may not be in the interests of the company if the constitution of the company allows him to act as such.

An important case on this matter is *Berlei Hestia (NZ) Ltd v Fernyhough* ([1980] 2 NZLR 150). In this case an

Australian Company had 40% shares in a New Zealand company and the articles of association of the latter allowed the Australian company to appoint directors in the New Zealand company. Later, there was a dispute between the two companies, which resulted in a breakdown in their relationship. Subsequently, the nominee directors were refused access to the company's records and premises on the grounds that they were in a position to act in derogation of their duty to the company. In determining the nominee directors' access to corporate information, Mahon J (at pp. 162-6) opined that to perform his duties as a director, it would be necessary for the director to be given access to corporate records and premises. His Justice further asserted that on the basis of the facts there was no evidence that showed that the Australian directors intended to act in breach of their fiduciary duty towards the company. The court in its decision relied on the decision of Jacobs J in *Levin and Re Broadcasting Station* that a nominee director should prefer the interests of the company rather than of their nominator; however, the nominee director may act for the interests of the nominator if there is no conflict.

Besides *Levin and Re Broadcasting Station*, *Molomby v Whitehead* ((1985) 63 ALR) is also essential as in this case, it was held that the nominee director, Molomby, was entitled to information relating to the management and affairs of the company. In this case, Molomby had requested director access from the managing to documents relating to legal fees and various legal actions. The managing director refused

to supply all the documents requested, asserting that they were confidential. Beaumont J of the Federal Court highlighted that the case was different from *Bennetts*, which involved clear conflict of interest on the part of the director, and there was no such conflict in *Molomby*. This has been viewed as a pragmatic approach compared with *Bennetts*, which has been described as a strict view (Sievers, 1993).

Similarly, in an American case, *Kortum v Webasto Sunroofs, Inc.* (Del. Ch 2000), the court held that a director who represented 50% of shareholders in a joint-venture corporation was entitled to inspect all books and records without any restrictions. It would be unreasonable to restrict Kortum's inspection with an undertaking that he would not disclose the information to his nominator. The court agreed that in the absence of conflict Kortum may disclose the information to his nominator.

The Australian Corporation Act 2001 makes no provision discussing specifically about nominee director; however, Section 187 has implied concerns related to the issue. According to the section, a director of a wholly-owned subsidiary may act in the best interests of the holding company if:

- The constitution of the subsidiary expressly authorises the directors to act in the best interests of the holding company;
- The director acts in good faith in the best interests of the holding company; and
- The subsidiary is not insolvent at the time the director acts and does

not become insolvent because of the director's act.

The above provision allows a nominee of a holding to act in the best interests of the holding while acting as a director in a subsidiary by fulfilling certain requirements. This can be construed to include disclosing the company's information to the holding company.

In the United Kingdom, Section 173(2) of the Companies Act 2006 elucidates that directors would not be in breach if they acted in accordance with an agreement duly entered into by the company that restricts future exercise of discretion by its directors or if they acted in a way authorised by the company's constitution. Based on this section, directors' duties could be qualified by an agreement or by the company's constitution. In *Cobden Investment Ltd ([2008] EWHC 2810 (Ch))*, the court held that interests of the company could be qualified if there were unanimous consent of the shareholders but not to abrogate the duties owed to the company. This section, to a certain extent, will minimise the challenges faced by nominee directors in protecting the company's confidential information. This means that nominee directors may disclose certain information to their nominators provided that it will not undermine the company's interests. The position of nominee director in relation to company information has been elaborated in *Richmond Pharmacology Ltd v Chester Overseas Ltd ([2014] EWHC 2692)*. In this case Chester held 44 % shares in Richmond.

As agreed in the shareholders' agreement, Chester appointed two nominee directors to the Company's board. The agreement provided that all commercially sensitive information should be treated as strictly confidential. However, the agreement provided that any party to the agreement may disclose the confidential information to its professional advisers and bankers and should procure that those persons should treat the information as confidential as well. Chester decided to sell its shares in Richmond, and for that purpose Chester appointed a financial advisor to whom it disclosed confidential information. The financial advisor then disclosed the information to the prospective buyer of Chester's shares. Richmond brought action against Chester for breach of shareholders' agreement and breach of directors' duties against the two nominee directors as stated under Section 172 (duty to promote the success of the company), Section 174 (duty to exercise reasonable care, skill and diligence) and Section 175 (duty to avoid conflict of interests).

The defendants in this case argued that the information could be treated as confidential even if it were communicated to a third party, provided care was taken to ensure that the third party was trustworthy and undertook to keep the information confidential. On that point, the court held that the ordinary and natural meaning of an obligation to treat information as confidential is that it may not be disclosed to anyone else.

The court emphasised that the nominee directors owed to Richmond the duties set out in sections 172, 174 and 175 of the Companies Act 2006. The nominee directors in performing this duty could take the interests of Chester (their nominator) into account, provided that their decisions were in what they genuinely considered to be the best interests of Richmond (citing *Hawkes v Cuddy* [2009] EWCA Civ 291). As for Section 175, which demonstrates duty to avoid conflict of interest that relates to exploitation of any property, information or opportunity, this duty is not infringed if the matter has been authorised by the board of directors. The court further explained that the test of whether there is a breach of Section 175 is an objective one and it is immaterial that the nominee directors acted in good faith or in the mistaken belief that they are entitled to do so. In other words, it does not depend on whether the director is aware that what he is doing is a breach of his duty.

On the other hand, there is a provision in the Singapore Companies Act (revised 2006) allowing nominee directors to disclose to their nominators information they have obtained as director of the company. Section 158 of the Act states that a nominee director may disclose information to his nominator provided:

- The director declares at a meeting of the directors of the company the name and office or position held by the person to whom the information is to be disclosed

and the particulars of such information (Section 158[3][a]);

- The director receives prior authorisation by the board of directors to make the disclosure (Section 158[3][b]);
- The disclosure will not be likely to prejudice the company (Section 158[3][c])

The existence of this section is approved as it may ease the challenges faced by the nominee directors especially when their nominators enquire about certain information. However, it would not be easy for the board of directors to authorise the disclosure and it is also not easy to ascertain whether the information would prejudice the company or not (Kala & Foo, 2004).

As for the Malaysian Companies Act 1965, Section 132(1E) merely explains the general duty of a nominee director. In relation to confidential information it could be implied that nominee directors may disclose the information so long as it will not conflict with the interests of the company. To determine whether it is conflicting or not it would be necessary for the nominee directors to obtain approval from the board of directors. The provision has not been elaborated on and this requires the court to further interpret the provision. In the new Malaysian Companies Act 2016, to be enforced in stages by 31st January 2017, there are no changes regarding the responsibilities of nominee directors. The provision in Section 132E is now in Section 217(1) of the Companies Act 2016.

CONCLUSION

It is indeed obvious that the fiduciary duty to act for a company's best interest and to avoid conflict of interest is very much related with the duty to protect the confidentiality of company information. Similarly, the vulnerable position of nominee directors, who are subject to dual loyalty, would be a great challenge for them as they seek to discharge their duty. Case laws and earlier writings have suggested that in facing the challenge, the task of the nominee director would be feasible by the existence of express contractual consent. Such a confidentiality agreement would be the threshold for nominee directors in disclosing company information and would also prevent misuse of company information (Moscow, 2011). In the absence of express consent, the existence of implied consent could be assumed. Implied consent would be based on accepted business practices and whether the information were confidential or not.

The legislation and decided cases highlight that the directors, whatever name they are called, are subject to the same fiduciary duties. However, certain legislation and case laws allow the nominee directors some flexibility by allowing them to consider the interests of their nominator, which may include sharing certain company information with their nominators. However, this is only possible if there is no conflict with the best interests of the company. This shows that in whatever circumstances, the interests of the company are paramount and the flexibility given should not be

considered discrimination of duties among the directors.

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