Representative Directors*
Directors expected to represent the interest of the appointing party

*The term Representative Director is neither a legal nor a generally accepted term. It is used in the context of this paper to refer to a director who is expected to represent the interest of the appointing party.
CONTENTS

- Introduction
- Duties of directors
- Threats to performing fiduciary duties
- Manner of appointment and related responsibilities
- Practical guidelines
- Developing a framework
- Conclusion

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Introduction

Directors are generally appointed by the shareholders at a shareholders’ meeting. However, in limited instances where there is a vacancy on the board, the Companies Act, 2008 allows for directors to be appointed other than by shareholders. Where the shareholding is widespread and no concentrations of power exist, the shareholders will generally appoint directors that are representative of the broader interests of all shareholders.

However, in certain instances, where the shareholding of the company is more concentrated, for example when an entity is a subsidiary, associate, or joint venture of another entity or individual, the shareholder with the concentration of power may be in a position to influence or secure the appointment of one or more directors. An entity may also be in a position to influence the appointment of directors through a contractual relationship, for example the appointment of a representative of a significant lender to the board.

In other instances representatives of significant creditors, banks or similar funding institutions may be appointed to the board.

This paper seeks to clarify that the responsibilities of such a director (the ‘representative’ director) are to the company on whose board they have been appointed and aims to provide guidelines to both directors and the shareholders that appoint them in order to allow them to fulfil their responsibilities.

Duties of directors

The Companies Act, 2008 does not distinguish between ‘representative’ directors and other directors. The duties of both of these are therefore identical from a legal perspective. Both have a fiduciary duty to act in the best interests of the company on whose board they serve. Directors should therefore always be appointed based on their level of knowledge, skill and expertise that they bring to the board, and their ability to make the most appropriate decisions with due care, skill and diligence that are in the best interest of the company.

However, the courts have specifically considered the duties of these directors.

In the Fisheries Development Corporation of SA Ltd case the court found that “A director in that capacity is not the servant or agent of a shareholder who votes for or otherwise procures his appointment to the board ... The director’s duty is to observe the utmost good faith towards the company, and in discharging that duty he is required to exercise independent judgement and to take decisions according to the best interests of the company as his principal. He may in fact be representing the interests of the person who nominated him, and he may even be the servant or agent of that person, but, in carrying out his duties as a director, he is in law obliged to serve the best interests of the company to the exclusion of the interests of any such nominator, employer or principal.” (Fisheries Development Corporation of SA Ltd vs Jorgensen and Another; Fisheries Development Corporation of SA Ltd vs AWJ Investments (Pty) Limited and Others 1980 (4) SA 156 (W) on pages 158 and 164)

The rationale for a major shareholder appointing a director to the board should be that they have appointed a trusted person who they believe will take the appropriate action when circumstances arise with due care, skill and diligence. The objective should not be to appoint a director who will champion the cause of action beneficial to the shareholder.

As part of broader stakeholder engagement, the board often seeks input from stakeholders to identify what stakeholders believe may be an appropriate course of action. One of these stakeholders may be a major shareholder or creditor who has appointed a director to the board. In this instance the director may serve as a conduit for relaying the views of the shareholder or creditor. However the director must still do that which is in the best interests of the company on whose board he or she serves.

Threats to performing fiduciary duties

The director may have a responsibility to the company which has appointed him or her. This may be in the form of an employment contract with the appointing company or he or she may be a director of the appointing company.
However, it is important for the director to understand that he or she has two distinct roles. These dual responsibilities cannot be allowed to impinge on the decisions of the director in his or her capacity as the director of the company on whose board he or she has been appointed.

Where the appointed director is a director on the boards of both companies, he or she will need to consider whether a conflict of interest exists when making decisions. Examples of this may include instances where the actions of the board on which he or she has been appointed as a director will negatively impact the performance of the shareholder.

Where the appointed director is an employee of the appointing company, the employee may inappropriately face potential retribution from his or her employer for not doing as the employer had instructed in relation to the execution of his or her duties as a director.

The appointing shareholder also needs to be aware that it may be considered to be the de-facto director if it controls and commands the ‘representative’ director to perform tasks that are in its own best interests, rather than those of the company.

In all instances, it is important to remember that an individual director carries personal liability. This needs to be understood by both the employer and employee as it has potentially adverse consequences for the director, which includes criminal liability, exposure to civil action and disqualification from acting as a director. However, the risk of financial liability can be mitigated by liability insurance cover (D&O cover) and indemnity from the company which is available to directors, except in certain circumstances.

**Manner of appointment and related responsibilities**

Directors must in all circumstances discharge their duties as required by law. However, in discharging these duties, directors who are expected to represent the interest of the appointing party may face practical issues, some of which are discussed below:

**Major shareholder nominating directors**

Where major shareholders nominate individuals to the board of directors, they should carefully consider the objectivity, skill and experience of those individuals. Other aspects that the nominator may consider include whether the individual has been nominated onto other boards by the same party and whether the nominated individual is an employee of the nominator. Any of the above may be an indicator that the individual may not be perceived to be independent.

**Profit companies**

1) **Appointed to represent a shareholder who shares joint control**

In such a case the board is usually established as a forum for communication and decision-making between the joint venturers. The joint venture may take the form of a partnership or a separate company. Where the joint venture is conducted through a company, the normal company law rules apply and the director has a duty of care towards the company. Where the joint venture is unincorporated or a partnership, the duty of care may be somewhat different and the directors are bound by the partnership or other agreement between the parties.

The terms of the joint venture agreement, be it a partnership or company, will usually regulate its affairs in the knowledge that disagreements may occur and will thus have built-in safeguards to resolve them. For example, the joint venture agreement will usually require that important decisions must be made on a consensus basis, failing which a deadlock mechanism comes into play. The role of the director who has been appointed to represent the interest of a shareholder will generally be to participate in meetings of the joint venture according to the terms of the agreement between the parties.
2) Appointed to represent a holding company of a partly held subsidiary
In this case there may be a number of instances where the director may be conflicted. Examples of some of these are:
• Provision of services by the holding company to subsidiaries (often on an outsourced basis)
• Dividend policy
• Rights issues and other financing arrangements
• Strategic direction of the company
• Differences in values between the company and one or more of its shareholders.
• Sharing of price-sensitive information relating to a listed company.
• Sharing of confidential information, disclosure of which may prejudice the commercial interests of the company.
• Litigation affecting the company and its shareholders.
• Transfer pricing.
• Management fees between companies in a group.
• Possible competition issues when the company is in a similar market to other group companies.
• Instances where the holding company guarantees all of the debt of the partly held subsidiary.

3) Appointed to represent a financier to the company
In this case the ‘representative’ director may be appointed as a result of an agreement between the company and the financier. The director may be under the impression that he or she has been placed into that position to protect the interests of the appointing company. However, even though the director may have been appointed as a result of a specific agreement, once appointed, the normal fiduciary responsibilities towards the company on which board he serves, apply.

Non profit companies
1. Appointed to the board to represent a constituency of interests (geographical, ideological etc)
The director in this position must simply perform his or her duty in the interests of the company, which prevails over the interests of his or her constituency.

The section below discusses guidelines to assist in resolving some of these practical dilemmas.

Practical guidelines

Sharing of information
Directors may be requested to provide feedback to the shareholders and other parties who appointed them. In some instances directors may even be requested to share board packs and management information with these stakeholders. It is important in such instances to consider whether the director has in fact divulged information that may be considered to be confidential or price sensitive or which may result in the director breaching his or her fiduciary duties. For publicly listed companies, the requirements and criminal penalties imposed by the Securities Services Act (SS Act) should also be considered.

In the case of a listed company, price sensitive or confidential information should only be shared in circumstances permitted by the SS Act and be clearly marked as such and the relevant document classification levels within the organisation as regards sensitive information should be adhered to. As discussed below, it is also important that the party providing the original information be aware of the fact that this information will be divulged to another party.

The parties should therefore develop rules on how information may be shared with the appointing shareholder. This would be with the agreement of the board on which the director serves. Particular care should be taken to ensure that the rules developed around the sharing of information are not in contravention of the law, with a particular focus on this matter in foreign jurisdictions.

Shareholder guiding director decisions
In exercising their fiduciary duties, directors often also seek instruction from the appointing shareholder in relation to decisions that need to be made, for example, the manner in which to vote during a particular resolution.
It is important for the director to remember that his or her fiduciary responsibility requires him or her to vote in the best interests of the company, not the best interests of the shareholder who appointed him or her.

**Wholly owned subsidiaries**
Where the company on whose board the representative has been appointed is a wholly owned subsidiary, directors are often of the view that decisions may be taken from a ‘group’ perspective. However in terms of sound governance a board has a duty to a broader range of stakeholders which may include creditors and employees. It is important to note that the new Companies Act also affords rights to a wider range of stakeholders.

Therefore even in those instances where the entity is wholly owned by a single shareholder, the directors have a responsibility to act in the best interests of the company and to take a longer term view. However, in these instances it may be possible to act in the interests of both the group and company as these interests may be aligned.

**Safeguards for representative directors**
Directors will find that it is in their best interests to appropriately manage the process and to have guidelines in place. Guidance for these directors includes:

- Understanding their fiduciary responsibilities as directors
- Ensuring that appropriate training is received on governance and directors’ legal duties
- Establishing at the outset what the appointing company expects from them in their role as directors and, by agreeing, with each of the parties involved, what may and may not be divulged, also bearing in mind the provisions of the SS Act. If, at the outset, the appointing company expects the director to breach his or her fiduciary duty, the director should decline the appointment
- Understanding what process they should follow when faced with a dissenting view from the board on which they serve
- Ensuring that they have access to legal advice.

**Developing a framework**
Companies that appoint directors who are expected to represent their interests may find it useful to develop a framework for these appointments. The framework essentially provides the directors with a set of rules to operate by. It should be agreed by all three parties (the appointing company, the individual director and the company on which board the director serves) and includes:

- The responsibilities of the appointed director in relation to the appointing company. This framework should also take cognisance of the fiduciary responsibility of the appointed director and may include items such as respecting the director’s ability to act independently, appropriate and adequate training, access to advice, guidance around instances where a director acts independently and where the director is acting as a proxy and a process for reporting issues. It should also cover the extent to which the director is entitled to share information with the appointing company.
- Ensuring that an individual who performs the dual role as employee of the appointing company and director and who acts in the best interest of the company on whose board the individual is appointed is treated in a fair manner even though these actions may be against the instruction of the employer. This may form part of the normal review of the performance process.
- Allowing directors to seek legal advice as it relates to conflicts of interest or other issues that may arise as a result of the appointment.

**Conclusion**
Appointing ‘representative’ directors who are expected to act in the interests of the appointing party is not a recommended practice and has the potential to result in directors who, due to their manner of appointment, are conflicted. To avoid such an outcome, all three parties within the arrangement, the appointed director, the appointing party as well as the company on whose board the ‘representative’ director has been appointed must ensure that the process is appropriately managed and that the ‘representative’ director is adequately protected. It is however, better practice to appoint independent directors who will best serve the interests of the company.