

Nominee Directorship in Kenya, an examination of a more Liberal Approach

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By

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Declaration

I, MOSES MUCHIRI KAHORO, do hereby declare that this research is my original work and that to the best of my knowledge and belief, it has not been previously, in its entirety or in part, been submitted to any other university for a degree or diploma. Other works cited or referred to are accordingly acknowledged.

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Abstract

Kenya's legal position in regards to directorship and more specifically to Nominee Directorship has been indistinct, often silent but in commercial practice it does occur frequently as more and more companies have designed complex ownership structures and overall management. This dissertation shall dwell into how Nominee Directors are formed in corporate management, which directorship duties are brought into challenge as a result of such a position and how to address them using other jurisdictions methods while at the same time making a note as to how they fit in the commercial sense.

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LIST OF ABBREVIATIONS

UKHL	United Kingdom House of Lords Decisions
QB	Queen's Bench
ALL ER	All England Law Reports
N.S.W. R	New South Wales Report
E.W.C. A	England and Wales Court of Appeal
B.C.L.C	Butterworth Company Case Law
B.C.C	Britain Company Case Law
WRL	The Weekly Law Reports
N.Z.L. R	New Zealand Law Reports
E.W.H.C	High Court of England and Wales

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BACKGROUND

In terms of company management various companies offer the position of a nominee director in their company structure so as to cater for the interests of various stakeholders.¹ By definition a nominee director is a person who is appointed to the board of a company to represent the interests of his appointer. The appointer may either be a shareholder or a stakeholder (such as a creditor) who is involved in the company affairs². The appointer may also be an institutional investor, a joint venture partner, or a group of employees³

Primarily the duty of the nominee director is to look after the interests of the nominator but also has to look after the interests of the company as a whole⁴. Their appointment may also result from rights stipulated in the corporation's articles, a joint venture agreement or even a shareholders' agreement. Moreover, financing agreements often contain, as a condition precedent to advancing the necessary funds, the lender's right to nominate one or several board members.⁵

As to the motives of appointment to such a position, they may vary from as in the case in the case of a majority, or controlling shareholder, the primary motive for the appointment is often to ensure representation and protection of such shareholder's particular interests or in the case of an institutional investor, a nominee director shall likely be expected to ensure the adequate protection of the investment.⁶ In other perspectives the nominee director may be appointed to so as to cater for matter such as solving important matters in company management and policy such as ensuring harmonious operation of group companies, protection of strategic interests such as those of institutional investors who agree to lend funds on condition that they are granted board

¹ P. Redmond, "Nominee Directors" (1987) 10 University of New South Wales Law Journal 194.

² John Lowry and Arad Reisberg, *Pettet's Company Law: Company Law & Corporate Finance 4th Edition*, Pearson, 2012, pg. 179-181.

³ E. Norman Veasey & Christine T. Di Guglielmo, "How Many Masters Can a Director Serve? A Look at the Tensions Facing Constituency Directors" (2007-2008) 63 Bus. Law. 761 (HEIN) [Veasey & Di Guglielmo].

⁴ Gower & Davis, *Principles of Modern Company Law*, 9th Edition, Sweet & Maxwell, 2012, pg. 539.

⁵ Sarah Samara Sekouti, *A Comprehensive Analysis of the Legal Issues Relating to Nominee Directors*, Université de Montréal, September 2009.

⁶ Sarah Samara Sekouti, *A Comprehensive Analysis of the Legal Issues Relating to Nominee Directors*, Université de Montréal, September 2009, Pg.7.

representation, and finally to fill in for shareholders who do not necessarily possess the adequate expertise to personally serve as directors.⁷

In Kenya, provision of nominee directors is not provided explicitly by law as they are treated the same way as general directors of a company. In *Housing Finance Company of Kenya Ltd V Palm Homes Ltd*⁸ Justice Khamoni stated that “*the Companies Act does not make provisions for the concept of nominee directors and ...the concept is not known to Kenyan jurisprudence*”. The occurrence of Nominee directors mainly arises in the context of Fraud in Government Companies (Parastatals) where the nominee director represents well connected politicians. For example, in the case of *National Social Security Fund Board of Trustees v Ankhan Holding Ltd*⁹ the facts involved the illegal sale of public land to the National Social Security Fund (NSSF). The defendants were listed as the directors of the company. However, information arising from the case identifies the real owner of the company as a son of former President Moi.¹⁰

The aspect of nominee directors is closely linked to the fact that most companies operating hold a substantial interest in other companies¹¹ and thus it becomes vital to protect their interests in terms of nominating a director in such a position so as to look after their interests¹². In their position as directors they have responsibilities and duties towards the company that are enshrined by either statute or case law¹³ and also to their nominators. Their statutory duties according to the Companies Act¹⁴ fall mainly under the duty to act within powers, duty to promote the success of the company, duty to exercise independent judgment, duty to exercise reasonable care, skill and diligence, duty to avoid conflicts of interest and the duty not to accept gifts from third parties¹⁵.

⁷ John De Lacy, “The concept of a company director: Time for a new expanded and unified statutory concept” (2006) J. Bus. L. 267 at 284

⁸ *Housing Finance Company of Kenya Ltd v Palm Homes Ltd*, Civil Case No.918 of 1999

⁹ *National Social Security Fund Board of Trustees v Ankhan Holding Ltd*, HCCC No.268 of 2004.

¹⁰ Lois M. Musikali, “Director and Shareholding Interlocks in Kenya's Plcs: *How to Address the Nominee Question? A Cultural Perspective*”, *International Company and Commercial Law Review* Vol 23(9), 2013, pp.343-348

¹¹ Kenya Commercial Bank 2010 Annual Report and Financial Statements. *Kenya Commercial Bank Nominees Ltd A/C 769G is the 8th largest shareholder at NIC Bank Ltd owning 1.43%, the 7th largest shareholder at Nation Media Group owning 0.54% and the 9th largest shareholder at Bamburi Cement owning 0.29%.*

¹² Lois M. Musikali, “Director and Shareholding Interlocks in Kenya's Plcs: *How to Address the Nominee Question? A Cultural Perspective*”, *International Company and Commercial Law Review* Vol 23(9), 2013, pp.343-348.

¹³ Division 3, The Kenya Companies Act, (2015).

¹⁴ Division 3, The Kenya Companies Act, (2015).

¹⁵ Division 3, section 142-147, The Kenya Companies Act, (2015).

However, these prescribed duties mainly fall under the general scope of director's duties and does not go into detail as to how they govern the aspect of nominee directors. If the primary role of a nominee director is to look after the interests of the nominator or appointor, then he is put in a position where he has to balance the interests of the company and the nominator thus putting him or her into a collision course in respect of the two¹⁶.

In terms of English Jurisprudence, the question of Nominee directors is dealt with under the No conflict of interest rule section 175 of the Companies Act where it provides that 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.¹⁷

This provision has been used to interpret the position of the nominee director as in the case of *Boulting v Association of Cinematograph Television and Allied Technicians*¹⁸ where the facts consisted of two managing directors of a film company had applied for a declaration that while they were performing 'management functions' (e.g. producing and directing) and they were not eligible for membership of the trade union. Until 1950 they had been union members, but then they tore up their cards and paid no further subscriptions. In 1959 the union claimed that they needed to pay up to date for their membership fees, and said they must be members of the union. At this time, like many unions, there was a closed shop agreement. Rule 7 of the union's rules said that "The association shall consist of all employees engaged on the technical side of film production... including film directors." They also wanted an injunction restraining the union from making them join.

In Lord Denning's Judgement, he stated that

“take the nominee director ... There is nothing wrong in it ... so long as the director is left free to exercise his best judgment in the interests of the company which he serves. But if he is put upon terms that he is bound to act in the affairs of the company in accordance with the directions of his patron, it is beyond doubt unlawful.”

¹⁶P. Redmond, "Nominee Directors" University of New South Wales Law Journal 194,1987.

¹⁷ Section 175(1) of the England Companies Act 2006.

¹⁸*Boulting v Association of Cinematograph Television and Allied Technicians* [1963] 2 QB 606 at p.626.

This principle is further used in the case of *Kuwait Bank v National Mutual Life*¹⁹ where the facts were a bank had 40% shareholding in a certain company and as result had appointed two directors to the board of that company. The company was a money broker where its activities involved deposit taking activities. Unfortunately, the company went into liquidation and the depositors lost their money.

The question then arose as to whether the appointer bank, could be held liable for the negligence of its nominees. The main argument was that the appointer was vicariously liable because its nominees were appointed by the bank were employed by it and carried out their duties as directors in the course of their employment by it. The court disapproved such an argument and held that the bank was not vicariously liable because the nominees were bound by the fiduciary duties to the company and were to ignore the wishes of their employer, the bank.

This mode of interpretation of the position of nominee directors was used in the *National Social Security Fund Board of Trustees v Ankhan Holding Ltd* case where Justice Fred Ochieng held that individuals who incorporate companies to acquire benefits will not be allowed to allege later when liability arises that they cannot be sued because they are nominee directors. According to Justice Ochieng argument was that once a person is named as a director of a company, his rights and obligations are defined in the memorandum and articles of association. A director cannot purpose to diminish his legal responsibilities by “a side contract” between himself and the company especially when the said director is dealing with third parties.

In terms of Australia’s position towards Nominee directors their approach is different in that it takes into account the commercial realities in regard to the nominee position. In *Levin v Clark*²⁰ the facts were that the plaintiff purchased a majority shareholding in a company and took a mortgage for purchase monies from the vendor. The articles of the company provided for the appointment of two governing directors.

These positions were purportedly occupied, although there had been some irregularities in appointment, by individuals associated with the vendor. It was arranged that they would remain as directors but would not exercise their powers as governing directors unless the plaintiff defaulted

¹⁹*Kuwait Bank V National Mutual Life* [1990] 3 ALL ER 404, PC.

²⁰ *Levin v Clark* [1972] NSW 686

under the mortgage. When the plaintiff defaulted under the mortgage the two directors attempted to exercise their powers as governing directors, and the plaintiff sought to restrain them on various grounds, one of which was that they had breached their fiduciary duty by acting in the interests of the mortgagee rather than the company as a whole.

In the Judgement of Justice Jacobs, he stated that he had considered that Clark and Rappaport did act primarily in the interests of the mortgagee once they resumed the exercise of their powers as governing directors. However, he considered that it was permissible for them to act so. The rationale for this argument was that 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 third party and who may in that way be properly regarded as acting in the interests of the company as a whole.²¹

“To argue that a director particularly appointed for the purpose of representing the interests of a third party, cannot lawfully act solely in the interests of that third party, is in my view to apply the broad principle, governing the fiduciary duty of directors, to a particular situation, where the breadth of the fiduciary duty has been narrowed by agreement amongst the body of shareholders.”²²

In the case of *Re Broadcasting Station 2GB Pty Ltd*²³ it was alleged, in a suit complaining of statutory oppression, that the new controller of 2GB, Fairfax, had appointed directors to 2GB's board who were for all intents and purposes the nominees of Fairfax, although the articles did not provide for the appointment of nominee directors. In the judgment, Justice Jacobs differed with the argument brought forward and put it across that

“It is my view that conduct of the kind which I have related [where nominees acted in accordance with their appointer's interests] is not reprehensible unless it can also be inferred that the directors, so nominated, would so act even if they were of the view that their acts were not in the best interests of the company ...”

²¹ R P Austin Minter Ellison, *Representatives and Fiduciary Responsibilities - Notes on Nominee Directorships and Life Arrangements* (1995) 7 BOND L R.

²² *Levin v Clark* [1972] NSW 686

²³ *Re Broadcasting Station 2 GB Pty Ltd* [1964–1965] N.S.W.R.R. 1648

The Australian position treats the position of a nominee director in a more flexible manner than the Kenyan and England position. It realizes that there is a certain threshold of fiduciary obligations for different types of obligations and not just a blanket provision in regards to directors.²⁴

These different approaches of analyzing the role of nominee directors is what this paper seeks to address bearing in mind the duties they owe to both the company they serve and their nominator interests. The following chapters seek to go further in analyzing the specific duties that nominee directors possess, analyzing the question of liability of their actions and also understanding the position of nominator or appointor.

1.1 Statement of Problem.

Kenya's position in regards to the Nominee Director position has the problem of not bearing in mind the commercial realities of company management and a more liberal attitude is needed to understand the complexities and benefits of such a position.

1.2 Research Questions

- Which directorship duties are put into jeopardy when dealing with the Nominee Directorship position and how have different jurisdictions handled the position? (Chapter 2)
- What is to be done when dealing with Corporate Groups where one company holds a substantial holding in other companies which then proceeds to nominate its own directors on the board? (Chapter 3)
- How to address the question of Appointor liability as a result of the Nominee Director's actions. (Chapter 4)

²⁴ *Henderson v Merrett Syndicates Ltd* [1995] 2 A.C. 145 HL at 206.

1.3 Theoretical Framework

1.3.1 Classical view.

Corporate governance is generally understood as the relationship among various participants in determining the direction and performance of corporations. The primary participants are (1) the shareholders, (2) the management (led by the chief executive officer), and (3) the board of directors. Other participants include the employees, customers, suppliers, creditors, and the community.²⁵In relation to directors or the management the law prescribes a specific code by law as to how they are to operate and in most jurisdictions, it is prescribed by Statutes governing Companies.²⁶ When it comes to Nominee Directors the law is restrictive in its nature as it puts them on the same threshold as normal directors, their duties such as the duty of loyalty are held to be the same as the rest of normal directors. Lord Cranworth in *Aberdeen Rly Co v Blaikie Bros*²⁷ stated explicitly with regards to Duty of Loyalty, that in dealing with a company its only representative will be its agents and in the course of duty, their work will be to best promote the interests of the company. The agents shall not be allowed to enter into engagements in which they have a personal interest conflicting or which may possibly conflict with the interest so company

In Kenya, this classical view on Nominee Directors is seen in *National Social Security Fund Board of Trustees v Ankhan Holding Ltd* ²⁸where according to Justice Fred Ochieng once a person is named as a director of a company, his rights and obligations are defined in the memorandum and articles of association. A director cannot purpose to diminish his legal responsibilities by “a side contract” between himself and the company especially when the said director is dealing with third parties. These two examples from different jurisdictions show that in view of Nominee Directors, courts are reluctant to diverge from the common norm of putting all directors on the same threshold.

²⁵ R A G Monks and N Minow, *Watching the Watchers: Corporate Governance for the 21st Century* (1996) at xvii.

²⁶ Kenya Companies Act of 2015.

²⁷ *Aberdeen Rly Co v Blaikie Bros* 1854] UKHL 1

²⁸ *National Social Security Fund Board of Trustees v Ankhan Holding Ltd*, HCCC No.268 of2004.

1.3.2 Liberal Theory

The liberal view of looking into Nominee Directorship is enhanced by the constant development of complex governance structures in the current society of corporate governance. This theory is driven by the need of greater oversight over company affairs drives the need to increase more representation of stakeholder interests in the board. This theory finds its authority from mostly Jurisdictions of Canada and Australia which have a recognition of Nominee directorship. Under the liberal view, it is widely accepted that Nominee directors serve a different role or special role than normal role. As Justice E W Thomas²⁹ puts it, at times in respect to Nominee Directors their obligations have to be adjusted in contrast to the traditional obligations of directors.

The Liberal theory brings in a different manner in which to look at the Nominee Director position. The first one being the corporate primacy approach, where it perceives the possibility of acting in a manner that is compatible with the interests of both company and appointer. It is, however, founded on the principle that the company's interests prevail, so that if it is not possible to please the appointer and act in the company's interests, the company's interests must win out.³⁰ This shall be discussed further in chapter 2 on Duties of Nominee Directors. The other approach will be the Attenuated Duty Approach where, it involves recognizing the permissibility of private ordering by the shareholder body as the primary corporate organ in the form of contractual attenuation of the duties applicable to nominee directors³¹

²⁹ The Role of Nominee Directors and the Liability of their Appointors by Justice E W Thomas, Chapter 9, The Centre for Corporate Law and Securities Regulation Faculty of Law, The University of Melbourne, 1997.

³⁰ Deirdre Ahern, Nominee Directors 'Duty to Promote the Success of the Company: Commercial Pragmatism and Legal Orthodoxy, Law Quarterly Review January 2011.

³¹ Deirdre Ahern, Nominee Directors 'Duty to Promote the Success of the Company: Commercial Pragmatism and Legal Orthodoxy, Law Quarterly Review January 2011. Pg. 133.

Chapter 2: Duties of Nominee Directors.

In order to put into context as to which type of directorship duties is put into conflict in respect to the Nominee position one has to understand the legal principle regarding general directorship duties. At the most fundamental level of company law the duty to be loyal and competent when acting as a director form the basic backbone of directorship duties.³²The former encompasses the most fundamental duty of a director as it entails not only the obligation of being loyal to a company but also putting the company's interests first at all times. The fiduciary duty of loyalty is a duty not to utilize the fiduciary position in a way which is averse to the interests of the person for whom the fiduciary is acting.³³

In Item *Software (UK) ltd v Fassih* Lord Arden brought about the duty of loyalty to be of a fundamental importance as it under pins more specific obligations which instantiate (put into effect) its fundamental nature in different regulated contexts. It is fundamental because loyalty is an extricable aspect of the original instruction -namely to act on behalf of the instructing person or the person who the instructing person tells you to act on behalf of.

When it comes to Nominee Directors, they are often appointed on an informal basis, on the mere understanding that they will act in favor of their appointer. The position of a nominee director faces the challenge of loyalty as put by Ross W. Parsons³⁴ a director who is a nominee is between the devil and the deep blue sea. He will only remain in such a position if he keeps the interests of his nominator while carrying out his duty.

Paul Redmond³⁵ also questions the position of a nominee director by noting that the duty of loyalty to the shareholder is put at risk where the position of a Nominee Director exists whose main purpose is to look after the interests of another a party who may not be in the same group as the shareholders.

³² David Kershaw, *Company Law in Context*, Second Edition, Oxford University Press 2012.

³³ Mayson, French & Ryan on *Company Law* 2013-2014, Edition, Oxford University Press, pg478.

³⁴ Ross W. Parsons, "The Directors' Duty of Good Faith" (1967) 5 *Melbourne U. L. Rev.* 395 at 418 [Parsons].

³⁵ P. Redmond, "Nominee Directors" *University of New South Wales Law Journal* 194,1987.

The duty of loyalty encompasses two principal foundations that form its core. Firstly, is the duty to act in good faith and in the best interests of the company (more commonly known as the duty to promote the success of the company) and secondly is the duty to avoid conflict of interest.³⁶This chapter shall be divided into these two foundations and see how they may come into play with regards to Nominee directors.

2.1 Duty to promote the success of the company

The Kenya Companies Act was recently passed into law³⁷ and with it came the legislation of the duty of directors to promote the success of the company.³⁸The provision provides that director of a company shall act in the way in which the director considers, in good faith, would promote the success of the company for the benefit of its members as a whole, and in so doing the director shall have regard to the long term consequences of any decision of the directors³⁹; the interests of the employees of .the company⁴⁰; the need to. foster the company's business relationships with suppliers, customers and others⁴¹;the impact of the operations of the company on the community and the environment⁴²; the desirability of the company to maintain a reputation for high standards of business conduct⁴³; and the need to act fairly as between the directors and the members of the company.⁴⁴

Given the Kenya's Company Act contained similar provisions as to the England Company's Act the duty to promote the success of the company is better understood in regards to England Jurisprudence.⁴⁵ This Provision is similar to the Section 172 of the England Company Act⁴⁶ where it provides that a director of a company must act in the way he considers, in good faith, would be

³⁶ David Kershaw, *Company Law in Context*, Second Edition, Oxford University Press 2012, pg. 316.

³⁷ Change looms with the New Companies Act <http://www.businessdailyafrica.com/Opinion-and-Analysis/Change-looms-with-the-New-Companies-Act/539548-2898342-5f8nlm/index.html> > Accessed on 22nd October 2016.

³⁸ Section 143 of the Kenya Companies Act 2015.

³⁹ Section 143(1)(a) of the Kenya Companies Act 2015.

⁴⁰ Section 143(1)(b) of the Kenya Companies Act 2015.

⁴¹ Section 143(1)(c) of the Kenya Companies Act 2015.

⁴² Section 143(1)(d) of the Kenya Companies Act 2015.

⁴³ Section 143(1)(e) of the Kenya Companies Act 2015.

⁴⁴ Section 143(1)(f) of the Kenya Companies Act 2015.

⁴⁵ How new set of regulations will change the business landscape <http://www.nation.co.ke/lifestyle/smartcompany/How-new-set-of-regulations-will-change-the-business-landscape/1226-2870484-q57igrz/index.html> > Accessed on 27th October 2016.

⁴⁶ Section 172 of the England Company's Act 2006.

most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to—

- a) the likely consequences of any decision in the long term⁴⁷
- b) the interests of the company's employees⁴⁸
- c) the need to foster the company's business relationships with suppliers, customers and others⁴⁹
- d) the impact of the company's operations on the community and the environment⁵⁰
- e) the desirability of the company maintaining a reputation for high standards of business conduct,⁵¹ and
- f) the need to act fairly as between members of the company.⁵²

The duty to promote the success of the company arises out of an equitable fiduciary duty which was made in connection with the duty to act within their powers. Lord Greene in *Re Smith and Fawcett Ltd*⁵³ where he stated that directors of a company must act at all times in what they consider to be in the best interests of the company and it is not the duty of the court to determine it .

In *JJ Harrison (Properties) Ltd v Harrison*⁵⁴ Lord Chadwick bringing also a connection between the two duties, stated in relation to the power of a director to dispose company property that such power must be exercised in the interests of the company.

The main feature of a company is the principle of separate legal identity which was established clearly in the case of *Salomon v. Salomon*⁵⁵ where Lord Macnaghten stated categorically that the company is at law a different person altogether from the subscribers to the memorandum. In the words of Lord Macnaghten;

⁴⁷ Section 172(1)(a) of the England Company's Act 2006.

⁴⁸ Section 172(1)(b) of the England Company's Act 2006.

⁴⁹ Section 172(1)(c) of the England Company's Act 2006.

⁵⁰ Section 172(1)(d) of the England Company's Act 2006.

⁵¹ Section 172(1)(e) of the England Company's Act 2006.

⁵² Section 172(1)(f) of the England Company's Act 2006.

⁵³ *Re Smith and Fawcett Ltd*. [1942] Ch 304.

⁵⁴ *JJ Harrison (Properties) Ltd v Harrison*; CA 11 Oct 2001.

⁵⁵ *Salomon v Salomon & Co Ltd* [1896] UKHL 1.

“...the company is at a law a different person altogether from the subscribers and though it may be that after incorporation the business is precisely the same as it was before, and the same persons are managers, and the same hands receive the profits, the company is not in law the agent of the subscribers or trustee for them nor are the subscribers as members liable in any shape or form except to the extent and manner prescribed by the Act....”

Section 172 (1)⁵⁶ thus therefore neatly brings in the interests of both the company as a separate person and of its members by expressing a director’s duty in terms of promoting the success of the company for the benefit of its members as a whole.⁵⁷

In the report of the Company Law Review Group ⁵⁸stated that there is importance in attaching reference to duty to promote the success of the company as what is being analyzed is not the individual interests of the members of the company but the interests as member of an association with the purposes and mutual agreements embodied in the company constitution.

In ***Mutual Life Insurance Co of New York v Rank Organization Ltd***⁵⁹ the facts were that in 1975 Rank Organization Ltd, an entertainment company, decided to offer 20 million ordinary shares to the public, with a preference to existing Rank shareholders. This preference offer did not however extend to shareholders based in the United States and Canada (including Mutual Life), because it was thought not to be in the company's interest to have to register there. Rank's articles of association stated that directors could allot, deal with or dispose of company shares "on such terms as they think proper". But the American and Canadian shareholders (they owned shares "beneficially" through nominee companies, who were defendants alongside Rank in the case) were still unhappy. They said they had been discriminated against, and that was a "breach of contract" because section 20 of the Companies Act 1948⁶⁰ implied shareholders deserved equal treatment.

In the Judgement of Lord Goulding he stated that provisions of the company’s constitution conferring powers on its directors are subject to two implied terms firstly being the time-honored rule that the director’s powers are to be exercised in good faith in the interests of the company and

⁵⁶ Section 172(1) of the England Company Act 2006.

⁵⁷ Mayson, French & Ryan on Company Law 2013-2014, Edition, Oxford University Press, pg. 488.

⁵⁸ Modern Company Law for a Competitive Economy: Developing the Framework (URN 00/656) (London: DTI ,2000), para 3.51.

⁵⁹ *Mutual Life Insurance Co. of New York v The Rank Organization Ltd.* [1985] BCLC 11.

⁶⁰ Section 20 of the England Company’s Act 1948.

secondly that they must be exercised fairly as between different shareholders. This case is followed up by *Re BSB Holdings Ltd*⁶¹ where her Ladyship stated that in terms of the law it does not require that interests of the company to be sacrificed in the interest of a group of shareholders.

*In Gaiman v National Association for Mental Health*⁶², Megarry J observed that as a company is an artificial legal entity, it is not easy to determine what is in its best interests without paying due regard to its present and future members as a whole. Nevertheless, his Lordship went on to decide that whereas persons exercising a power of expelling members from an unincorporated association may have a duty to the persons sought to be expelled to observe the rules of natural justice when it comes to an Incorporated Association the directors or others exercising the powers in question are bound not merely by their duties towards the other members but also by their duties towards the corporation.

How does this duty relate to Nominee Directors?

An analysis of judicial decisions in regards to nominee directors, common law has three distinct approaches to the duty of nominee directors to act in the interests of the company.

These can be categorized as an absolutist approach, a corporate primacy approach and an attenuated duty approach⁶³.

2.1.1 The absolutists Approach

Under the absolutists approach, the duty on directors to act in the interests of the company is understood to operate in total exclusivity with no mention of the appointor interests. In *Dawson, International Plc v Coats Paton Plc*⁶⁴ Lord Cullen made the observation that directors can only have one master.

This position holds the Nominee director position as not being afforded a distinct legal status from that of other de jure directors. Another illustration of this principle is in the South African case of *Fisheries Development Corp of SA Ltd v Jorgensen*⁶⁵ where Margo J. elaborated the position of

⁶¹ *Re BSB Holdings Ltd* [1992] BCC 915.

⁶² *Gaiman v National Association for Mental Health*, CHD 1970.

⁶³ Deirdre Ahern, Nominee Directors 'Duty to Promote the Success of the Company: Commercial Pragmatism and Legal Orthodoxy', Law Quarterly Review January 2011.

⁶⁴ *Dawson International Plc v Coats Paton Plc* [1989] B.C.L.C. 233 at 243.

⁶⁵ *Fisheries Development Corp of SA Ltd v Jorgensen* 1980 (4) SA 156(W).

the Nominee director in respect to his duties where he is supposed to observe the utmost good faith to the company. It doesn't matter if he may in fact be representing the interests of the person who nominated him but, in carrying out his duties and functions as a director, he is in law obliged to serve the interests of the company to the exclusion of the interests of any nominator.

In *Scottish Co-operative Wholesale Society, Ltd v Meyer*⁶⁶, the facts involved a joint venture company which was involved in the manufacture of rayon cloth. The company had directors representing both the appellants and the respondents. Hostility had developed between the two sides and the appellants began restricting the supply of rayon cloth on which the company was dependent.

It was said that the nominee directors adopted a policy of passively supporting the appellants by inactivity thus allowing the company's trading activities to decline. The respondents petitioned to have the company wound up on the basis that its affairs were being conducted in a manner oppressive to some of its members.

The House of Lords solved the dispute by the absolutist approach, holding that a nominee director must not place the interests of those who nominated him above those of the company and concluded that the passive neglect amounted to oppression.

Lord Denning in *Boulting v Association of Cinematograph Television and Allied Technicians*⁶⁷ used the absolutists approach where he indicated that if a nominee director is bound to act in accordance with the directions of his appointer his actions shall be declared illegal.

In Canada, this position is held in the case of *PWA Corp v Gemini Group Automated Distribution Systems Inc*⁶⁸ where Callaghan C.J.O.C. emphasized that

*"...a nominee director is not accorded an attenuated standard of loyalty to the corporation and that it was not permissible to subordinate the interests of the corporation to those of an appointer..."*⁶⁹

⁶⁶ *Scottish Co-operative Wholesale Society, Ltd v Meyer* [1959] A.C. 324

⁶⁷ *Boulting v Association of Cinematograph Television and Allied Technicians* [1963] 1 All E.R. 716

⁶⁸ *PWA Corp v Gemini Group Automated Distribution Systems Inc* (1993) 8 B.L.R. (2d) 221 (Ont. Gen. Div. (Comm. List)), affd. (1993) 10 B.L.R. (2d) 109 (O.C.A.). See also *Wood v CFN Precision Inc* (2008) Can LII 19797 (Ontario S.Ct.).

⁶⁹ *PWA Corp v Gemini Group Automated Distribution Systems Inc* (1993) 8 B.L.R. (2d) 221 at 265

This position is also held in Kenya the case of *National Social Security Fund Board of Trustees v Ankhan Holding Ltd*⁷⁰ where according to Justice Ochieng, once a person is named as a director of a company, his rights and obligations are defined in the memorandum and articles of association. A director cannot purpose to diminish his legal responsibilities by “a side contract” between himself and the company especially when the said director is dealing with third parties.⁷¹

2.1.2 Corporate Primacy Approach

In regards to the corporate primacy approach, it perceives the possibility of acting in a manner that is compatible with the interests of both company and appointer. It is, however, founded on the principle that the company’s interests prevail, so that if it is not possible to please the appointer and act in the company’s interests, the company’s interests must win out.

This approach tries to mediate between strict legal principle and commercial reality.⁷² From the commercial point of view it sees that the position of a nominee director is one which is made possible out of the wishes of the nominator to preserve his interests in the company.⁷³ If the Nominee director does not preserve the interests of the nominator, then he or she deserves to abdicate such a position in place of someone else who will.

The corporate primacy approach involves taking a more realistic approach to the plight of the nominee director than under the absolutist approach, which purely recognizes the company’s interests. The downside of the corporate primacy approach is that nominee directors are left with difficult judgment calls to make as to whether the interests of the company and those of their appointer can be said to coincide, particularly where there is no clear collective vision of what is in the best interests of the company.⁷⁴

This approach is seen more in Australia’s Jurisdiction in the case of *Re Broadcasting Station 2GB Pty Ltd*⁷⁵ which concerned nominee directors in a partly-owned subsidiary. Jacobs J. in the

⁷⁰ *National Social Security Fund Board of Trustees v Ankhan Holding Ltd*, HCCC No.268 of2004.

⁷¹ Lois M. Musikali, “Director and Shareholding Interlocks in Kenya’s Plcs: How to Address the Nominee Question? A Cultural Perspective”, *International Company and Commercial Law Review* Vol 23(9), 2013, pp.343-348.

⁷² Andrew Keay, “The Duty of Directors to Exercise Independent Judgment” (2008) 29 *Comp. Law.* 290 at 295.

⁷³ P. Crutchfield, *Nominee Directors: The Law and commercial Reality* (1991) 12 *Co Law* 136.

⁷⁴ Deirdre Ahern, *Nominee Directors ‘Duty to Promote the Success of the Company: Commercial Pragmatism and Legal Orthodoxy*, *Law Quarterly Review* January 2011. Pg. 131.

⁷⁵ *Re Broadcasting Station 2 GB Pty Ltd* [1964–1965] N.S.W.R.R. 1648

Supreme Court of New South Wales was of the view that it was commercially unrealistic to expect that nominee directors would act without regard to an appointer's interests. For a court to determine whether they had breached their duty it has to look at whether they would have acted in the same manner if they did not believe that to do so would be in the company's interests.

In the Irish Courts had the recognition of the dual role that Nominee directors play in company management. Such recognition is placed on the view that it is possible to listen to the views of the Nominator if his views go hand in hand with the interests of the company as a whole. *In Irish Press Plc v Ingersoll Irish Publications Ltd*⁷⁶ Barron J. stated:

*"...There is nothing wrong with the appointing body or party having a view as to where the interests of the company lie and ensuring that its nominees follow that direction provided that in so doing they are not seeking to damage anybody else's interest in the company..."*⁷⁷

This approach respects the collective interests of the members but also acknowledges the reality of the nominee director being stuck between a rock and a hard place⁷⁸.

2.1.3 Attenuated Duty Approach

Lastly is the Attenuated duty approach. Under this approach, it involves recognizing the permissibility of private ordering by the shareholder body as the primary corporate organ in the form of contractual attenuation of the duties applicable to nominee directors.⁷⁹ In essence the Nominee Position is created out of contract which specifies what obligations he or she has to the Nominator. This principle is found in Australia and New Zealand Jurisprudence where in both jurisdictions it has long been judicially accepted that the duties owed by a nominee director can be contractually attenuated.⁸⁰

⁷⁶ *Irish Press Plc v Ingersoll Irish Publications Ltd High Court (Ireland)* Unreported December 15, 1993

⁷⁷ *Irish Press Plc v Ingersoll Irish Publications Ltd* Unreported, December 15, 1993 at 77

⁷⁸ Deirdre Ahern, Nominee Directors 'Duty to Promote the Success of the Company: Commercial Pragmatism and Legal Orthodoxy, *Law Quarterly Review* January 2011. Pg. 132.

⁷⁹ Deirdre Ahern, Nominee Directors 'Duty to Promote the Success of the Company: Commercial Pragmatism and Legal Orthodoxy, *Law Quarterly Review* January 2011. Pg. 133.

⁸⁰ Deirdre Ahern, Nominee Directors 'Duty to Promote the Success of the Company: Commercial Pragmatism and Legal Orthodoxy, *Law Quarterly Review* January 2011. Pg. 133.

In Australia, the leading authority bringing in this approach is the case of *Levin v Clark*⁸¹. In this case. The decision concerned two directors who were appointed as nominees of a mortgagee of shares in the company.

The Supreme Court of New South Wales was to determine whether the decisions they had acted in the interests of the company. It was held that the company's act of taking a secured loan on terms which required the appointment of the secured creditor's nominee as a director amounted to a waiver of the company's right to the undivided loyalty of the director. Jacobs J. was of the view that the nominee directors did act primarily in the interests of the mortgagee.

He went on to observe:

*"...To argue that a director particularly appointed for the sole purpose of representing the interests of a third party, cannot lawfully act solely in the interests of that third party, is in my view to apply the broad principle, governing the fiduciary duty of directors, to a particular situation, where the breadth of the fiduciary duty has been narrowed, by agreement amongst the body of shareholders..."*⁸²

This decision is generally regarded as authority for the proposition that it is possible for a company to modify a nominee director's duties so as to take cognizance of the Nominator Interests although this does not allow directors to act contrary to the interests of the company as a whole.

In the New Zealand case of *Berlei Hestia (NZ) Ltd v Fernyhough*, Mahon J. recognized that where a company's articles allowed a specified shareholder or group of shareholders having the power to nominate a director or directors, the director or directors may have a special responsibility to those who nominated them.

This mode of thought as to how to approach the Nominee Director position has become more accepted in the United Kingdom as they try to move away from the Absolutist Approach but they have been restricted in terms of being Obiter

⁸¹ *Levin v Clark* [1962] N.S.W.R 686. See also the Privy Council's advice in *Cumberland Holdings Ltd v Washington H Soul Pattinson & Co Ltd* (1977) 2 A.C.L.R. 307 at 318; *Re News Corp Ltd* (1987) 70 A.L.R. 419 at 436.

⁸² *Levin v Clark* [1962] N.S.W.R 686 at 700–701

In Re Southern Counties Fresh Foods Ltd; Cobden Investments Ltd v RWM Langport Ltd

⁸³related to a joint venture company called Southern Counties Fresh Foods Ltd (SCFF), where it was held on an equal share basis between Cobden Investments and Heffer Family. It was alleged that the RWM Langport directors of SCFF had acted in breach of their duties to SCFF in preferring the interests of RWM Langport Ltd and RWM Dorset Ltd and that such conduct amounted to unfair and prejudicial conduct.

According to Warren J, he held that directors' duties could be expressly or impliedly qualified by the unanimous agreement of the shareholders but he gave the condition this did not mean that they could be completely abrogated from duty but the onus would lie on those asserting that their obligations were different under contract agreed to by all shareholders.

In Re Neath Rugby Ltd; Hawkes v Cuddy⁸⁴ a new rugby team was formed where Mr. Cuddy and Mr. Hawkes were 50:50 shareholders in Neath Rugby Ltd (Neath). Mr. Cuddy was Neath's nominee director on the board of Neath-Swansea Ospreys Ltd (Ospreys) in which Neath and Swansea each held a 50 per cent shareholding.

It was alleged that Mr. Cuddy had failed to promote Neath's interests and had preferred the interests of Ospreys and accordingly the affairs of Neath had been conducted in a manner that was unfairly prejudicial to Mr. Hawkes as a member.

The main issue in this case was whether it was capable for Mr. Cuddy to have Neath's interests before the team on the basis of a contract. The Court of Appeal held that there was a possibility of attenuation of duty in regards to the case⁸⁵ but It was said that there was no evidence that Swansea as the other shareholder of Ospreys had agreed to "any dilution of Mr. Cuddy's duties to the company" which would "justify his putting the interests of Neath ahead of those of Osprey when making decisions as a director of the latter."⁸⁶

⁸³ *In Re Southern Counties Fresh Foods Ltd; Cobden Investments Ltd v RWM Langport Ltd* [2008] EWHC 2810 (Ch).

⁸⁴ *Re Neath Rugby Ltd; Hawkes v Cuddy* [2009] EWCA Civ 291; [2009] 2 B.C.L.C. 427 CA

⁸⁵ It was noted that on the basis of *Re Duomatic Ltd [1969] 2 Ch. 365*, the agreement of all shareholders would be required and it would not be sufficient to show that the directors of the company had agreed to such a dilution of the respondent's duties to the company

⁸⁶ *Re Neath Rugby Ltd; Hawkes v Cuddy* [2009] EWCA Civ 291; [2009] 2 B.C.L.C. 427 CA at [44].

2.2 Duty to avoid Conflict of Interest.

The Kenya Companies Act section 146, provides a provision that a director has a duty to avoid conflict of interest and this includes situation where there is a conflict and where there is a potential to be such a conflict with the interests of the company.⁸⁷ The Act then proceeds to give the provision that such conflict to be consisting of the act of exploitation of any property, information or opportunity, and it does not matter whether the company could take advantage of the property, information or opportunity.⁸⁸

The rationale for developing such a provision can be illustrated by Lord Herschell in **Bray v Ford**⁸⁹ where he states that a director is not allowed to put himself in a position where his interests and duty conflict. As a fiduciary person, he is supposed to cater only for the interests of the company in which he was appointed.

This duty came to the force in the eighteenth century with the emergence of the family trust and was applied to commercial relationships where fiduciary obligations were found to exist.⁹⁰

The duty not to avoid conflict of interest as mentioned before, mainly covers the following

- Interest in contracts made by the company
- Making of secret profits out of knowledge of possessed by the company
- Interlocking directorships.

2.2.1 Interests made by the company

Under interests in contracts made by the company, the basic rule is that if a director has a personal interest in a contract made by the company, equity demands that he discloses the interest to the company, failing which, the contract is voidable at the option of the company.

In **Cook v Deeks**⁹¹ company by the name Toronto Construction Co. had four directors. The first three directors wanted to exclude Mr. Cook from the business. Each held a quarter of the company's shares. The three directors took a contract with a Canadian Pacific Railway but

⁸⁷ Section 146(1) of the Kenya Companies Act 2015.

⁸⁸ Section 146(2) of the Kenya Companies Act 2015.

⁸⁹ *Bray v Ford* (1896) AC 44.

⁹⁰ John Lowry and Arad Reisberg, Pettet's Company Law: *Company Law and Corporate Finance*, Pearson Publishers, 4th Edition 2012, pg. 171.

⁹¹ *Cook v Deeks* [1916] UKPC 10

indicated that they has no interest in the contract after a shareholder resolution. Mr. Cook claimed that the contract did belong to the Toronto Construction Co and the shareholder resolution ratifying their actions should not be valid because the three directors used their votes to carry it.

According to the Privy Council it held that the three directors had breached their duty of loyalty to the company, that the shareholder ratification was a fraud on Mr. Cook as a minority shareholder, and invalid. The result was that the profits made on the contractual opportunity were to be held on trust for the Toronto Construction Co.

2.2.2 Making secret profits out of knowledge possessed by the company

In regards to this any secret profit made by way of bribe, secret commission, or from the use of information without disclosure must be accounted to the company, failing to which the company is entitled to the same under an action for money had and received.

In *Regal Hastings, Ltd V Gulliver*⁹², directors acquired shares not taken up by the public and subsequently sold them at a profit, it was held that they were liable to account to the company. A similar holding was made in *Industrial Development Consultant's Ltd V Cooley*⁹³ where the defendant was a former Managing Director of the plaintiff company which had unsuccessfully submitted a tender to the Gas Board, for a particular project. Soon after a private meeting was held between the chairman of the Gas Board and the defendant, the former offered the latter the contract personally. Soon after the defendant resigned from the company on the grounds of ill health and took up the project as its manager. The company subsequently sued for the profit he had made on that project. It was held that he had breached his fiduciary obligations and was liable to account.

2.2.3 Interlocking Directorships

In terms of Interlocking Directorships, it's not uncommon for one person to hold several directorships of a non-executive nature in different companies. This is unlikely to cause any problems or give rise to a conflict of interests except where two or more companies are in competition with each other⁹⁴. In *London & Mashonaland Exploration Co Ltd v New*

⁹² *Regal (Hastings) Ltd v Gulliver* [1942] UKHL 1

⁹³ *Industrial Development Consultants Ltd v Cooley* [1972] 1 WLR 443

⁹⁴ Stephen Mayson & Derek French, "A practical approach to Company Law", 3rd Edition, Financial Training Publications Limited, Great Britain, 1982, pg. 345.

*Mashonaland Exploration Co Ltd*⁹⁵ Justice Chitty refused to grant an injunction to restrain the chairman of one company becoming a director of a rival company on the basis that the chairman was not required to give any time, let alone the whole of his time, to his company.

In the words of Justice Chitty;

“...there is nothing inherently objectionable in the position of a company director (and chairman) who, without breaching any express restrictive agreement or disclosing any confidential information, becomes engaged, whether personally or as a director of another company, in the same line of business...”

In the United States, Interlocking directorates are forbidden by virtue of the Clayton Act⁹⁶ whereby it provides that no person shall, at the same time, serve as a director or officer in any two corporations (other than banks, banking associations, and trust companies) that are engaged in whole or in part in commerce.

How does this duty relate to Nominee Directors?

By virtue of their position, nominee directors may come across information which is confidential information and thus the question arises as to whether such information may be given to the Nominator. The general rule is that directors are precluded from disclosing or using corporate information, whether for their personal benefit, for the benefit of any third party, or to the detriment of the company.⁹⁷

In dealing with this question of confidentiality, I shall cover two aspects in how it relates to Nominee Directors with the first of which being access to such information and secondly the disclosure of such information to their Appointers.

When it comes to Access to information, all directors have the right to all information that pertains to the running of the company so as to perform their duties.⁹⁸ However, as part of their fiduciary duties, directors are required to preserve the confidentiality of information received through their

⁹⁵ *London & Mashonaland exploration co Ltd v New Mashonaland exploration co Ltd* [1891] WN 165.

⁹⁶ The Clayton Antitrust Act of 1914 United States of America.

⁹⁷ See *Eurasian Natural Resources Corporation Ltd v Judge* [2014] EWHC 3556 (QB)

⁹⁸ Sarah Samara Sekouti, A Comprehensive Analysis of the Legal Issues Relating to Nominee Directors, Université de Montréal, September 2009, pg. 61.

position. As such, directors are precluded from disclosing or using corporate information, whether for their personal benefit, for the benefit of any third party, or to the detriment of the company.⁹⁹

But looking at the position of Nominee Directors their primary duty is to represent the interests of the Nominator and this may involve the delivering of information to the appointor whether or not it is confidential or not.¹⁰⁰ For example take the situation the situation of a financial lender or creditor who has nominated a director to the board of a company so as to know any information in regards to the finances of the company.¹⁰¹

A nominee director is reasonably expected to come across financial information that may be useful to the nominator and it matters not whether the information is confidential or not. This information is vital to the nominator as it will act as a guide to know whether or not to invest more money into the company.

In the case of *Berlei Hestia*, the court held that nominee directors, like any other directors, should not be denied access to corporate information unless it suffices that they would misuse such information.¹⁰²

In New Zealand decision of *Trounce and Wakefield v. NCF Kaiopoi Ltd*¹⁰³ involved an application to illegalize the act of creating a subcommittee to listen to a takeover bid on the grounds that it excluded two nominee directors on the board. On the defense, it was argued that the Nominee Directors would report back the information back to their nominators and as such creating a conflict of interest and thus the creation of a subcommittee was vital. The court rejected the defense by stating that all directors have the right to attend all meetings and receive all information regarding the company¹⁰⁴

⁹⁹ Sarah Samara Sekouti, A Comprehensive Analysis of the Legal Issues Relating to Nominee Directors, Université de Montréal, September 2009, pg. 61.

¹⁰⁰ Lois M. Musikali, "Director and Shareholding Interlocks in Kenya's Plcs: How to Address the Nominee Question? A Cultural Perspective", International Company and Commercial Law Review Vol 23(9), 2013

¹⁰¹ Mark Yeo, "The Myth of Undivided Loyalty" (1990)

¹⁰² *Berlei Hestia (NZ) Ltd. v. Fernyhough*, (1980) 2 N.Z.L.R. 150

¹⁰³ *Trounce & Wakefield v NCF Kaiopoi Ltd & Ors* (1985) 2 NZCLC 99-422.

¹⁰⁴ *Trounce and Wakefield v. NCF Kaiopoi Ltd.*, (1986) 2 N.Z.C.L.C.

In the Singapore Decision of *Lim Kok Leong v Seen Joo Company Pte Ltd and others*¹⁰⁵ the plaintiff, Lim Kok Leong, had been a “sleeping” director of the first defendant, Seen Joo Company Pte Ltd (“the Company”) since 1997. He had not been involved in the management, or the day to day operations, of the Company. On 1 July 2014, the plaintiff sought to inspect the accounting and other records of the Company for the last five years. This was not acceded to. Thereafter, his other similar requests were also unsuccessful. The court held that it was in his inherent right as a director to access the information he requested in performance of his duties.

In the above cases, it has been established that a director has the right to access all information in regards to the company whether or not he or she is a nominee director.

When it comes to the disclosure of such information to the Appointer or Nominator the duty not to use information obtained as a result of, or through their positions, whether confidential or not, for their personal benefit or for the benefit of any third party comes into conflict. But given the nature of the Nominee position this is inevitable consequence and the issue that arises is whether there is rise in liability.¹⁰⁶

*In Michel v. Lafrentz*¹⁰⁷ the Alberta Court of Appeal held that, absent any conflict of interest, directors of a subsidiary company are not precluded from providing their parent company with confidential corporate information and that any strict rule precluding such disclosure would be both impractical and difficult to enforce.

It may be argued that in most circumstances, it is not when the nominee director’s disclosure of confidential information back to his appointer that will incur legal consequences; but rather, it is the appointer’s conduct as a result of being provided with such information.

If an appointer does not act on the information, the practical consequences of the nominee director’s conduct, in having disclosed the information, shall likely be minimal.¹⁰⁸ For example if the information provided is in regards to the level of ownership in a company which is deemed

¹⁰⁵ *Lim Kok Leong v Seen Joo Company Pte Ltd and others* [2014] SGHC 239

¹⁰⁶ Elizabeth Boros “The Duties of Nominee and Multiple Directors: Part I” (1989) 10:11 *Company Lawyer* 211 at 212(HEIN) [Boros].

¹⁰⁷ *Michel v. Lafrentz*, (1992) 4 C.P.C. (3d) 155 at 4 (WEST).

¹⁰⁸ Sarah Samara Sekouti, *A Comprehensive Analysis of the Legal Issues Relating to Nominee Directors*, Université de Montréal, September 2009, pg. 71.

confidential, if a Nominator acts on such information so as to increase his ownership level in may bring in a question of liability of such disclosure.

In several jurisdictions, there has been several proposals in regards to this and the first one being in the United Kingdom through the United Kingdom's Institute of Directors where they had put forth a proposition suggesting that the appropriate test should simply be whether such disclosure was in the best interests of the company:

“The simple criterion is whether the disclosure is bona fide in the interests of the company. It is for the director concerned to prove that any disclosure is indeed bona fide. A director cannot be acting bona fide in the interests of his company if he fetters his discretion as to how he is to act. Thus, if a nominee director agreed always to pass on to his nominator the management accounts of the company of which he is a director, that action alone would be a breach of his duty to act in good faith towards that company”¹⁰⁹

In New Zealand, corporate legislation, contains a statutory exception allowing nominee directors to pass on corporate information to their appointers subject to the fulfillment of certain conditions contained in the legislation. Section 145(2) of the New Zealand Act¹¹⁰ .

¹⁰⁹ U.K., Institute of Directors, Nominee Directors (London: Guide to Boardroom Practice No. 8, 1985) at para. 17.

¹¹⁰ Section 145 of the New Zealand Companies Act of 1993. 145(2) A director of a company may, unless prohibited by the board, disclose information to

(a) a person whose interests the director represents; or

(b) a person in accordance with whose directions or instructions the director may be required or is accustomed to act in relation to the director's powers and duties and, if the director discloses the information, the name of the person to whom it is disclosed must be entered in the interests register.

Chapter 3: Nominee Directors in the Corporate Group Context

A corporate group is basically a collection of parent and subsidiary companies that function as a single economic entity through a common source of control. Increasingly in Kenya in the corporate context, there has been a move of mergers taking place where the goal is to increase the shareholding value of the companies in question by the increase in the number of subsidiaries.¹¹¹ The subsidiaries according to the traditional legal principle are treated as separate legal entities and as such the doctrine of Limited Liability, exercise of fiduciary duties independently by directors still remains.¹¹² The exercise of fiduciary duties by directors is particularly important in the corporate group context in view of the fact that legal principles require directors to discharge their duties in the interests of the individual company they have been appointed to govern as opposed to the group¹¹³.

In practice, however, such a principle does not seem to hold effectively because normally directors on the board of a subsidiary company are increasingly nominees of the parent and are therefore expected to perform their functions in line of the interests of the Parent Company.¹¹⁴

*“...it is unrealistic to insist that the interests of an entity which is part of a larger group can be completely isolated and divorced from the rest of the group, disregarding the fact of their interdependence....”*¹¹⁵

¹¹¹ Centum makes history with Longhorn stake buy <http://www.businessdailyafrica.com/Centum-makes-history-with-Longhorn-stake-buy/-/539552/3213984/-/iiqggd/-/index.html> See also, UAP to acquire Old Mutual firms ahead of listing on bourse <http://www.nation.co.ke/business/UAP-to-acquire-Old-Mutual-firms-ahead-of-listing-on-bourse/996-3303922-11ulx1v/index.html> . See also ,Mwalimu Sacco gets green light to buy Merali bank <http://www.businessdailyafrica.com/Mwalimu-Sacco-gets-green-light-to-buy-Merali-bank/-/539552-2663498-Iugfyk/index.html> . See also KCB Group to Buy Chase Bank Kenya After Reopening Branches <https://www.bloomberg.com/news/articles/2016-04-20/kcb-group-plans-to-buy-majority-stake-in-chase-bank-kenya> > Accessed on 5th November 2016.

¹¹² Salomon v Salomon & Company Ltd [1897] AC 2.

¹¹³ Ian M. Ramsay & Dr. Geof P. Stapledon, Corporate Groups in Australia, (Working Paper No. 26) (Melbourne: Faculty of Law of Melbourne Public Law and Legal Theory, 2002) at 18, online: SSRN <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=286116>; Robert Baxt, “Issues Facing Directors in Corporation Groups” (1997) 25 Austl. Bus. L. Rev. 436 at 436 [Baxt, “Issues”].

¹¹⁴ Ross Grantham, “Liability of Parent Companies for the Actions of the Directors of their Subsidiaries” (1997) 18:5 Company Lawyer 138 at 138 (WEST) [Grantham].

¹¹⁵ Lee, Pey-Woan. “Serving two masters – The dual loyalties of the nominee director in corporate groups” (2003) J. Bus. Law 449 (WEST).

In such a scenario, the Nominee directors have a two-sided role in that they must govern the interests of both the company in which they have been appointed while at the same time making sure that they take into consideration the interest of the parent company.¹¹⁶

In ordinary circumstances, the long-term interests of each company within the group are often intrinsically linked with the success of the corporate group as a whole but in certain circumstances, such as when there arises a difference of opinion between the directors of the different companies within the group, including between those of a parent and subsidiary, or in situations of insolvency, conflict may occur¹¹⁷.

Given that the parent company has the power to remove the director situated in the Subsidiary company, the director will really defend what they consider to be in the best interest of the company they have been appointed to. With that in mind they are precluded from actually exercising true independence.¹¹⁸

In view of the predicament faced by directors nominated to the boards of companies within corporate groups; the judiciary, particularly in Australia, New Zealand and England has adopted several approaches in responding to alleged breaches of director's duties in the corporate group context. These approaches shall consist of the following;

- Entity Approach
- Enterprise Approach

3.1: Entity Approach

This approach is deemed to be the traditional mode of analyzing the role of directors in the Corporate group context where they are treated as being only representative of the company where they are appointed to never mind they are in a corporate group.

In *Walker v. Wimborne*¹¹⁹ directors of a company, operating as part of a group of companies, authorized and effected a series of intra-group transactions. One of these intra-group transactions

¹¹⁶ Sarah Samara Sekouti, A Comprehensive Analysis of the Legal Issues Relating to Nominee Directors, Université de Montréal, September 2009, pg. 77.

¹¹⁷ Hadden, Tom. "The Regulation of Corporate Groups in Australia" (1992) 15 U.N.S.W.L.J. 61.

¹¹⁸ Hadden, Tom. "The Regulation of Corporate Groups in Australia" (1992) 15 U.N.S.W.L.J. 61.

¹¹⁹ *Walker v. Wimborne*, (1976) 137 C.L.R. 1

involved loan payments to another company within the group that was in dire need of financial assistance. However, the lending company did not receive any reciprocal benefits from the deal but for an implied promise of repayment upon demand.

Unfortunately, the lending company went into liquidation and the liquidators challenged the validity of the aforementioned loan payments, on the grounds that the directors of the lending company had breached their fiduciary duty in authorizing the loan. Essentially, the liquidators alleged that the loan payments were not made in the bona fide interest of the lending company and therefore constituted a misapplication of its funds.

The High Court of Australia sided with the liquidators and concluded that the directors were wrong in having authorized most of the loan payments in view of the fact that they did not benefit the lending company. As regards the duties of the directors, the court stipulated the following:

“...each of the companies was a separate and independent legal entity, and that it was the duty of the directors of [the lending company] to consult its interests and its interests alone in deciding whether the payments should be made to other companies...”¹²⁰

According to this approach, directors must govern in the interests of the specific company they have been appointed to direct and not in the interests of the group as a whole.

3.2: Enterprise Approach

The enterprise approach allows the corporate group to be treated as a single economic enterprise that functions as a whole. According to the enterprise approach, the corporate group may adopt governing principals that allow the controlling or parent company within the group to operate the companies within its control for the benefit of the corporate group as a whole.¹²¹

Basically, the directors of each company within the corporate group may owe their primary allegiance to the controlling or parent company or even to the corporate group as a whole, rather than to the individual company they have been appointed to govern.

¹²⁰ *Walker v. Wimborne*, (1976) 137 C.L.R. 1 at pg. 7.

¹²¹ Sarah Samara Sekouti, A Comprehensive Analysis of the Legal Issues Relating to Nominee Directors, Université de Montréal, September 2009, pg. 81.

This approach is mainly seen in the case of *Charterbridge Corporations Ltd. v. Lloyds Bank Ltd*¹²² where it involved a large group of companies, interrelated by both common shareholding and directorate. The group was involved in the property development industry where they both shared the same objectives. A separate company was then created so as to deal with any new property to be acquired in the future.

What led to the conflict was that there was the existence of overdrafts from the accounts of the companies in the corporate group which made the bank to ask for more guarantees. The corporate group then went ahead to form interrelated guarantees by various companies within the corporate group. One of the companies, Pomeroy Developments(Castleford) Ltd. guaranteed the payments on demand owed by another company within the group, Pomeroy Developments Ltd.

Then after, Pomeroy Developments (Castleford) entered into several agreements for the sale of its property; however, the property could not be sold free and clear from encumbrances as a result of the security granted in exchange for the financial assistance to Pomeroy Developments.

In order to complete the purchase of the property it had to be free of the encumbrances that had been placed by Pomeroy Developments and as result the purchasing party instated proceedings to invalidate the securities charging on the property.

Justice Pennycuik, recognized that the directors of Pomeroy Developments (Castleford) had not considered the interests of the former company separately from the interests of the corporate group, but the court felt that by accepting the plaintiff's contention that only the individual consideration for Pomeroy Developments (Castleford) was acceptable, would be too strict an approach in the context of a corporate group.

*"...that is, I think an unduly stringent test and would really absurd results, i.e., unless the directors of a company addressed their minds specifically to the interests of the company in connection with each particular transaction, that transaction would be ultra vires and void, notwithstanding that the transaction might be beneficial to the company...."*¹²³

The act of sacrificing the interests of one of the company for the benefit of the whole was rejected by the judge who then went on to say that the test to apply to directors in a group context will be

¹²² *Charterbridge Corporations Ltd. v. Lloyds Bank Ltd.*, [1970] 1 L.R. Ch. 62

¹²³ *Charterbridge Corporations Ltd. v. Lloyds Bank Ltd.*, [1970] 1 L.R. Ch. 62 at 74.

ascertain as to whether an intelligent man in such a position will have reasonably believed that the transactions will be in the interest of the whole company.

In the case of *Ford Canada v. Ontario*¹²⁴, the minority shareholders of Ford Motor Company of Canada, made an application to the court declaring that a series of intercompany transactions relating to price transfer allocations costs between Ford Canada, the subsidiary, and Ford U.S., the parent company, were oppressive to the minority shareholders. This was due to the risks associated with the overall operation of the transfer -pricing system.

It was noted by the court that Ford Canada was an independent entity with its own board of directors that was charged with acting in the best interests of Ford Canada and all of its shareholders. The court then went on to state that even if a company holds a majority stake in a subsidiary company they cannot use such a position to make decisions which will only benefit them at the expense of the minority shareholders in the subsidiary company.

¹²⁴ *Ford Motor Co. of Canada, Ltd. v. Ontario Municipal Employees Retirement Board*, [2004] 41 B.L.R. (3d) 74 (QL)

Chapter 4: The liability of the Appointer or the Nominator.

It has already been established that the primary role of the nominee directors is to cater for the interests of the Nominator in the running of the company.¹²⁵ In such a role, the fundamental question of liability of the Appointer due to the breach of fiduciary obligations on the part of the Nominee Director may arise. Is it proper to hold the Appointer into account due to the actions of the Nominee Director? This chapter shall seek to address this question by first of all establishing whether liability may be imposed and if such a liability exists will it be in the purview of piercing the corporate veil.

In Kenya, the official position was established in *National Social Security Fund Board of Trustees v Ankhan Holding Ltd*¹²⁶ case where Justice Ochieng explicitly stated that Nominators cannot be held into account due to the actions of the Nominee Directors.

In other Jurisdictions, this issue has been dealt with in two circumstances one of them being shadow directorships and Vicarious Liability. A shadow director is defined under the England Companies Act ¹²⁷as a person in accordance with whose directions or instructions the directors are accustomed to act. In other words, a holder of controlling or majority stock (share) of a private firm who is not (technically) a director and does not openly participate in the firm's governance, but whose directions or instructions are routinely complied with by the employees or other the directors. ¹²⁸Justice Finn in *Australian Securities Commission v. AS Nominees Limited*¹²⁹ stated that shadow directorship requires directors to act at all times in the interest of their appointer.

In order to impose a liability on the Shadow director evidence of active interference in the running of the company must be present and so the fact that a nominee director naturally favors his appointer's interest is not itself sufficient to infer the appointer's liability and it is also it is unlikely that an appointer shall be attributed liability as a shadow director merely because he provides

¹²⁵ Gower & Davis, Principles of Modern Company Law, 9th Edition, Sweet & Maxwell, 2012, pg. 539.

¹²⁶ *National Social Security Fund Board of Trustees v Ankhan Holding Ltd*, HCCC No.268 of 2004.

¹²⁷ Section 251 of the England Companies Act 2006.

¹²⁸ Shadow Director, <http://www.businessdictionary.com/definition/shadow-director.html> > Accessed on 17th November 2016.

¹²⁹ *Australian Securities Commission v. A.S. Nominees Limited*, (1995) 62 F.C.R. 504.

instructions to his nominee.¹³⁰ Liability may arise when the Nominee director is at all times acting on instructions of the Nominator without due discretion¹³¹ .

The mere fact of substantial ownership of the company does not give rise to shadow directorship as put in the British case of *Secretary of State for Trade and Industry v. Deverell*¹³², where the court of Appeal had to determine whether two individuals could be qualified as shadow directors. The court declined to use the evidence of ownership or control of the company and instead used the evidence of personal involvement in the running of the company and playing an important role in company transactions.

A substantial ownership in company may be considered where the management and finances are effectively controlled by the Nominees. This was brought up in the case of *Standard Chartered bank of Australia Ltd. v. Antico* where according to the facts of the case, Pioneer International Ltd was a parent company which held around 42% in Giant Resources Ltd which was a subsidiary the board they had appointed 3 directors as nominees who later on entered into an agreement with Standard Chartered Bank of Australia Ltd. for a loan of \$30,000,000. Unfortunately the subsidiary company went into liquidation and the issue arose as whether the Nominee Directors should be held liable which the court ruled that bearing in mind they held a 42% ownership and effectively controlled the financial control over Giant including the imposition of severe financial reporting requirements.¹³³

In terms of Vicarious Liability, the common-law principle is that an Employer can be held liable for the actions of the employee.¹³⁴ In *Via Systems (Tyneside) Ltd v Thermal Transfer (Northern) Ltd and others*¹³⁵, the Court of Appeal looked at the issue of who was vicariously liable for the negligence of an employee working temporarily for another company. In that case the Court held that it is possible for both the general employer and the temporary employer (i.e. the company to

¹³⁰ Sarah Samara Sekouti, A Comprehensive Analysis of the Legal Issues Relating to Nominee Directors, Université de Montréal, September 2009, pg. 99.

¹³¹ *Australian Securities Commission v. A.S. Nominees Limited*, (1995) 62 F.C.R. 504 at para. 331.

¹³² *Secretary of State for Trade and Industry v. Deverell*, (2000) 2 B.C.L.C. 133 (QL).

¹³³ *Standard Chartered bank of Australia Ltd. v. Antico*, (1995) 131 A.C.L.C. 1 at 381 (QL)

¹³⁴ *Morgan vs Launchbury* (1972)2 All ER 606

¹³⁵ *ViaSystems (Tyneside) Ltd v Thermal Transfer (Northern) Ltd* [2005] EWCA Civ 1151

whom the individual is temporarily providing his services) to be vicariously liable for the negligent acts of an employee.

This principle of vicarious Liability may be imposed in the Nominator -Nominee relationship as stated in the case of *Dairy Containers v. NZI Bank*¹³⁶ where it was held that Nominee Directors are normally responding to the commercial imperative maxim of “he who pays the piper calls the tune”.

In New Zealand, the issue of vicarious Liability on part of the Nominator was firstly addressed in the case of *Kuwait v National*¹³⁷ where the facts were; National Mutual Life Nominees Ltd. acted as a trustee to AIC Securities Ltd while Kuwait Asia Bank EC had a substantial ownership of 40% in AIC Securities. An agreement was drawn into place where Kuwait appointed two directors on the Board of AIC. Later on, AIC Securities became insolvent and went into liquidation.

National Mutual Life Nominees Ltd was later on sued by one of the depositors (a representative suit) alleging that there was a breach of duty committed by the former. The suit was settled but the issue arose when National wanted to sue Kuwait Asia on the ground that the Nominee Directors appointed on the Board had committed a breach of duty so as to be able to have the defendants make a contribution to the settled suit.

According to the Privy Council, the submissions of National Mutual Life Nominees Ltd were held to be inadmissible due to the absence of fraud or bad faith on the part of Kuwait Asia and thus Kuwait Asia could not be held liable for the shortcomings of the Nominee Directors. It was also noted by the Privy Council that despite the fact that there was a Nominee- Nominator relationship the Nominee Directors were obligated to ignore the interests of the Nominators and focus only on the interests of AIC Securities.

This decision was criticized later in the case of *Dairy Containers v. NZI Bank*¹³⁸ where the facts were that Dairy Containers Ltd was a wholly-owned subsidiary of the New Zealand Dairy Board, which was essentially comprised of a board of NZDB-appointed directors.

¹³⁶ *Dairy Containers Ltd v NZI Bank Ltd Dairy Containers Ltd v Auditor-General* - [1995] 2 NZLR 30

¹³⁷ *Kuwait Asia Bank EC v National Mutual Life Nominees Ltd* 1990 5 NZCLC 66,509.

¹³⁸ *Dairy Containers Ltd v. NZI Bank Ltd Dairy Containers Ltd v Auditor-General*, (1995) 2 N.Z.L.R. 30

It was soon discovered that in 1989 the three nominee directors on Dairy Containers' board had misappropriated Dairy Containers' funds. The nominee directors were later on fired and pleaded guilty to criminal charges of Fraud.

Dairy Containers instituted legal proceedings against the New Zealand Auditor-General, who had audited Dairy Containers during the relevant time frame, and several other banks, alleging that the audit was deficient and claiming over \$11,000,000 dollars for damages suffered as a result of the misappropriation of the nominees. However, the Auditor-General argued contributory negligence on the part of Dairy Containers and its directors as well as the liability of the NZDB in its capacity as the employer of the nominee directors and as a shadow director.

With regards to Vicarious Liability, Judge Thomas emphasized that one must not overlook commercial reality in which an employee shall undoubtedly favor their employer, particularly in circumstances where they have been given a clear mandate to "to protect and promote their employer's interests."

In the end the Nominator holds the power to dismiss him and thus reinforces that their relationship is to be treated as an Employer -Employee Relationship. The case however was bound by the Kuwait Decision and thus the court was forced to deny claims of Vicarious Liability.

Chapter 5: Conclusions and Recommendations.

This Dissertation has focused with the Nominee Director Position in corporate management and starting with the Kenya's position where the courts have limited themselves in having a liberal mindset in accepting the viability of such a position. But such a position has a negative effect in that it does not bear in mind the commercial reality in that companies and stakeholders have developed a more inquisitive attitude in the way companies which they have a share hold or interest and as such they may need to be informed of the general policy of the running of their company.

In chapter 2, we have looked at the two fundamental duties of directors that may be put into disarray being the duty to promote the success of a company encompassing three approaches as to how to deal with it. The one approach is the Absolutist Approach where the duty of Nominee Directors is to act in the interests of the company is understood to operate in total exclusivity with no mention of the appointor interests.

The Second Approach is the Corporate Primacy Approach where it perceives the possibility of acting in a manner that is compatible with the interests of both company and appointer. It is, however, founded on the principle that the company's interests prevail, so that if it is not possible to please the appointer and act in the company's interests, the company's interests must win out.

The third approach is the Attenuated Duty approach where it involves recognizing the permissibility of private ordering by the shareholder body as the primary corporate organ in the form of contractual attenuation of the duties applicable to nominee directors. The other fundamental duty is the duty to avoid conflict of interest where more specifically we have dealt with the role of Nominee Directors in having access to corporate information while at the same time the implications of giving out this information to the Nominators.

In Chapter 3, we have dealt with Nominee Directors in a Corporate Group Context, where we have mentioned the two approaches as to how to handle it. The first one being the Entity Approach where it is deemed to be the traditional mode of analyzing the role of directors in the Corporate group context where they are treated as being only representative of the company where they are appointed to never mind they are in a corporate group.

The second Approach is the Enterprise Approach where the corporate group is to be treated as a single economic enterprise that functions as a whole. According to the enterprise approach, the

corporate group may adopt governing principals that allow the controlling or parent company within the group to operate the companies within its control for the benefit of the corporate group as a whole.

In chapter 4 we have dealt with the liability of the Nominators where we have established that liability may be established using two criteria i.e. the Shadow Directorship method where in order to impose a liability on the Shadow director evidence of active interference in the running of the company must be present. The other method is using the question of vicarious liability.

This dissertation has gone into grave detail as to how other jurisdictions; Australia, Canada, New Zealand and England have handled this aspect with a more liberal mindset and a more commercial accepting attitude. And so, the courts of Kenya have to accept that in the effort of creating a more decisive corporate law this position of Nominee Directorship has to be accepted in the judicial way of thinking. The benefit of recognizing such a position is that stakeholders will be better informed in the decisions of the company and secondly is that instances of corruption will be easily abated as the courts will be able to see who exactly is responsible for an illegal act in the mire of corporate management.

In corporate arena corruption, has been a key issue such as the Chase Bank and Imperial Bank saga where depositor had no idea as to how their funds were being utilized. Creating a position such as the Nominee position enables persons with a stake in a company to be better informed of the general running of the company rather than relying on the words of normal directors.

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