



## **DIRECTOR'S DUTIES AND LIMITS**

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Disagreements concerning management and direction of a company have given rise to frequent legal disputes in courts. The Federal Court in ***Tengku Dato' Ibrahim Petra Bin Tengku Indra Petra v. Petra Perdana Berhad [2017] 1 LNS 1929*** is a case on point, whereby the subject matter of the appeal revolves around the issue of a director's duties to act in the best interest of the company and on the issue of governance and management of a company as between directors and shareholders in general meeting.

### **Brief Facts**

Petra Energy Berhad ("PEB") was a wholly owned subsidiary of Petra Perdana Berhad ("the Plaintiff"). The appeal concerns alleged breaches by the directors of the duty owed to the Plaintiff in the divestments of the PEB shares, whereby the Defendants were directors of the Plaintiff who effected the divestments to alleviate PEB's dire cash flow problems. The Plaintiff alleged that the divestments caused the Plaintiff to have lost the controlling block of shares in PEB which effectively means PEB ceased to be a subsidiary of the Plaintiff. The divestments were made pursuant to a Shareholders' Divestment Mandate and a Board Mandate.

The High Court found in favour of the Defendants but on appeal, the Court of Appeal overturned the High Court decision and the dispute went up to the Federal Court. On the 18 questions of law put to the Federal Court, the Federal Court held as follows:

- i. Whether the powers of management conferred on directors by the Act and the articles of association of a company can be overridden by an ordinary resolution passed by a simple majority of shareholders?

The Federal Court held that shareholders in general meetings **may not control** the powers of management conferred on directors and that they can only do so by altering the articles of association of the company to take away the powers of the board of directors. The Federal Court also held that business management control resides with its directors and not its shareholders. Shareholders of the Plaintiff in general meeting cannot interfere with or override management decisions of its board of directors, even if all shareholders agree. Interestingly, the Federal Court also refuted the Court of Appeal's finding that the directors' broad powers of management were subject to shareholders' supervision and that the Plaintiff's director's decision could be overridden and directors were obliged to follow the will of the members. Effectively, the powers of management conferred on directors by

the Companies Act and the articles of association could not be overridden by an ordinary resolution passed by a simple majority of shareholders.

- ii. Whether the board of directors of a company who has been authorized by a resolution passed in a general meeting that approved the sale of shares may thereafter act in its best judgment in the interests of the company in the implementation of the resolution?

The Federal Court held that the board of directors of a company authorized by a resolution passed in a general meeting that approved the sale of shares may thereafter act in its best judgment in the interests of the company in the implementation of the resolution.

- iii. Whether the correct test of "the best interest of the company" is what a reasonable board could consider to be within the interests of the company?

The Federal Court refuted the Court of Appeal's finding that the shareholders mandate at the EGM on the Divestment provide a barometer as to what the shareholders gauged as being the interests of the company and was relevant in examining the directors' conduct on whether they had breached their fiduciary duty. The Federal Court disagreed with the Court of Appeal that "in the best interest of the company" is a matter for the majority of the shareholders to decide. The Federal Court in reaffirming various authorities, *inter alia*, *Charterbridge Principle (Charterbridge Corpn Ltd v. Lloyds Bank Ltd (supra))*, adopted by the Court of Appeal in *the Pioneer Haven Sdn. Bhd. v. Ho Hup Construction Co. Bhd (supra)* held that the test combines both subjective and objective tests. The **test is subjective** in the sense that the breach of the duty is determined on an assessment of the state of mind of the director. The classic formulation of the subjective test is found in *Re Smith & Fawcett Ltd [1942] 1 Ch 304*; which required directors to exercise their powers honestly in what they believe, and not what a court may consider, as the best interests of the company. The **test is objective** in the sense that it is subject to an objective review or examination by the Courts; whether an intelligent and honest man in the position of a director of the company concerned could have reasonably believed that the transactions were for the benefit of the company. The Federal Court further decided that divestments decision was a business judgment made by the defendants and an honest and intelligent man in the position of the defendants would reasonably have concluded that divestments were in the best interests of the plaintiff.

- iv. Can shareholders determine or dictate what is in 'the best interest of the company' by passing an ordinary resolution by a simple majority in general meeting in the context of determining the conduct of a director?

The Federal Court has emphasized the point that the Courts do not undertake the exercise of assessing the merits of a commercial or business judgment made by directors. Courts will not interfere with business decisions as long as the directors acted bona fide. Shareholders cannot determine or dictate what is in "the best

interest of the company” by passing an ordinary resolution by a simple majority in general meeting.

**Conclusion**

The Federal Court decision has reaffirmed and empowered directors of companies by “drawing a distinctive line” between directors and shareholders, whereby shareholders cannot interfere or override management decisions and the business judgment rule conferred on and enjoyed by directors.



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