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3 JULY 2020

‘Sleeping’ Directors: Time to Wake Up?

Who are they?

“Sleeping” directors are directors who are passive and are not actively involved in the management of their company. By merely being in the background, these directors may not be familiar with their company’s financial affairs and performance.

In recent years, Malaysian courts have increasingly prompted directors to adopt a more hands-on approach with reasonable diligence in monitoring the operations of their company.

Duties cast upon directors

All directors of a company, whether holding executive or non-executive designations, are clothed with fiduciary duties and legal responsibilities. Section 213 of the Companies Act 2016 requires directors to:

- at all times, exercise their powers for a proper purpose and in good faith in the best interest of the company.
- exercise reasonable care, skill and diligence.

Increased focus on effective corporate governance, coupled with the complexities of the corporate landscape today, calls for a higher standard expected of directors. The question therefore remains — whether a director’s defence that he or she was unaware of the company’s state of affairs could hold water.

Calls for accountability

The potential liability faced by “sleeping” directors was outlined by the Malaysian Court of Appeal in *Zaharen Hj Zakaria*:¹

“In other words, a director of a company has to give his all to serve in the best interest of the company of which he is

¹ *Zaharen Hj Zakaria v Redmax Sdn Bhd & other appeals* [2016] 5 MLJ 91 (CA)

a director. As a fiduciary, the company is backed up by the statutory provision to expect nothing less from its directors. **Gone are the days when a company director can be heard to say that he was a sleeping director and expect to escape liability.** His duty may appear onerous but that is to be expected as he is part of the alter ego of the company. He is a fiduciary, a trustee.”

Thus, a director who takes a backseat in management is not exempted from the requirement to exercise an adequate level of vigilance over the goings-on in the company.

Based on these reported decisions, the courts have ruled that directors are accountable in the following situations:

- Turning a blind eye and approving all the steps needed to divert the company’s business and operations to another entity. The fact that a delinquent director took little part in management and left control to the other director was not an excuse — silence can be seen as complicity.²
- Non-compliance with the company’s policy and procedure. Although delegation is possible, the director failed to discharge his supervisory responsibilities by merely giving instructions to subordinates while ignoring all discrepancies that arose.³
- Failure to raise any inquiries or take steps to ensure that the company is compliant with the statutory duty to remit contributions to the Employees Provident Fund. The non-executive director could not escape liability by asserting that he had no knowledge of the company’s activities.⁴

Wake-up call for ‘sleeping’ directors

The cases above highlight the risk of “sleeping” directors being exposed to personal liability for closing an eye, failing to make reasonable inquiries and/or exercise independent judgment. Even if particular functions were delegated to those down the chain of command, a director’s idleness or failure to supervise could constitute a breach of directors’ duties.

Thus, if a company suffered losses due to the directors’ actions (or inactions), a possible consequence is to make good those losses. It is not the case that directors must devote their full attention to managing every business matter. However, their role cannot be reduced to the extent that they make the most minimal or no contribution to the collective responsibility of the board.

² *Taz Logistics Sdn Bhd v Taz Metals Sdn Bhd & Ors* [2019] 3 MLJ 510 (CA)

³ *Kontron Asia Pacific Design Sdn Bhd & Anor v Quah Sin Chye & Ors and Another Appeal* [2018] 8 CLJ 490 (HC)

⁴ *Ravichanthiran Ganesan v Percetakan Wawasan Maju Sdn Bhd* [2008] 9 CLJ 546 (HC)

As alluded by the Court of Appeal of Singapore, “A director cannot now be viewed as a mere sentinel who may occasionally doze off at his post. Directors are officers who must remain alert and watchful at the helm.”⁵

Directors should apply the best practices set out in the Malaysian Code on Corporate Governance (2017), which include:⁶

- review, challenge and decide on management’s proposals for the company, and monitor its implementation;
- supervise and assess management performance to determine if the business is being properly managed; and
- ensure that the company has in place procedures to enable effective communication with stakeholders.

Conclusion

As directors are the alter ego of their company, many jurisdictions have stressed the crucial role played by independent, non-executive and part-time directors in supporting good corporate governance.

Those accepting directorships should realise that the days of “just lending my name to the company” or “leaving it to my fellow executive director to call the shots” are now over. If there has been complete unawareness of the company’s affairs or sheer inactivity, courts are less willing to take a lenient approach.

It is indeed time for companies to assess whether warning bells have started to ring within the boardroom.

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Published by the Dispute Resolution Practice

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⁵ *PlanAssure PAC (formerly known as Patrick Lee PAC) v Gaelic Inns Pte Ltd* [2007] 4 SLR(R) 513 (SGCA), citing *Vita Health Laboratories Pte Ltd v Pang Seng Meng* [2004] 4 SLR(R) 162 (SGHC)

⁶ Malaysian Code on Corporate Governance (2017), p 14