The Non-Executive Director And His Duty Of Care

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INTRODUCTION

Ownership and control within a company are vested in two separate organs. Ownership in shareholders; control in directors. In companies where shareholders and directors are not the same persons, there is a principal-agent relationship where directors function as agents of shareholders. To reduce agency costs, the law has imposed duties on directors. These include the duty to act honestly and the duty to act with due diligence - otherwise known as the duty of care.

In respect of the duty of care, should all directors in a company be subject to the same standards? Particularly in larger companies where there are executive directors (EDs) and non-executive directors (NEDs), should there be a differentiation between these two categories? After all, NEDs who have principal commitments outside the company and who are valued precisely for their outside business experience, are understandably less familiar with the operations of the company compared to the EDs. The issue is: how closely do NEDs have to monitor the affairs of the company in order to properly discharge their duty of care?

This article will explore the duty of care imposed on NEDs in Singapore through statutory and case law. Comparative analyses will be made with the position in Australia.

Ultimately, the purpose of this article is to provide an analytical framework of the NED’s duty of care. The trend in Singapore is to increase the role of the NED to improve corporate governance. In the context of listed companies, the Singapore Code of Corporate Governance now requires at least half of the Board to comprise Independent Directors in several situations. There is thus a need for more Independent Directors and correspondingly, more clarity on what their duty of care entails.

STATUTORY FRAMEWORK

Singapore

Companies incorporated in Singapore are governed by the Companies Act (Cap. 50)(“CA”). The CA is modeled on the Australian Companies Act of 1961 which in turn evolved from the UK Companies Act of 1948. For that reason, Singapore courts rely extensively on cases decided in Australia and England. Section 4 of the CA provides that “director” includes “any person occupying the position of director … by whatever name called …”. Section 157(1) then goes on to impose the duty of care by providing that “A director shall at all times … use reasonable diligence in the discharge of duties of his office.”

An ED is generally understood to be a director who has executive responsibility for the day-to-day operations of the company. An example is the Managing Director of the company. In contrast, an NED does not have such an executive responsibility in the company. He primarily attends Board meetings while undertaking his principal commitments outside the company. NEDs include nominee directors and independent directors.

It is clear from the above that under the Singapore CA, EDs and NEDs fall within the definition of “director” and the duty of care is imposed on both types of directors with no differentiation between them.

1 Principle 2.2 of the Singapore Code of Corporate Governance 2012 (CCG) lists the situations. Although the CCG is non statutory, listed companies are expected to comply or explain why it deviates from it.
Australia

Section 180(1) of the Australia Corporations Act 2001 (Cth) (“Australia CA”), provides that a director must exercise his power “with the degree of care and diligence that a reasonable person would exercise … if they … had the same responsibilities … as the director”.

OBJECTIVE TEST

Singapore

In the case of Lim Weng Kee v Public Prosecutor, the court stated that the standard of care expected of a director is objective, meaning whether he has exercised the same degree of care as a reasonable director would, in his position. The standard will not be lowered to accommodate a director’s own inadequacies, but may be raised if he held himself out to possess some special knowledge.

Australia

From section 180(1) of the Australia CA as well as case law, it is evident that Australia adopts the same approach of an objective standard of care.

DELEGATION – CASE DISCUSSIONS

In the Singapore CA, section 157C allows a director to rely on reports, financial data and other information prepared by other persons. The safe harbor is subject to the director acting in good faith and making proper inquiry where the need for inquiry is indicated by the circumstances. The contentious issue is: Since the NED does not supervise the day-to-day operations like the ED, is he allowed to rely more on management? Further, should the standard care expected of him differ according to the type of transaction?

Singapore

Two interesting cases have tested the limits of the NEDs’ power to delegate. While both cases produced different outcomes, it is important to highlight that the type of activity and the type of NED were different. The first case was about regulatory compliance by the company and involved an independent director. The second case was about business decision-making by the company and involved nominee directors.

Case 1 - Ong Chow Hong v PP (2011) (OCH case)

In this case, Mr. Ong Chow Hong, an independent director of Airocean Ltd was convicted of breaching his duty of care because he neglected to review an announcement that the company made in response to a query by the Singapore Exchange. Mr. Ong could not attend the meeting where the draft announcement was to be discussed internally before release to the Singapore Exchange. However, he had told the company secretary that he would agree to the announcement if another co-director who was a lawyer approved of it. Ong never asked for, nor saw the draft announcement.

When charged with the crime of breaching his duty of care, Ong pleaded guilty. He was fined and disqualified from being a director for 12 months. When he appealed against the disqualification order, the High Court not only rejected Ong’s appeal for leniency, it enhanced the disqualification order to 24 months.

In the 2011 High Court judgment, the court stated:

“While ... there are of course limits to the extent of knowledge and expertise a director may be expected to have, and that some reliance may be placed on the advice given by professionals, each director of a listed company has a solemn and non-delegable duty of due diligence to ensure compliance with market rules and practices.”

1 [2002] 4 SLR 327

2 One example is Daniels v Anderson (1995) 16 A.C.S.R. 607, which is discussed in the text accompanying note 9 below.

4 [2011] 3 SLR 1093
Therefore, any reliance on professionals or specialized directors had to be balanced against the responsibility the law placed upon every individual director to exercise their own judgment in evaluating the advice received. Directors cannot adopt a silo approach and seek shelter behind other “specialized” directors on the notion of reliance.

The above principles (2011 principles) have been cited with approval in subsequent judgments, including a Court of Appeal decision in 2014. At this juncture, it should be stated for correctness that Ong’s conviction was subsequently set aside in 2014. The reason was that Mr. Ong’s co-directors who had approved the announcement and charged with more serious offences were subsequently acquitted for technical reasons. It was therefore felt that to allow Mr. Ong to remain convicted when he had not even seen the announcement would “constitute a serious injustice”.

In the author’s opinion, this move exemplifies how courts dispense justice with compassion. Justice because Mr. Ong’s conduct as an NED which fell short of the ideals laid down by the 2011 principles remains on record as such. In the 2014 setting aside of his conviction, the court was careful not to overrule the 2011 principles. Compassion because in view of the outcome for his co-directors, Mr. Ong deserved to have his criminal record erased.

Overall, the 2011 principles remain as good law in Singapore for setting standards for NEDs.

Case 2 - Prima Bulkship Pte Ltd (in creditors’ voluntary liquidation) and ano. v Lim Say Wan and ano (Prima case)

In this case, two nominee directors, Mr. Lim Say Wan and Mr. Beh Thiam Hock (Defendant Directors) were alleged to have breached their duty of care for failing to supervise their delegates. They were the sole directors of 2 companies which were special purpose vehicles incorporated for the purpose of purchasing and owning 2 vessels. The 2 companies were controlled by 3 other individuals who had been granted powers of attorney (POA Holders) by the Defendant Directors to transact the business of the companies.

When the 2 companies breached the agreement for the purchase of the 2 vessels, the seller sued the companies and this led to their liquidation. The liquidator in turn sued the Defendant Directors for breaching their duty of care on the grounds that they had failed to be aware of the terms of the agreement, and had delegated every function relating to the agreement to the POA Holders without supervising them.

The court took a pragmatic view of the reality of the situation vis-a-vis nominee directors. At the outset, it accepted the common industry practice of appointing persons as nominee directors merely to fulfill the regulatory requirement of having a Singapore-resident director. The court acknowledged that such nominee directors typically do not play an executive role, and also do not shoulder responsibility for commercial decision-making. Instead, the decisions and management of the company are typically left to the parties who incorporated the company and intend to do business through the company. The court explicitly stated that while the acknowledgment of the limited role of nominee directors “does not mean that the Defendant Directors are relieved of their duties of care ... it does impact the extent to which they are expected to be informed of the companies’ affairs.”

The court also reviewed the Nominee Director Indemnity Agreement (NDI Agreement) that the Defendant directors had each signed with his company. In the NDI Agreement, the Defendant

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5 Ho Kang Peng v Scintronix Corp Ltd [2014] SGCA 22 at para 44.
7 Another recent case which cited the 2011 principles notwithstanding the 2014 setting aside of Ong’s conviction is PP v Chua Hock Soon James [2016] SGDC 71.
8 [2016] SGHC 283
Directors had signed that they would provide routine services which does not include making inquiries into audit accounts, and that they will not act in any executive capacity or undertake any commercial decision or assume any commercial responsibility. It was alleged that such NDI Agreements amounted to a fetter of their discretion as directors and in some other cases, this was ruled to be a breach of a director’s duty towards the company. However, the court disagreed by distinguishing those cases, and ruled that the NDI Agreement was simply a reflection of the purpose for which the Defendant Directors were appointed and this in turn had an impact on the standard of care that is expected of them.

Applying the pragmatic approach, the court concluded on the facts of the case that it was entirely reasonable for the Defendant Directors to have left all matters pertaining to the agreement to the POA Holders. They had not breached their duty of care.

Australia

In a similar fashion, 2 contrasting Australian decisions on NED’s liabilities will be discussed.

Case 1 - Daniels v Anderson⁹ (AWA case)

In this case, AWA Ltd set up a foreign exchange operation (“FX operation”) which was run by a single person, Koval. Concerned about the high risk FX operation, the Board laid down general policies and rules regarding its operation. The NEDs sought verification from the company’s ED and external auditors that the policies were observed. They were assured that everything was in order. In fact the FX operations were severely mismanaged and substantial losses were incurred. The ED and NEDs were thus sued for failing to supervise Koval adequately. The trial court held that the ED was negligent. However, it ruled that the NEDs were not negligent as they were entitled to rely on assurance from management and the auditors. On appeal, the Court of Appeal upheld the finding that the NEDs were not negligent.¹⁰

It is pertinent to note that this judgement which imposed liability on the ED but not the NEDs was about supervision of the company’s FX operations which falls under business decision- making of the company. This can be contrasted with the next case below which deals with regulatory compliance by the company.

Case 2 – ASIC v Healey¹¹ (Centro case).

In this case, the Australian Securities and Investments Commission instituted civil actions against the directors and CFO of Centro Property Ltd for breach of duty in respect of financial statements issued by the company. The actions were based on several statutory provisions, one of which was the duty of care under s.180(1) of the Australia CA.

It was alleged that the directors had failed to disclose significant matters in respect of the financial statements, resulting in the statements not reflecting a “true and fair” view as required by the Australian CA, and that such failure meant that they had failed to fulfill their duty of care.

The court ruled that the ED, CFO and NEDs had breached their duty of care. With specific reference to the NEDs, although the court accepted that they had relied on the expertise and experience of the company’s management and external auditors, the fundamental mistake that they had made was failing to bring an inquisitive mind to the Board meeting. They should have asked fundamental questions and sought specific assurance of the correctness of the financial statements.

Up to this point, the court adopted a strict approach towards NEDs in the same way as towards the ED and CFO. However, in terms of punishment, there was a differentiation. While the ED and CFO were


¹⁰ While this is indeed the final ruling, it has been commented that the Court of Appeal appeared to adopt a stricter standard on the NEDs compared to the trial court. See Roman Tomasic, Modernising the Rules of Corporate Governance - The AWA case on appeal, 1995 AICL LEXIS 43 where it was observed that the Court of Appeal had queried whether during one particular short period, the NED should have done more than they did.

¹¹ [2011] FCA 717
slapped with a civil penalty and a 2-year disqualification order respectively, the NEDs were spared such punishment.\textsuperscript{12}

**COMPARATIVE ANALYSES - RATIONALIZATION**

In terms of imposition of liability, the Singapore decisions resonate with the highlighted Australian decisions. Although contrasting in outcomes, all 4 decisions demonstrate common underlying principles.

First, while it is clear that all NEDs owe a duty of care, the court takes a pragmatic view of the reality of the situation by looking carefully at the role that the particular NED has been given. The Prima case is particularly illustrative of how the court accepted the commercial norm of having nominee directors for the main purpose of fulfilling the Singapore requirement of having one Singapore resident director, with the actual control of the company’s business vested in other persons.

Second, the court scrutinizes the actual transaction in which it is alleged that the NED has breached his duty of care and adjusts its expectations accordingly.

If it is about business decision-making (Singapore Prima case and Australia AWA case), the standard of care expected is lower. This is justifiable on the basis that the NED is not as familiar with the business of the company by virtue of his non-executive position.

If it is about regulatory compliance by the company (Singapore OCH case and Australia Centro case) the standard of care expected is higher. In both cases, the NEDs were found guilty of breach of duty in respect of ensuring regulatory compliance by the company.

The lesson learnt from the Singapore OCH case is that while an NED can seek professional advice and views of specialized co-directors, he has a solemn and non-delegable duty to exercise an independent judgment of whether the company is in fact complying with rules and regulations.

Similarly, as succinctly put by another academic paper\textsuperscript{13}: the lesson learnt from the Australia Centro case is that the NEDs should not passively accept information and advice given to them without applying an independent inquiring mind.

An NED in Singapore would thus need to do his utmost to verify the accuracy of statements issued by the company for regulatory compliance. For non-financial statements, the Singapore OCH case is exactly on point. For financial statements, even if the Australia Centro case is non-binding, guidelines issued by the Accounting and Regulatory Authority of Singapore (ACRA) are instructive. Since 2012, ACRA has issued guidelines termed as Financial Reporting Practice Guidance, to guide directors in their review and approval of financial statements to help ensure compliance with existing financial reporting standards.\textsuperscript{14}

\textsuperscript{12} See Jean J. Du Plessis, Iain Meaney, “Directors’ liability for approving financial statements containing blatant incorrect items: lessons from Australia for all directors in all jurisdictions”. (2012) 33 The Company Lawyer, Issue 9, where it was reported that the NEDs were ordered only to share in paying prosecution costs of ASIC. In that paper, it was postulated that since this would most probably be covered by their Directors’ and Officers’ liability, the NEDs suffered no real loss.

\textsuperscript{13} Ibid

\textsuperscript{14} ACRA has issued 5 sets of Financial Reporting Practice Guidance since 2012, the latest being issued on 8 December 2016. These provide practical pointers to directors on what they must look out for, in specific parts of the financial statements. See the ACRA website www.acra.gov.sg.
However, in terms of meting out punishment, the two countries’ courts have shown a divergence of views.

The Singapore court in the OCH case imposed on the NED a 2-year disqualification order and a fine. This was justified on the basis that Singapore adopts a disclosure-based regime where accurate information disclosure to the public is pivotal. Hence, even if harsh on an individual director, it was deemed necessary for the protection of the general public to send a right signal. As stated in the judgment, “This is the need to generally protect the public from all errant directors by an uncompromising reaffirmation of the expected exemplary standards of corporate governance”. Clearly, it was deterrence which took centre stage.

In contrast, the Australian court in the Centro case did not impose any civil penalty or disqualification order on the NEDs. Lord Middleton J explained that while the court recognized the seriousness of the contraventions, in meting out punishments, it took into account the overall conduct of each of the directors. In other words, while general deterrence was the driving force behind the imposition of liability, it took a backseat as far as punishment was concerned. There, the individual circumstances of the NEDs featured strongly.

**RELIEF FROM LIABILITY**

Any discussion on liability imposed cannot be complete without consideration of relief that may be granted. Indeed, it is common for the statute imposing liability on directors to also have a provision allowing the court to grant relief in appropriate circumstances.

**Singapore**

In Singapore, section 391 of the Singapore CA allows a court in any proceedings for negligence or breach of duty by a director to grant relief in appropriate circumstances. These circumstances are where the director has acted honestly and reasonably, and that having regard to all the circumstances of the case including those connected with his appointment, he ought fairly to be excused.

At first glance, it is tempting to disregard the usefulness of this section for breach of duty of care. The requirement of the director to have acted “reasonably” seems impossible for a director who has already been judged to have breached his duty to act with reasonable care. However, on closer examination, this is not the case.

In the case of JSI Shipping (S) Pte Ltd v Teofoongwongeloong this requirement of reasonableness was scrutinized. Although the case involved an auditor, the same section 391 was invoked since it applies equally to auditors as directors. It was stated in that case:

“... (auditors) can undoubtedly be held to have acted reasonably for the purposes of this exculpatory section notwithstanding that they are found to be negligent. ... The determination of reasonableness for the purposes of this section is not to be limited by the specific breach, but can encompass wider considerations such as the nature of the (audit) and other relevant circumstances ... which ... ought surely to include the conduct of the directors”.

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15 Supra note 4 at para 23 of the Judgment.


17 [2007] 4 SLR (R)

18 Section 391 of the CA applies to officers of a corporation, auditors, receivers, receivers and managers and experts as defined by the Act.

19 Supra note 17 at para 168 of the Judgment.
Just as the conduct of directors would affect the assessment of whether an auditor acted negligently, it is the author’s view that the conduct of the other directors (including the EDs) would also affect the assessment of whether an NED acted reasonably. If an NED’s reliance on EDs cannot absolve him from liability for breach of his own duty of care, surely it would still serve as a relevant factor in deciding whether to grant partial relief.

Further, section 391 refers specifically to the circumstances “connected with his appointment”. This must justify consideration of the NED being appointed in a non-executive role and hence relying to some extent on management’s report of the company’s affairs.

Support for acknowledging the different position of the NED can also be found in the 2012 revisions to the Singapore Code of Corporate Governance (CCG). While the previous CCG referred only to NEDs serving on multiple boards, there is now reference to “other principal commitments” which has been defined widely to include significant time commitments such as the full-time occupation of NEDs.20

**Australia**

The Australia CA provides relief from liability through sections 1318 and 1317S. As Singapore’s section 391 was modeled on the Australian Companies Act 1961, the grounds for relief are similar.

On the reference to circumstances “connected with the person’s appointment,” it has been commented21 that this was aimed at providing relief particularly for NEDs, and that the intention was to draw a distinction between the unique position of NEDs compared to EDs.

While it is the case that the Australian provisions do not have the equivalent requirement of the director having acted “reasonably”, it has been observed that notwithstanding that, the Australian courts have held that whether a director’s conduct was reasonable is still a relevant consideration for the granting of relief.22

**CONCLUSION**

NEDs will play an increasing role in the corporate governance landscape in Singapore. As their role evolves with changing business needs, it is vital for the law to adjust its standards on them accordingly. The most recent Prima case has shown that the Singapore courts adopt a pragmatic view of the varied roles of different types of NEDs. This is a positive development. When considered against the backdrop of earlier cases, there is, as described above, a coherent approach towards NEDs depending on the role they are given, and the transaction in which the duty of care is tested.

Indeed, if we want more to assume the role of NEDs, it is vital to have clarity in the standards that are expected of them. Prospective NEDs will weigh risks and rewards before assuming the role, and if they know how to reduce the risk of being sued for breaching their duty of care, more will be incentivized to jump on board.

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21 Supra note 12 at pg. 282