

# The reasonable independent director

Courts and regulators commonly use the 'reasonable man' test to determine, well, if one had acted reasonably.

This 'reasonable man' has often been referred to as 'the man on the Clapham omnibus.' This is a hypothetical ordinary and reasonable person, used by the courts in English law where it is necessary to decide whether a party has acted as a reasonable person would.

The man on the Clapham omnibus is a reasonably educated, intelligent but nondescript person, against whom the defendant's conduct can be measured.

And in the context of the Genting Malaysia Bhd (GenM) saga, we can substitute the words 'reasonable man' with 'reasonable independent director' and apply the reasonableness test accordingly.

This then begs the question, 'Have the independent directors of GenM acted like reasonable independent directors?'

## Definition of an independent director

Bursa Malaysia's Listing Requirements (LR) have a two-pronged definition of an independent director. The first test is a subjective one where the director, with hand on heart, swears that he is an independent director.

The independent director would have to swear that he/she is independent of management and free from any business or other relationship which could interfere with the exercise of independent judgement or the ability to act in the best interests of GenM.

This test is generally quite easy to pass as it is one of self-assessment for, after all, independence is a state of mind.

## Functions of the Audit Committee

Paragraph 15.12 of the LR states that a listed issuer must ensure that an audit committee reviews any related party transaction (RPT) and conflict of interests situation that may arise within GenM or group, including any transaction, procedure or course of conduct that raises questions of management integrity and reports this to the board of directors of GenM.

The four-member audit committee, comprising entirely of independent directors and chaired by Tan Sri Clifford Herbert (a former finance ministry secretary-general), would have made its recommendations to the board of GenM.

One can only assume that there must have been passionate debates, detailed deliberations, robust due diligence and candid discussions at the audit committee level before a recommendation was made to the board.

Alternatively, there may not have been such debates and discussions. Minority shareholders will never know.

But what we do know is that it was either a unanimous or majority recommendation that was made to the board to approve the RPT.

If it was not unanimous, the opposing minority of directors



GenM's resorts are very popular with the public but investors on Bursa are negative on its stock over its RPT proposal to take over a loss-making entity



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are bound by 'collective responsibility' to speak with one voice.

But what we do know is that none of the directors thought that the RPT was offensive enough for them to speak out against the RPT publicly.

Only a regulator can intervene to identify the independent directors who voted for and those who voted against the RPT by examining the minutes of the audit committee meeting.

The announcement made through Bursa Malaysia on the RPT includes a statement that the Audit and Risk Management Committee of GenM, after having considered all aspects of the proposed transaction including the rationale, prospects and risk factors, felt that the proposed transaction is:

- (i) in the best interest of GenM;
- (ii) fair, reasonable and on normal commercial terms; and
- (iii) not detrimental to the interest of GenM's minority shareholders

## But the market does not agree

On Aug 19, GenM shares declined 14.95% to RM3.07 from RM3.61 on Aug 6, wiping out RM3.2 bil of GenM's market capitalisation.

Genting Bhd also suffered a share price drop of 9.92% to RM5.99 (Aug 14) from RM6.65 (Aug 6), wiping out RM2.55 bil in market capitalisation.

All things being equal, as of

Aug 19, the total market capitalisation wiped out from GenM and Genting is a whopping RM5.75 bil.

## The role of independent directors

Based on GenM's Annual Report 2018, the board comprises two executive directors and seven independent non-executive directors (INEDs) - a commendable 78% of independent directors, well above the over-50% prescribed under Practice 4.1 of the Malaysian Code on Corporate Governance (MCCG).

There exists a paradoxical position of majority shareholders electing independent directors who are often relied upon to watch out for the minority shareholders' interests.

Such a situation often begs the cynical question as to how independent these independent directors can be.

In such situations, there is a risk that the independent directors would be patronising towards the major shareholders at the expense of minority shareholders.

Such a situation has spawned a cynical joke that there are two types of independent directors - independent directors and 'independent' independent directors.

And that is why the 'two-tier' voting Practice 4.2 under the MCCG must be made into a rule-based LR as opposed to a principle-based LR, which can be explained away by a cleverly drafted 'alternative practice.'

The 'two-tier' voting does not actually cure the cynicism on the role of the independent directors as the 'two-tier' Practice only

kicks in from the 12th year of an independent director's tenure.

There is clearly a catastrophic difference of opinion between the board of GenM and the way the market has punished both GenM and Genting.

## MSWG's observations

MSWG, in its pre-AGM (annual general meeting) letter to the GenM board dated 10 June, raised concerns in relation to the long tenure of independent directors.

Practice 4.2 of the MCCG says the tenure of an independent director does not exceed a cumulative term limit of nine years.

Upon completion of the nine years, an independent director may continue to serve on the board as a non-independent director.

If the board intends to retain an independent director beyond nine years, it should justify and seek shareholders' approval.

If the board continues to retain the independent director after the 12th year, it should seek annual shareholders' approval through a two-tier voting process.

GenM says in its CG statement that it has departed from this practice.

MSWG noted that no additional Quah Chek Tin as an independent director though he has exceeded the tenure of nine years.

There were also no resolutions to retain Herbert, Gen Tan Sri Mohd Zahidi Zainuddin (Rtd) and Teo Eng Seong, as independent directors although they have exceeded the tenure of nine years.

As two of the directors,

Herbert and Mohd Zahidi, have both also exceeded a tenure of 12 years, the board should have also sought annual shareholders' approval through a two-tier voting process.

MSWG has also raised the issue of departure from Practice 1.3 of MCCG which stipulates that the positions of chairman and CEO are held by different individuals.

In GenM's case, the chairman also assumes the position of CEO.

## Board's collective responsibility

Although boards are bound by the principle of 'collective responsibility' in any of their decisions, it would be interesting to analyse the voting pattern of the directors and their rationale for their stance.

Given the massive amount of market capitalisation that was wiped out from GenM and Genting, there is another collateral factor to be considered: Has the RPT affected confidence in Bursa Malaysia as an exchange?

Has the RPT resulted in a situation where investors in general will be asking whether they wish to invest or stay invested in an exchange where such RPTs can happen?

It must be noted that the RPT followed the LR. Maybe the answer lies in tweaking the LR to include absolute trigger amounts for calling for an EGM, as opposed to only percentage trigger amounts.

If another few publicly listed companies were to conduct such RPTs, there will be severe attrition in the protection of minority interests.

That is why it is worthwhile for regulators to consider whether they should delve a bit deeper into the rationale for the board's decision by perusing the minutes of meeting.

If the Audit and Risk Management Committee and the board are of the view that the proposed RPT is truly in the interest of GenM and also not detrimental to the interest of GenM's minority shareholders, how do we then reconcile or explain why the market did not agree and "dumped" the shares, causing a massive erosion of the market capitalisation of both GenM and Genting.

## Attendance and voting at the next AGM

Minority shareholders must form an opinion as to whether the independent directors acted as reasonable independent directors and whether the RPT was in their best interest as minority shareholders.

If they do not think so, they must exercise their right to vote at the next AGM.

They may not be able to move mountains as the major shareholders have the bulk of the shares, but at least they will be able to exercise their right-to-vote.

It would be better still if they could attend the next AGM to better understand why the audit committee and the board felt that the RPT was in their best interest as minority shareholders. **FocusM**

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