Nominee Directors: Caught Between the Devil and the Deep Blue Sea

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Summary

A nominee director stands somewhat apart from the other directors by virtue of having been nominated by a shareholder, or other stakeholder of the company, to represent the shareholder's particular interest. Nominee directors are de jure *directors of the companies to whose board they have been appointed. They are not a distinct class of directors and they owe the same duties to the company as other directors, whilst at the same time, representing through expectation of loyalty or legal duty, the interests of the appointer. The difficulty that arises for a nominee director is that in the eyes of the law they are treated like any other director, but there is usually an expectation that they will act with some awareness of their appointer's interest. This article discusses the role of the nominee director with a particular focus on the English and Cayman Islands legal position.*

Keywords:

Nominee directors, English and Cayman Islands legal position, duties, conflict of interest

1 Directors' fiduciary duties to their creditors

Fiduciary duties of directors have been codified in the United Kingdom and are now contained in sections 171–177 of the Companies Act 2006 ('CA 2006'). There is no statutory codification in the Cayman Islands of the general duties, obligations and liabilities owed by directors. The duties are predominately based on the English common law concerning fiduciary duties and duties of skill, care and diligence. In the case of the *Cayman Islands News Bureau Limited v. Cohen and Cohen Associated Limited*, Harre J listed these duties as '*the observance of general standards of loyalty, good faith and the avoidance of a conflict of duty and self-interest*'.[1] English case law is highly persuasive, and the Cayman Courts have adopted the English common law principles relating to directors' duties.[2]

A director's main duty is to act bona fide for the benefit of the company as a whole, however, if the company is in financial difficulty, it has been established under common law that this will also include the interests of the creditors.[3]

In the case of *Kinsela v. Russell Kinsela Pty Ltd (In Liq)*, Street Chief Justice (CJ), stated that:

> *In a solvent company the proprietary interests of the shareholders entitle them as a general body to be regarded as the company when questions of the duty of directors arise. If, as a general body, they authorize or ratify a particular action of the directors, there can be no challenge to the validity of what the directors have done. But where a company is insolvent, the interests of the creditors intrude. They become prospectively entitled, through the mechanism of liquidation, to displace the power of the shareholders and the directors to deal with the company's assets. It is in a practical sense their assets and not the shareholders' assets that, through the medium of the company, are under the management of the directors pending either liquidation, return to solvency, or the imposition of some alternative administration* [4]

Dillon Lord Justice (LJ) in *Liquidator of West Mercia Safetywear Ltd v. Dodd & Anor* cited with approval the above *Kinsela* passage.[5] In *West Mercia*, it confirmed that directors owe a duty to take into account the interests of creditors in circumstances where the company, and the group of which it was a member, were in a '*very* dangerous' or 'parlous' financial position, such that the future of the group probably depended on satisfactory refinancing arrangements becoming available.[6]

In *Re MDA Investment Management Ltd* it was accepted that the duty arose when the company was in a '*dangerous*' or 'precarious' financial position, however, in that case, the court found that the company was insolvent anyway.[7] The company was also insolvent in *West Mercia Safetywear v. Dodd*,[8] *Official Receiver v. Stern*,[9] *Colin Gwyer & Associates Ltd v. London Wharf (Limehouse) Ltd*[10] and *Re Cityspan Ltd.*[11]

2 Duty of nominee directors

A nominee director stands somewhat apart from the other directors, by virtue of having been nominated by a shareholder or other stakeholder of the company to represent the shareholder's particular interest.[12] Nominee directors are de jure directors of the companies to whose board they have been appointed. They are not a distinct class of directors and they owe the same duties to the company as other directors, whilst at the same time, representing through expectation of loyalty or legal duty, the interests of the appointer.

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[1] *Cayman Islands News Bureau Limited v. Cohen and Cohen Associated Limited* [1988–1989] CILR 195.

[2] *Renova Resources Private Equity Limited v. Gilbertson* [2009] CILR 268.

[3] This position was re-enforced in the English Court of Appeal decision of *BTI 2014 LLC v. Sequane SA* [2019] EWCA Civ 112.

[4] *Kinsela v. Russell Kinsela Pty Ltd (In Liq)* [1986] 4NSW:R 722 at 730.

[5] *Liquidator of West Mercia Safetywear Ltd v. Dodd & Anor* [1988] 4 BCC 30.

[6] *Facia Footwear v. Hinchcliffe* [1998] 1 BCLC 218, *Walker v. Wimborne* [1976] 137 CLR 1, *Nicholson v. Permakraft* (NZ) Ltd [1985] 1 NZLR 242, *Kinsela v. Russell Kinsela Pty Ltd* [1986] 4 NSWLR 722 and *West Mercia Safetywear v. Dodd* [1988] BCLC 250.

[7] *Re MDA Investment Management Ltd* [2004] 1 BCLC 217, para. 75.

[8] *West Mercia Safetywear v. Dodd* [1988] BCLC 250.

[9] *Official Receiver v. Stern* [2002] 1 BCLC 119.

[10] *Colin Gwyer & Associates Ltd v. London Wharf (Limehouse) Ltd* [2003] 2 BCLC 153.

[11] *Re Cityspan Ltd* [2007] 2 BCLC 522, para. 31.

[12] *Boulting v. Association of Cinematograph Technicians* [1963] 2 QB 606, 626.

Lord Denning in *Boulting v. Associations of Cinematograph Technicians*[13] recognize that a nominee director's distinct commercial position did not create a deviation from the usual standard of care applicable to company directors.

The difficulty that arises for a nominee director is that in the eyes of the law they are treated like any other director, but there is usually an expectation that they will act with some awareness of their appointer's interest.

2.1 Conflict of Interest

A director of a company must avoid a situation in which he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company. This rule at the very outset has the potential to put a nominee in a peculiar and uncomfortable situation. This is where legal theory and commercial pragmatism collide in relation to the position of the nominee. Any decision or action of the nominee could be challenged by a perception if nothing else of a conflict of interest by the mere nature of the appointment. Under the common law a director should not put himself in a position where his interest and duty conflicts. Clearly this could put the entire appointment of a nominee director into question from the very outset. However, the judiciary have accepted the nature of the position of nominee and have instead focused on whether the nominee acted in the best interests of the company, or whether he preferred the interests of his appointer.

2.2 Promote the Success of the Company

Directors have a duty to act for the benefit of the company as a whole and to act in the best interests of the company. Lord Greene Master of the Rolls (MR) in *Re Smith & Fawcett* determined that it is for the directors and not the court to determine what is in the best interests of the company.[14] It is a subjective test. Therefore, in practice, the nominee director is granted some discretion in relation to satisfying the requirement of good faith. However, a director will have failed his duty if no reasonable director could, in good faith, have considered his decision to promote the success of the company, in *Re Sourthern Counties Fresh Foods* showed that there is an objective element to the director's discretion.[15]

2.3 Can a Nominee Director Act in the Interests of His Appointer?

The traditional or 'absolutist' approach taken by the English courts has been to accept that the nominee directors are a commercial reality and are in a difficult position, but to insist upon them exercising their powers subject to the same duties as other directors without being able to take into account the interests of the appointer.

Lord Denning in the *Boulting* case stated that:

> *There is nothing wrong in having nominee directors. It is done every day. Nothing wrong, that is, so long as the director is left free to exercise his best judgment in the interests of the company.*

This traditional approach was further shown in the *Scottish Co-operative Wholesale Society Ltd v. Meyers* where Lord Denning said that '*as soon as the interest of the two companies were in conflict, the nominee directors were placed in an impossible position … they probably thought "as nominees" of Scottish Co-operative Wholesale Society ("CWS") their first duty was to CWS. In this they were wrong*'.[16] Lord Denning was in no doubt that in preferring the interests of the appointer, they placed themselves in breach of duty. Lord Denning did recognize that the position of a nominee was '*impossible*' but reiterated that the interests of the company have to be the sole determining factor in the decision-making process.

In *Kuwait Asia Bank v. National Mutual Life* the Privy Council confirmed that in exercising their duties as directors of a company, nominee directors had to ignore the interests and wishes of their appointer.[17] The Privy Council reiterated the *Scottish Co-Op* position that nominee directors owed their duty only to the company and could not take into account the interests of the appointer.

This reasoning has been academically questioned as being too rigid and ignoring the commercial reality faced by nominee directors.[18] In *Hawkes v. Cuddy*, Stanley Burnton LJ emphasized that a nominee director could, without being in breach of his duties to the company, take the interest of his appointer into account, provided that he genuinely considered this to be in the best interests of the company.[19] Case law would suggest that a nominee director can take into account the interests of his appointer, however, in the event of a conflict, he must not prefer them over the company.

In the case of *Levin v. Clark*, directors nominated to the board of the company by a mortgagee were held to be entitled to act primarily in the interests of the mortgagee after a default by the mortgagor company.[20] Jacobs J emphasized that the scope and content of the fiduciary duty to act in the best interest of the company depended on the circumstances of each case. In the *Levin* case, it was decided on the basis that where the mortgagee appointed a director to represent his interest on the board of a company, the interest of the company could be best served if that director acts in the interests of the mortgagee in the case of a default. This has become known as a shift from the traditional approach *(reflected in Scottish Co-Operative and Kuwait Asia Bank)* to a corporate primacy approach, which provides for a more realistic attitude to nominee directors.

2.4 Nominee Directors and Insolvency Companies

As discussed above, the interests of the creditors are to be taken into account when a company is in a dangerous, precarious or insolvent financial position. The statement in *Kinsela v. Russell Kinsela Pty Ltd (in liq)* by Street CJ was affirmed in *Colin v. Gwyer v. London Wharf (Limehouse) Ltd*, Leslie Cosmin Queen's Counsel (QC) referred to the *Liquidator of West Mercia Safetywear* case and said that where a company was insolvent or of doubtful solvency or on the verge of insolvency and the creditor's money was at risk, the directors, when carrying out their duty to the company, have to consider the interests of the creditors as paramount and take those into account when exercising their discretion.[21]

[13] *Ibid*., at 10.
[14] *Re Smith & Fawcett* [1942] Ch. 304, 306.
[15] *Re Southern Counties Fresh Foods* [2008] EWHC 2810 (Ch) at 53.
[16] *Scottish Co-operative Wholesale Society Ltd v. Meyers* [1959] AC 324.
[17] *Kuwait Asia Bank v. National Mutual Life* [1991] 1 AC 187.
[18] Ahern, *Nominee Directors' Duty to Promote the Success of the Company: Commercial Pragmatism and Legal Orthodoxy,* [2011] LQR 118.
[19] *Hawkes v. Cuddy* [2009] EWCA Civ 219.
[20] *Levin v. Clark* [1962] NSWR 686.
[21] *Colin v. Gwyer v. London Wharf (Limehouse) Ltd* [2002] EWHC 2748 (ch).

Leslie Cosmin QC stated that the test was whether an intelligent and honest man in the position of the director concerned could, in the whole of the existing circumstances, have reasonably believed that the transaction was for the benefit of the company, but that in considering the benefit of the company the director must have been capable of believing that the decision was in the interest of and for the benefit of the creditors.

On insolvency, or on the verge of insolvency, the directors have to act in the interests of the creditors. The interest of the company at that point, is in reality the interest of the existing creditors. In this situation the duty to act in the interests of the creditors is seen as akin to the duty to act in the interests of the company. However, it is not to prefer the interests of one particular creditor but to act for the benefit of all the creditors as a whole.

3 Conclusion

Nominee directors face a challenging position at the outset. They have been described as being caught between the devil and the deep blue sea.[22] Clearly on one spectrum they face the commercial reality of their position which requires them to consider the interest of their appointer, yet on the other hand they face their legal obligations to act exclusively in the best interests of the company. English law has begun to accept the impossibility of their position as a conundrum and an area in which commercial reality and legal niceties frequently collide. It now accepts that a nominee director can take account of the interest of their appointers as long as this interest does not conflict with the interest of the company. If a nominee director has been appointed by a secured creditor, his obligation in times of an insolvent position, or a near insolvent position, is to the creditors as a whole. A nominee's primary obligation will always be to prefer the best interests of the company and any derivation from this in times of insolvency is to recognize that the creditors, as a whole, are in reality the interest of the company as a whole at this juncture. Outside of this it has now been established that it is not a breach of duty if what a nominee director considers the best interests of the company are also to the benefit of the appointer.

[22] Parsons, *The Director's Duty of Good Faith*, 5 MULR 395 at 418 (1967) describes the position of the nominee director as being 'between the devil and the deep blue sea'.