A CRITICAL EXAMINATION OF 'NOMINEE DIRECTORS' IN SOUTH AFRICA: Conflict situations, fiduciary duties, liability for breach and whether they should be entitled to remuneration from their appointer.

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This dissertation is submitted in partial fulfillment of the regulations for the LLM Business Law Degree at the University of Kwa-Zulu Natal (UKZN).

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Submission date: 30th November 2015

Abstract

This research was motivated by the need for more legal literature on Nominee Directors in South Africa, given that there is sparse material on offer in company law texts. It considered their fiduciary duties, liability for breach thereof and whether they should be entitled to directors' fees for their services rendered as a director. The research concluded that irrespective of the title attached to a director, his acceptance of such appointment triggers a range of statutory and common law fiduciary duties in favour of the company on which board he sits, which duties would also apply to a nominee director. The problem identified was that an appointer uses a nominee director to monitor its interests on the nominee company, which would require the nominee director to divulge anything that could detrimentally affect the appointer's interests to the appointer. Further, the appointer would then require the nominee to act in its best interests. It was found that this was in direct conflict with the common law and statutory duty to act in the best interests of the company that he (the nominee) serves as a director. Herein lies the conflict of interests that nominee directors faced. This research found therefore that the position of nominee directors in relation to their fiduciary duties is a precarious one. They are appointed with the purposes of performing an oversight function on behalf of their appointer, but could face personal liability for breach of fiduciary duties if they act in the furtherance of their appointers' interests to the detriment of the nominee company. The appointment of a nominee director is acknowledged as a commercial reality and the benefits of their use include investor privacy, meeting statutory requirements and logistical benefits. In the event of a nominee director wanting to receive remuneration by way of directors' fees for services rendered as a director, there needs to be an express agreement of that entitlement in place or a shareholders' resolution. If he is an employee of the appointer, and is subsequently nominated to the board of another company, perhaps where his employer is the majority shareholder, then it is advisable for the nominee director to assess the feasibility of accepting the appointment against whether he will receive the fees for his services as a director on the board, in conjunction with the possibility that he could be held personally liable for breach of a fiduciary duty while sitting on the nominee company's board. Finally and as a consequence of their lack of complete unfettered independence, this research finds that the Act does not sufficiently accommodate the split loyalties of nominee directors' and suggests that companies should avoid utilising them altogether in favour of the alternatives provided in King III, such as Lead Independent Directors or independent non-executive directors in view of exercising good corporate governance.

Statement of Originality

This dissertation is an original piece of work which is made available for photocopying and for inter-library loan.

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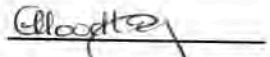

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Acknowledgements

I acknowledge and express gratitude for the invaluable guidance offered to me by my dissertation supervisor, Prof. Stephanie Luiz.

A special thank you to my family and friends for their support and to my principal and Managing Director, Derik Jaftha for encouraging me through to completion of this project.

TABLE OF CONTENTS

CHAPTER	TITLE	PAGE
1.	**INTRODUCTION TO THE RESEARCH**	**1 – 4**
1.1	*Introduction*	1 – 3
1.1	*Motivation for the Research*	4
1.2	*Critical Research Questions*	4
2.	**TYPES OF DIRECTORS AND THEIR FIDUCIARY DUTIES**	**5 – 24**
2.1	*Introduction*	5
2.2	*Different types of Directors*	6 – 13
2.3	*Directors Fiduciary Duties and when they arise*	14
2.3.1	*What is a "fiduciary relationship"?*	14 – 18
2.3.2	*Specific fiduciary duties under the common law*	18 – 20
2.3.3	*Statutory duties*	21 – 24
2.4	*Conclusion*	24
3.	**NOMINEE DIRECTORS**	**25 – 40**
3.1	*Introduction*	25 – 26
3.2	*Nominee Directors and their appointment*	26 – 27
3.3	*Reasons for and benefits of the appointment of Nominee Directors*	27 – 29
3.4	*Split loyalties and conflicts of interests*	29 – 32
3.5	*Nominee directors and liability for breach of fiduciary duties*	32 – 34
3.6	*Remuneration of the Nominee Director – when and by whom?*	34 – 39
3.7	*Conclusion*	39
4.	**IS THERE A NEED FOR LEGISLATIVE REFORM?**	**40 – 42**
4.1	*Introduction*	40
4.2	*Does the Act sufficiently accommodate for these split loyalties?*	40 – 41
4.3	*Conclusion*	42
5.	**IS THERE A FUTURE FOR NOMINEE DIRECTORS IN SOUTH AFRICA? SOME CONCLUDING REMARKS**	**43 – 44**
5.1	*Introduction*	43 - 44
6.	**BIBLIOGRAPHY**	**45 – 48**
6.1	*Table of Textbooks*	45
6.2	*Table of Journal Articles*	45 – 47
6.3	*Table of Cases*	47 – 48
6.4	*Table of Online Sources and Websites*	49

CHAPTER 1

INTRODUCTION TO THE RESEARCH

1.1 Introduction

Holding a company directorship places a complex range of fiduciary duties on a director.[1] When a director is appointed, not only does a fiduciary relationship between him and the company arise, but the director is entrusted with powers, in view of him exercising those powers for the benefit of the company.[2] Prior to the introduction of the Companies Act 71 of 2008 (hereafter "the Act") directors' duties were largely regulated by the common law and codes of good practice like the King Report on Corporate Governance.[3] The Act partially codified directors' fiduciary duties in section 76. Henochsberg[4] explains that the 1973 Companies Act[5] did not codify director's duties but rather provided for statutory duties in addition to the common law fiduciary duties and the duty of care and skill.[6]

Section 76 (3) of the Act specifically places an obligation on directors, when acting in that capacity, to exercise their powers and perform the functions of a director in good faith and further requires the director to promote the best interests of the company in which he performs these duties. While this section prescribes the directors standards of conduct, it does not exclude the common law duties placed on directors.[7] It actually reiterates the common law position.[8] These extensive duties include mandatory adherence to the company's Memorandum of Incorporation (MOI)[9] and rules,[10] the onus to disclose personal interests in company matters,[11] the duty to perform functions as a director in good faith and for a proper purpose in the best interests of the company[12] and the duty to exercise reasonable care, skill and diligence in carrying out his functions.[13]

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[1] Michele Havenga 'Directors' Fiduciary Duties Under Our Future Company-law Regime' 1997 *SA Merc LJ* 310, 311.
[2] Note 1, Havenga, 311.
[3] Mervyn King SC *King Report on Governance for South Africa* (2009). King III is the latest report.
[4] Henochsberg *On the Companies Act 71 of 2008* (2015) Vol 1: 290 (3).
[5] Act 61 of 1973.
[6] Note 4, Henochsberg, Vol 1, 290 (3).
[7] Piet Delport *The New Companies Act Manual* (2009) 59.
[8] *Sanlam Capital Markets (Pty) Ltd v Mettle Manco (Pty) Ltd and others* [2014] 3 All SA 453 (GJ), para 42.
[9] A company's MOI is defined in the Act (Part A, Section 1) in the definition section, as a document that sets out the rights, duties and responsibilities of shareholders, directors and others within and in relation to the Company.
[10] Section 15 (6)(c)(i).
[11] Section 75.
[12] Section 76 (3)(a) and (b).
[13] Section 76 (3)(c).

The term 'director' is widely defined in the Act.[14] It includes all persons who occupy the role of a director irrespective of their title. Further, in section 76, a director includes a prescribed officer, members of board committees (even if they are not members of the board) and audit committee members, who all need to be board members.

Although the concepts of a *de jure, de facto*, 'nominee', 'shadow' directors and so forth are commonly recognised commercially, they are not specifically defined in the Act. They all fall under the wide definition of 'director' as defined in section 1, irrespective of the title given to that person, provided that he occupies the position of a director. Focus is on the function or role the person plays in the company.

At common law level, the Appellate Division[15] recognised that classifying a director as 'executive' or 'non-executive' or '*de facto*' serves no purpose if one is attempting to ascertain the extent of their duties. Primarily, if a person accepts the appointment as a director by a company, then he must serve the best interests of that company.[16]

This approach highlights the difficulties faced by nominee directors. The Court in *Fisheries*[17] emphasised that a director's duty is to act in the utmost good faith towards a company even if he is representing the interests of a nominee and is a servant or agent of that nominee.[18] This judgment held that by law, the nominee director needs to serve the interests of the company to the exclusion of the interests of the nominator, employer or principal.[19]

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[14] Section 1 and Section 66.
[15] *Howard v Herrigel NNO* 1991 (2) SA 660 (A).
[16] Note 15, *Howard*, para 58.
[17] *Fisheries Development Corporation of SA Limited v Jorgensen* 1980 (4) SA 156 (W).
[18] Note 17, *Fisheries*, 163 para E-F.
[19] Note 17, *Fisheries*, 163 E- F.

After setting out the different types of directors, this dissertation will briefly highlight the fiduciary duties owed by directors to their company. The research will then examine the potential conflict situation that arises with the 'nominee director' who wears two 'hats' – his fiduciary duty obliges him to promote the interests of the company onto which board he is nominated ("the nominee company"), while his loyalty to the person who appointed him may require him to safeguard their interests. An attempt will be made to offer suggestions for good governance to companies who permit and or need nominee directors to be appointed onto their boards. Anyone who takes up the position of a nominee director would at least be able to gain an understanding of their position and how they must behave.

Normally, when an employee performs duties for a company, it follows that they will be remunerated accordingly. However, a director is not always an employee of the company, and consequently has no automatic right to the ordinary benefits of the employees and is not entitled to the usual rights flowing from a contract of service.[20] The fact that a person is appointed as a director does not *ipso facto* entitle him to claim remuneration for services rendered as a director.[21] This research will explore **when** a nominee director accrues the right to remuneration for performing his duties as a director on a nominee company, **who** is responsible for remunerating the nominee director and who is entitled to receive the director's fees.[22]

It will conclude with an opinion on whether the Companies Act 2008 should be amended to include provisions that specifically regulate the conduct of nominee directors. Further, it will conclude with an opinion on whether the partial codification of director's fiduciary duties accommodates the nominee directors split loyalties.

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[20] *Normandy v Ind Coope and Co Ltd* 1908 1 Ch 84.
[21] *Brown v Nanco Pty Ltd* 1976 (3) SA 832 (W) 834.
[22] By way of comment, there is a distinction between earning remuneration for being **employed** as a director (or in any other capacity as an employee) versus earning **directors fees** for services rendered as a director.

1.2 Motivation for the Research

There is not much information available on nominee directors in South Africa and our Courts last examined the concept of a nominee director over 30 years ago in the *Fisheries*[23] decision, which motivates for further research in this area.

Regarding the limited material on nominee directors available, Du Plessis[24] observes that the term 'nominee director' has not been used very often South African legal literature and the concept is covered very briefly in company law materials.[25] He also finds that even in international textbooks dealing exclusively with directors, nominee directors are covered very sparsely.[26] This solidifies the motivation for this research – to expand on the limited information available given that 'nominee directors' are a part of commercial reality.

1.3 Critical Research Questions

In summary, the aim of this paper is to critically examine nominee directors and in doing so, it will consider the following critical issues and attempt to provide answers thereto:

i) Who is a nominee director?
ii) What are the benefits of appointing a nominee director?
iii) What is meant by 'conflicts of interest' or 'split loyalties' that they face?
iv) To what extent does the Companies Act accommodate the divided loyalties of the nominee director?
v) To whom should the nominee director show complete loyalty when executing his fiduciary duties?
vi) What should a nominee director do when faced with a potential conflict of interest?
vii) Is the nominee director entitled to remuneration from both the appointer and the 'nominee company'? If so, under what circumstances?

[23] Note 17, *Fisheries*.
[24] J J Du Plessis 'Nominee directors *versus* puppet, dummy and stooge directors: Reflections on these directors and their nominators or appointers' 1995 *Journal of South African Law* 310.
[25] Note 24, JJ Du Plessis, 311.
[26] Note 24, JJ Du Plessis, 311.

CHAPTER 2
TYPES OF DIRECTORS AND THEIR FIDUCIARY DUTIES

2.1 Introduction

Section 1 of the Act defines a director 'as a member of the board of a company, as contemplated in section 66 or an alternate director of a company and includes any person occupying the position of a director or alternate director, by whatever name designated.' Coetzee & van Tonder[27] explain that from the wording of the definition, 'any person who occupies the position of director, is a director, for the purposes of the 2008 Act, whether he is described as such or not.'[28] The definition is wide enough to encompass executive and non-executive directors, *de facto* directors, *de jure* directors and nominee directors. Other directors that are additionally recognised include temporary directors, shadow directors and puppet directors.[29] Thus irrespective of a person's title within a company, they may still be regarded as a director based on the functions that he or she performs. The wide definition of the office of director has the effect of widening the liability net for persons occupying a director-like role.

Although the focus of this dissertation is on nominee directors, this chapter will identify the different types of directors and whether anything distinguishes them from nominee directors. It will then briefly highlight the fiduciary duties owed by a director and what triggers their obligation to adhere to these duties. This will form the basis of the exploration of the position of nominee directors.

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[27] Lindi Coetzee and Jan- Louis van Tonder 'The fiduciary relationship between a company and its directors' 2014 *Obiter* 285.
[28] Note 27, Coetzee and van Tonder, 296.
[29] Note 27, Coetzee and van Tonder, 297.

2.2 Different types of Directors

Although the Act refers to directors and alternate directors and provides certain definitions, a number of other designations are used in commerce to identify directors. Perhaps the idea in commerce is to try and use different terminology to highlight the different functions that the director performs. Upon perusal of the Act, it is apparent that it contains provisions that identifies four types of directors being:

i. A director who is appointed in terms of the MOI;[30]
ii. An *ex officio* director;[31]
iii. An alternate director;[32] and
iv. A director elected by shareholders[33]

An '**alternate director**'[34] means a person elected or appointed to serve, as the occasion requires, as a member of the board of a company in substitution for a particular elected or appointed director of that company. A company may only appoint an alternate director if it is provided for in the MOI.[35] Further, an alternate director exercises the same powers of a director, provided that in exercising these powers, he does not exceed those of his appointer.[36] It is instructive to note that they are not appointed with a view to act as agents of their appointers while acting as alternate directors.[37] This feature of an alternate director will be distinguished from that of a nominee director below.

A '**prescribed officer**' according to section 1 of the Act is a person who, within a company, performs any function that has been designated by the Minister in terms of section 66 (10). The Minister has exercised the power to define a prescribed officer under Regulation 38 of the Companies Regulations.[38]

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[30] Section 66 (4)(a)(i)
[31] Section 66 (4)(a)(ii)
[32] Section 66 (4)(a)(iii)
[33] Section 66 (4)(b) and s68 (1)
[34] Section 1 of the Act.
[35] Section 66 (4)(iii) of the Act.
[36] Note 27, Coetzee and van Tonder, 299.
[37] Note 27, Coetzee and van Tonder, 290.
[38] GNR 351 Government Gazette 34239, 26th April 2011.

According to the definition, even if a person is not a director of a company, he is considered a 'prescribed officer' if he exercises general executive control over and management of the whole or a significant portion of the business and activities of the company[39] or, if he regularly participates to a material degree in the business activities of the company.[40]

From the above definition, it is observed that the regulation makes use of open-ended phrases such as 'exercises general executive control' and 'significant portion' in reference to managerial control. There is no indication contained in the definition as to the limit of these criteria and consequently no indication of the extent of the participation or control that would suffice to render a person a 'prescribed officer.'[41]

Those persons who fall within the definition of a 'prescribed officer' are subject to substantially the same statutory duties, standards of conduct, restrictions and liability as company directors,[42] given that 'prescribed officers' are mentioned in the exactly the same provisions as 'directors' in those clauses in the Act relating to :

i. disclosure of information in annual financial statements,[43]
ii. the need for shareholder approval for share issues,[44]
iii. ineligibility for and disqualification from office,[45]
iv. liability for breach of statutory duty,[46]

to a list a few. From the afore-going it appears that focus will be on the type of duties that the 'prescribed officer' performs, and if those duties place him in a fiduciary position in relation to the company.

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[39] Regulation 38 (1)(a).
[40] Regulation 38 (1)(b).
[41] Kathy Idensohn 'The meaning of 'Prescribed Officers' under the Companies Act 71 of 2008' (2012) 129 *SALJ* 717, 718.
[42] Note 41, Idensohn.
[43] Section 30 (5)(a).
[44] Section 41(1)(a).
[45] Section 69.
[46] Section 77.

An ***ex officio* director**, according to the definition in section 1 of the Act, is a person who holds office as a director of a particular company solely as a consequence of that person holding some other office, title, designation or similar status specified in the company's MOI. By way of example, the MOI may state that the CEO shall be a member of the board of directors of the company, the general secretary of a trade union, the head of a political party or even a member of a family with an interest in the company.[47] The person occupying that office or who holds that status, automatically becomes a director, on assuming the designated position, on condition that he delivers his written consent, referred to in section 66(7) to take up the role.[48] An *ex officio* director's appointment terminates when he or she ceases to hold that position.[49]

In accordance with section 66 (4) and section 66 (5), an *ex officio* director has all the powers and functions of any other director of the company, except to the extent that the company's MOI restricts the powers, functions or duties. He is also subject to all of the liabilities any other director of the company faces.[50]

In the In *Re Hydrodam (Corby) Ltd*[51] judgement the court explained that a ***de facto*** director holds himself out to be a director and claims and purports to be a director without having been so appointed, either validly or at all.[52] The Court further held that in order to determine whether a person is a *de facto* director of a company it must be proved that he undertook functions in relation to the company that could properly have been discharged only by a director.[53] Locke concludes that a ***de facto* director,** is one who purports to be a director and conducts himself in such a manner, but has never been validly appointed as a director.[54]

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[47] Ian Cox 'South Africa: The Appointment Of Directors Under The 2008 Companies Act' , 25 October 2012 *http://www.mondaq.com/southafrica/x/203172/Directors+Officers/The+Appointment+Of+Directors+Under+The+2008+Companies+Act*, accessed 30th July 2015.
[48] Note 47, Ian Cox.
[49] Note 47, Ian Cox.
[50] Section 66 (5)(b)(ii) of the Act.
[51] 1994 BCC 161.
[52] Note 51, *In Re Hydrodam (Corby) Ltd*, 163.
[53] Note 51, *In Re Hydrodam (Corby) Ltd*, 163.
[54] Natania Locke 'Shadow Directors: Lessons from abroad' 2002 (14) *SA Merc LJ* 420, 421.

A ***de jure*** director is not really a different type of director. The term describes any director who was properly and lawfully appointed.[55]

A **shadow director** is someone on whose instructions other director's act,[56] he is not held out to be a director,[57] but merely someone who has dominance over the board directors to such an extent that he influences them to act to his direction[58] and the board exercises no substantial or independent judgement.[59] In other words, a shadow director has no valid appointment to the board, his name will not appear on a register of directors but he has substantial influence over the board itself, perhaps as a major investor or founder of the company that the board finds itself submissive to, and or obedient to his instructions.[60]

Legal texts often refer to **executive and non-executive directors.**

At common law level the Court held in *Howard v Herrigel*[61] that:

> It is unhelpful and even misleading to classify company directors as 'executive' or 'non-executive' for purposes of ascertaining their duties to the company or when any specific or affirmative action is required of them. No such distinction is to be found in any statute. At common law, once a person accepts an appointment as a director, that person becomes a fiduciary in relation to the company and is obliged to display the utmost good faith towards the company and in his dealings on its behalf.[62]

The above judgment was handed down in 1991 but the position that there is no distinction between executive and non-executive directors in statute, still holds true under the Act.[63]

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[55] Note 37, Idhensohn, 720.
[56] Note 27, Coetzee and van Tonder, 300.
[57] Note 27, Coetzee and van Tonder, 301.
[58] Note 27, Coetzee and van Tonder, 302.
[59] Note 27, Coetzee and van Tonder, 302.
[60] Note 27, Coetzee and van Tonder.
[61] 1991 (2) SA 660 (A).
[62] Note 15, *Howard v Herrigel Ibid*, para 58.
[63] Act 71 of 2008.

Despite the common law position, enunciated above, that the distinction between the two being unhelpful when determining a directors duties, the King Report[64] on Corporate Governance[65] (specifically King III) does define executive and non-executive directors and promotes their inclusion on the composition of the board of directors.[66]

An executive director is defined in the Code as someone who is involved in the day-to-day management of the company or who is employed on a full-time basis, earning a salary from the company or its subsidiary or both.[67] A **non-executive director** is defined in the Code as a director who is not involved in the management of the company but plays an important role in providing objective judgement on issues facing the company, which judgement is to be exercised independently.[68] [69]

A nominee director could potentially be either an executive or non-executive director, but if he was also an employee of the company he would be in a difficult position – he would have to remember that he is employed by the company and that he is a director of the company and owes his fiduciary duty to the company on the one hand and on the other hand he would need to remember his obligations to his appointer. It may be unlikely that a company would employ a nominee director as an executive knowing that he has been appointed to keep a "watching brief" over the company to make sure nothing is done to severely prejudice the interests of the appointer who nominated him to serve.

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[64] Note 3, Mervyn King SC, King III

[65] King III is essentially a Code that sets out guiding principles of Corporate Governance that aligns with international standards. In the introduction and background to the Code, Mervyn King SC explains that the third report on corporate governance in South Africa became necessary because of the new Companies Act no. 71 of 2008 ('the Act') and changes in international governance trends.

[66] King III, Principle 2.18 "The board should comprise a balance of power, with a majority of non-executive directors. The majority of non-executive directors should be independent." The principles goes on the further to state at para 62 : 'Given the positive interaction and diversity of views that occur between individuals of different skills, experience and backgrounds, the unitary board structure with executive directors (refer to Annex 2.2) and non-executive directors (refer to Annex 2.3) interacting in a working group remains appropriate for South African companies. The unitary system has been well established in South Africa."

[67] Annex 2.2 to the King III Report.

[68] Annex 2.3 to the King III Report.

[69] The Code defines "Independence" in the glossary section as 'the absence of undue influence and bias which can be affected by the intensity of the relationship between the director and the company.'

The Code goes on to describe an **independent non-executive director**[70] as a non-executive director who does not represent a shareholder, which shareholder neither wields significant influence over management or the board nor does he have a direct or indirect interest in the company or a subsidiary thereof. A nominee director cannot be an independent non-executive director because their appointment is made with a view to represent and or monitor their appointer's interests.

The Code also introduces the concept of a **lead independent non-executive director (LID),**[71] whose main function is to provide leadership and advice to the board without detracting from the authority of the chairman, when the chair is faced with a conflict of interest.[72] The Code suggests that the chairman of the board should be LID and such chairman should not also be the CEO of the company.[73] The rationale behind the suggestion of the appointment of a LID is that a chairman should be independent and free of conflicts of interest at appointment.[74] If a scenario arises that places his independence into question, then a LID should be appointed for so long as the situation causing the lack of independence exists.[75]

Du Plessis[76] observes that the term "**nominee director"** has not been used very often in South African legal literature and the concept is covered very briefly in company law materials.[77]

In *S v Shaban*[78] the High Court explained that a **nominee director** is a director lawfully elected onto the board by someone with an interest in the nominee company, such as a shareholder who controls sufficient voting power for the purpose.[79]

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[70] Note 3, King III, Principle 2.18 para 67.
[71] Note 3, King III, Annex 2.1.
[72] Note 3, King III, Annex 2.1.
[73] Note 3, King III, Principle 2.16.
[74] Note 3, King III, Principle 2.16, para 38.
[75] Note 3, King III, Principle 2.16, para 38.
[76] Note 24, J J Du Plessis, 310.
[77] Note 24, JJ Du Plessis, 311.
[78] *S v Shaban* 1965 (4) SA 646 (W).
[79] Note 78, *Shaban,* para 651G-H.

The King III Report describes a nominee director as

> Any director who is appointed to the board as the representative of a party with a substantial interest in the company, such as a major shareholder or a substantial creditor.[80]

Whereas a nominee director is actually lawfully appointed to the board by 'internal or external shareholders who have an interest in how the company conducts its affairs,'[81] this contrasts with a *de facto* director, defined above, who is holds himself out to be a director, but has never been validly appointed as such.

A **nominee director** may be appointed to represent the interests of another, or act as an agent – this is in direct contrast with an **alternate director** who sits as a substitute for an appointed director but in doing so, does not act an agent of him.

It is submitted that the intended function of a nominee directors is to serve as agents of their appointers or to monitor their appointer's interests in the nominee company, which is directly opposite to that of an alternate director, discussed above, who are elected or appointed to serve, as a member of the board of a company in **substitution** for an existing elected or appointed director of that company.

When referring to nominee directors, the Court in *S v Shaban*[82] explained that:

> He goes to a meeting and *acts in the way his principal wants him to*. (My italics). But normally he knows what is going on and does not pretend that he applied his mind to resolutions whilst not even knowing that such a resolution has been recorded.[83]

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[80] Note 3, King III, para 24.
[81] Deirdre Ahern 'Nominee Directors' duty to promote the success of the company: Commercial Pragmatism and Legal Orthodoxy' 2011 (127) Law Quarterly Review 118.
[82] Note 78, *Shaban*.
[83] Note 78, *Shaban*, 651G-H.

The court went on further to state that it was strongly opposed to the idea that 'puppets can be lawfully employed in our company system'[84] and explained that a **puppet director** refers to 'persons placed on boards who pretend to have taken part in resolutions of which they know nothing.'[85] It would seem that the Court considered a situation where a puppet director participated in a vote to pass a resolution, without any independent judgement and consideration of the impact of that resolution on the company, but voted solely at the behest of their appointer.

Judge Hiesmtra emphasised that through practice, it is acknowledged that **nominees** have arisen but their functions are not a hollow pretence.[86] It is submitted that the comments of the Court indicate that nominee directors are a commercial reality but their presence on boards as directors are significant and they cannot purport to be directors but fail to give effect to their functions as a director.

From the afore-going it may be concluded that there is a distinction between a **nominee director** and a **puppet director**, in that a nominee director is lawfully appointed but with the appointment comes the responsibility to act in accordance with the standards of conduct expected of a director under the Act and the common law. A puppet it would seem is appointed to a board with the sole purpose of acting on the **directions** of his appointer – this is why, it is submitted, that the court found such appointment unlawful, as he would be ignoring his fiduciary duty to the company.

This potential for conflict and a directors fiduciary duties will be explored below.

From the definitions above it is clear that irrespective of the categorisation of a director or labels used to identify him, of paramount importance is that by accepting the role of director, attached to the position are a set of expectations by way of standards of conduct imposed upon them, in relation to the company. These duties will be briefly explained below and it will be explained when these duties arise.

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[84] Note 78, *Shaban*, 651H.
[85] Note 78, *Shaban*, 652A.
[86] Note 78, *Shaban*, 652A-B.

2.3 Directors' fiduciary duties and when they arise

2.3.1 What is a "fiduciary relationship"?

The word ***'fiduciary'***, from its Latin origins, means to trust.[87]

Idenson[88] explains that the test for whether a functionary owes the company a fiduciary duty is whether the person in question assumed the status and functions of a company director, having regard to their actions rather than what they call themselves.[89] She says that this would include persons who claim to be and/or are held out as directors as well as those who perform the functions of and act on an equal footing with *de jure* directors.[90]

Cilliers and Benade[91] explain that 'a person usually comes into a fiduciary relationship when he controls the assets of another or holds the power to act on behalf of another.'[92] This section will explain the meaning of being a fiduciary in relation to the company and when that relationship arises. It will then discuss the meaning of a directors fiduciary obligations.

The challenge for a person or the entity alleging a fiduciary relationship existed, is to establish the ***existence*** of a fiduciary relationship to begin with. According to the Supreme Court of Appeal (SCA), a person in a fiduciary position **exercises discretion over the affairs of another**.[93] This ties in with the definitions above and the principle that irrespective of the title attached to a person, so long as his duties are akin to those traditionally associated with that of a director, then a fiduciary relationship exists.

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[87] http://www.oxforddictionaries.com/definition/english/fiduciary, accessed on 6th April 2015.
[88] Note 41, Idensohn, 717.
[89] Note 41, Idensohn, 717.
[90] Note 41, Idhensohn, 721.
[91] Cilliers and Benade *Corporate Law* 3 ed (2000).
[92] Note 91, Cilliers and Benade, 139.
[93] *Volvo (Southern Africa)* v *Yssel* [2009] 4 All 497 (SCA) para 17.

The SCA in the *Volvo*[94] decision identified some factors or characteristics that imply a fiduciary relationship exists but did not provide an exhaustive list. To paraphrase, these factors or characteristics include:

i. the discretion that one party may have in relation to the affairs of another;
ii. the influence that he or she is capable of asserting;
iii. the vulnerability of one person to another; and
iv. the trust and reliance that is placed in the other.[95]

In the *Volvo*[96] decision Yssel was employed by a labour brokerage service and was appointed to the most senior position within Volvo Southern Africa's information technology department. His duties, the SCA explained, included the 'management of the information technology infrastructure of Volvo by mean of user support, user training, liaison with local suppliers'[97] and so forth. His duties had nothing to do with recruitment, selection and placement of staff, but he engaged in a 'facilitation scheme' with his labour brokerage whereby he arranged for existing Volvo personnel who were dissatisfied with their labour brokers, to be transferred to his own labour brokerage, Highveld.[98] The transfer was done with the consent of Volvo and the personnel concerned, but what he failed to disclose to Volvo was that he had arranged to receive a 'commission' from Highveld for every person transferred to them. By the time that Volvo discovered his scheme, Yssel had received R775 107.00 in commissions from Highveld, which Volvo now sought to recoup from him. Yssel was not a Volvo employee.

However, the SCA held that notwithstanding that contractual privity did not exist between Yssel and Volvo, he did indeed still owe a fiduciary duty to Volvo, taking the factors outlined above into consideration, and thus had to always conduct himself in the best interests of Volvo.[99]

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[94] Note 93, *Volvo Ibid.*
[95] Note 93, *Volvo*, para 17.
[96] Note 93, *Volvo.*
[97] Note 93, *Volvo*, para 2.
[98] Note 93, *Volvo* para 4.
[99] Note 93, *Volvo*, para 18 – 19.

The SCA observed that:

> It was the position to which he was appointed, rather than the nature of the contractual relationship that defined what Volvo could expect of him. He had not been brought in to its offices so as to provide him with an opportunity to hawk his own wares but had been brought there in the interests of Volvo. That his functions might not have included recruiting, employing and acquiring staff, does not seem to me to be material. No doubt he could not be compelled to accept instructions to engage himself in matters of that nature. But the fact is that he did engage himself in arranging matters between Volvo and its staff. And in doing so he did not purport to be doing so as a stranger who was conducting his own affairs. He did so as an incident of his function as manager of the division. It was only because Yssel was the manager that the transaction came about at all. Indeed there can be no doubt that Yssel was well aware that it was precisely because he was the manager of the division that Volvo could be induced to relax the care and vigilance it would have ordinarily exercised in dealing with a stranger.[100]
>
> I have no doubt that Yssel was in a position of trust when he engaged himself in the matter and was not entitled to allow his own interests to prevail over those of Volvo. He is obliged in those circumstances to disgorge his secret commissions and the appeal must succeed.[101]

From the aforegoing it is apparent that even in instances where a person does not have a contractual obligation in place in favour of a company, he could still be viewed as being in a fiduciary relationship. Focus is on the position that a person holds and as such, his title is irrelevant. Here, the fact that Yssel held a senior position induced the company to be lax its vigilance, which vigilant stance is normally reserved for dealings with strangers.

In this case, the principle that even when a party in a position of trust is not contractually bound to a company breaches that trust, they are still not permitted to act in the furtherance of their own interests. By analogy, with a nominee director, they are actually formally appointed to the board; there is often mention of such nominee in the MOI and these directors are faced with conflicts of interest when faced with making decisions on the nominee company's board which may be in conflict with their appointer's interests.

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[100] Note 93, *Volvo*, para 19.
[101] Note 93, *Volvo*, para 20.

The SCA decision highlights how vigorously a Court will apply common law principles of acting in good faith when faced with a conflict of interest, which would apply equally to a nominee director.

In *Ghersi v Tiber Developments (Pty) Ltd*[102] the court recognised that

> the ambit of the duty can change from time to time' and that '[t]he existence of . . . a [fiduciary] duty and its nature and extent are questions of fact to be adduced from a thorough consideration of the substance of the relationship and any relevant circumstances which affect the operation of that relationship.[103]

Once a fiduciary relationship is established, it triggers certain fundamental duties on a director[104] and a Court has to examine the relationship to ascertain the ambit of the duties.[105]

The SCA in *Phillips*[106] came to the conclusion that the duty to avoid conflict of interests is the extent of a directors fiduciary duty.[107] To determine the extent of a director's fiduciary duties and what it entails, the relationship between the director and the company needs to be examined, the tasks or functions assigned or assumed by the directors are relevant and the nature of the company and the course of dealing actually pursued by the company must be assessed.[108]

There are common law and statutory fiduciary duties that will discussed below.

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[102] 2007 (4) SA 536 (SCA).
[103] Note 102 at para 9 quoting *Phillips v Fieldstone Africa (Pty) Ltd and Another* 2004 (3) SA 465 (SCA) at 477H.
[104] *Phillips v Fieldstone Africa Pty Ltd* 2004 1 All SA 150 (SCA), 159.
[105] Note 104, *Phillips*, 159.
[106] Note 104, *Phillips*.
[107] Note 104, *Phillips*, 160-161.
[108] *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168, 178 – 179.

The Western Cape High Court[109] commented in a reportable judgment that:

> Directors' duties are now at least partially codified under the Act. They observe that the common-law duties of a director are still applicable and that the common-law remedies flowing from such breaches still apply. The importance of section 76 is that the distinction between statutory and common-law duties has now been clearly defined, and that they must coexist alongside each other.[110]

2.3.2 *Specific fiduciary duties under the common law*

> The exercise of corporate powers are often subject to express or implied qualifications. In the case of directors, for example, it has always been the position under our law that they occupy a fiduciary position and must thus exercise any power conferred on them in what they *bona fide* consider to be the best interests of the company, for the purpose for which the power was conferred, and within any limits which may be imposed for the exercise of the power. There are other duties flowing from the fiduciary character of the office and there is, besides, a duty to act with care, skill and diligence. With the coming into force of the 2008 Companies Act, the duties of directors have been codified at a fairly high level by s 76.[111]

Pursuant to the above, essentially, under the common law, there are two over-arching duties that directors must fulfil – the duty to act in a *bona fide* manner in dealing with company affairs and to avoid conflicts of interest.

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[109] *Omar v Inhouse Venue Technical Management (Pty) Limited and others* (2015) JOL 32880 (WCC)

[110] Note 109, *Omar Ibid*, para 61

[111] *Visser Sitrus Pty Ltd v Goede Hoop Sitrus Ltd and two others* 15854/2013 (WC) Judgment delivered on 19/06/14.

The common law duties were extracted by Cilliers and Benade[112] and listed hereunder:

i. Directors should prevent conflict of interest
ii. May not exceed the limitations of their power
iii. Must maintain an unfettered discretion
iv. They should exercise their power for the purpose for which they were conferred.[113]

An explanation of the common law duties will follow hereunder. It is a well-established principle under the common law, that directors have a fiduciary duty to exercise their powers in good faith and in the best interests of the company and they may not make a secret profit or otherwise place themselves in a position where their fiduciary duties conflict with their personal interests,[114] barring the remuneration he is entitled to,[115] in terms of the MOI. This strict limitation against benefiting from holding the office of director serves to 'diminish possible conflicts of interest between a director and his company.'[116] Neither the Act nor the common law provides any exceptions for directors to deviate from these fiduciary duties.

In taking this principle against making a secret profit further the SCA explains that:

> A consequence of the rule is that a director is in certain circumstances obliged to acquire an economic opportunity for the company, if it is acquired at all. Such an opportunity is said to be a 'corporate opportunity' or one which is the 'property' of the company. If it is acquired by the director, not for the company but for himself, the law will refuse to give effect to the director's intention and will treat the acquisition as having been made for the company. The opportunity may then be claimed by the company from the delinquent director. Where such a claim is no longer possible, the company may in the alternative claim any profits which the director may have made as a result of the breach or damages in respect of any loss it may have suffered thereby.[117]

[112] Note 91, Cilliers and Benade.
[113] Note 91, Cilliers and Benade 137.
[114] Note 108, *Robinson*, 177.
[115] Note 91, Cilliers and Benade 137.
[116] Note 91, Cilliers and Benade 137.
[117] *Da Silva v C H Chemicals (Pty) Ltd* [2008] ZASCA 110, para 18.

It is irrelevant that the opportunity would not or even could not have been taken up by the company.[118] The SCA[119] has supported several common law authorities in holding that that the opportunity in question must be one which can properly be categorized as a 'corporate opportunity', which the company was 'actively pursuing'[120] or which 'related to the operations of the company within the scope of its business'[121] or which falls within its 'line of business.'[122] Ultimately, a Court will assess each case closely and carefully and examine all the relevant circumstances, including in particular the opportunity in question, to determine whether the exploitation of the opportunity by the director, whether for the director's own benefit or for that of another, gave rise to a conflict between the director's personal interests and those of the company which the director was then duty-bound to protect and advance.[123]

McLennan[124] observes that our common law has evolved to set out the fiduciary position of directors with the focal point of judgments, as seen above, being the loyalty owed to the company by these directors, collectively and individually.[125]

Practically, the expertise and experience acquired by a director while employed by the company and even the personal relationships established by him during that period, belong to him and not to the company. It is a well-established principle of the common law, now enshrined in s 22 of the Bill of Rights that all persons should in the interests of society be productive and be permitted to engage in trade and commerce or their professions.[126]

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[118] *Regal (Hastings) Ltd v Gulliver* [1942] 1 All ER 378 (HL) at 389D, 392H-393A; *Phillips v Fieldstone Africa (Pty) Ltd* 2004 (3) SA 465 (SCA) para 31.
[119] Note 117, *Da Silva,* para 19.
[120] *Canadian Aero Service v O'Malley* (1973) 40 DLR (3d) 371 SCC at 382.
[121] *Bellairs v Hodnett* 1978 (1) *SA* 1109 (A) at 1132H.
[122] *Movie Camera Company (Pty) Ltd v Van* Wyk [2003] 2 *All SA* 291 (C) at 308b; 313d-e.
[123] Note 117, *Da Silva,* para 19.
[124] J.S McLennan 'Directors Fiduciary Duties and the 2008 Companies Bill' *TSAR* 2009 (1) 184
[125] Note 124, McLennan, 185.
[126] *Reddy v Siemens Telecommunications (Pty) Ltd* 2007 (2) *SA* 486 (SCA) para 15.

2.3.3 *Statutory Duties*

Upon perusal of the 1973 Act it can be observed that the Old Act did not contain a list of duties and responsibilities for directors to follow, but the new 2008 Act partially codified directors' fiduciary duties in section 76. Section 76 does not exclude the common law duties owed by directors to a company therefore those that are not listed in section 76, will still apply, hence the reference to only a 'partial codification'.[127] The partial codification of directors duties serves to clarify directors obligations but it also tells 'foreign and domestic investors which rules govern the behaviour of directors and what remedies are available when those rules are violated.'[128]

Section 76 (1) provides a specific definition of a director, which section is set-out hereunder for ease of reference:

> 76. Standards of directors conduct
> (1) In this section, "director" includes an alternate director, and-
> (a) a prescribed officer; or
> (b) a person who is a member of a committee of a board of a company, or of the audit committee of a company, irrespective of whether or not the person is also a member of the company's board.

Section 76 (2) specifically prohibits a director from using any information obtained while acting in the capacity as director to gain an advantage for another company or to knowingly cause harm to the company in which he performs as director.

At common law level, directors have never owed subsidiary companies a fiduciary duty.[129] Upon examination of section 76 (2)(a)(i) specifically, it is a prohibition against using his position as director to gain an advantage for himself or anyone else other than the company on whose board he sits or a wholly owned subsidiary of that company. Put differently, he can use his position as director to gain an advantage for the company on whose board he sits or a wholly owned subsidiary of that company.

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[127] Note 4, Henochsberg.
[128] Michelle Havenga 'Regulating Directors Duties and South African Company Law Reform' *Obiter* (2005) 609, 619.
[129] Note 124, McLennan, 187.

Section 76 (2)(a)(ii) prohibits a director from knowingly causing harm to the company or a subsidiary of the company. This would mean that there is a duty on the director to act in the best interests of a subsidiary if he sits on the board of the subsidiary.

By way of example, a nominee director might also serve as a director on the board of the appointing (holding) company, which is the only shareholder in a subsidiary. In this scenario, the likelihood of a conflict arising, between what is best for the appointer versus what is best for the nominee company is clear. The statutory obligation makes it peremptory for the nominee director to act in a manner that is not detrimental to the subsidiary or the appointing company. In this case, it is submitted, that even if he declares the conflict of interest to both boards, and withdraws from participation in any vote, it cripples his ability to perform his duties as a director on either board. This would apply to any director, not just nominee directors. This illustrates that the Act does not accommodate for the split loyalties that the nominee faces. That is, when the nominee director acts in the best interests of the nominee company on whose board he sits, conflicts with the best interests of the appointer.

The SCA[130] explained that:

> Section 76(3) emphasises the fiduciary duties of a director to act in the best interest of the company, to act in good faith, with proper purpose and with the degree of diligence, skill and care to be expected of a reasonable director in the position of the director concerned. This subsection reiterates what was already established by the common law.[131]

In other words, section 76 (3) specifically places an obligation on directors, when acting in that capacity, to exercise their powers and to perform the functions of a director in good faith and further requires the director to promote the best interests of the company at which he performs these duties. This is where the possibility of split loyalties arises.

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[130] *Sanlam Capital Markets (Pty) Ltd v Mettle Manco (Pty) Ltd and others* (2014) 3 All SA 454 (SCA).
[131] Note 130, *Sanlam Ibid*, para 42.

Section 76 (4) (a) sets out the specific circumstances under which a director would have satisfied his obligations under section 76 (3) (b) and (c).[132] These include that the director took reasonably diligent steps to become informed about the matter; or that he had no personal financial interest; disclosed any conflicts of interest; and did the director make a decision based on advice from a committee or the board with a rational basis for believing and did he believe that such an decision was in the best interest of the company.

In the reportable High Court decision of *Visser*[133] Honourable Justice Rogers held that :

> Section 76 (4) makes clear that the duty imposed by section 76 (3)(b) to act in the best interests of the company is not an objective one, in the sense of entitling a court, if a board decision is challenged, to determine what is objectively speaking in the best interests of the company. What is required is that the directors, having taken reasonably diligent steps to become informed, should subjectively have believed that their decision was in the best interests of the company and this belief must have had a rational basis. The subjective test accords with the conventional approach to director's duties.[134]

The above finding aligns with the common law duty to act with care and skill, and in good faith in relation to the company. From the definition of an *ex officio* director in Chapter 2, it was established that he owes a fiduciary duty to the company. The refuge ordinarily available to an employee of following lawful instructions is not available to an *ex officio* director appointed on account of an office of employment.[135] Given that the fiduciary duty to act in the best interests of the company is essential, a director is legally bound to refuse any instruction that would involve a breach of his or her fiduciary duties.[136] Consequently *ex officio* directors may be denied a right to vote, rendering them with more a consultative rather than a director-like role on the board.[137]

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[132] The Act and *Visser Sitrus Pty Ltd v Goede Hoop Sitrus Pty Ltd and Two Others* 15854/2013, para 73.
[133] Note 111, *Visser*.
[134] Note 111, *Visser*, para 74.
[135] Note 47, Ian Cox.
[136] Note 47, Ian Cox.
[137] Note 47, Ian Cox.

This significantly reduces the exposure of such directors to the liability that ordinarily reposes in directors of the board in respect of the matters referred to in section 77(3)(e).[138] Such restrictions will not have the effect of reducing an *ex officio* director's appointment to a sham.[139]

2.4 Conclusion

This chapter discussed the different types of directors, their fiduciary relationship with the companies on whose boards they sit and the types of duties imposed upon them when holding the office of director. It was submitted that irrespective of the title attached to a director, his acceptance of such appointment triggers a range of statutory and common law fiduciary duties in favour of the company on which board he sits. Consequently, even a nominee director owes fiduciary duties to the nominee company by virtue of being appointed to that board. The problem identified is that an appointer uses a nominee director to monitor its interests on the nominee company. This would require the nominee director to divulge anything that could detrimentally affect the appointer's interests to the appointer and further, it would require him to act in the best interests of the appointer. This is in direct conflict with the common law and statutory duty to act in the best interests of the company that he serves as a director.

A director cannot contract out of his fiduciary duties under statute (section 247 of the Act) or the common law. The cases referred to, such as *Hydrodam*[140] highlight that irrespective of the type of appointment of a director, his judgement ought to be exercised independently in the best interests of the company he serves as a director. Therefore the position of nominee directors in relation to their fiduciary duties is a precarious one. They are appointed with the purposes of performing an oversight function on behalf of their appointer, but could face personal liability for breach of fiduciary duties if they act in the furtherance of their appointer's interests to the detriment of the nominee company. The next chapter will focus more on nominee directors, and the consequences of them breaching these fiduciary duties.

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[138] Note 47, Ian Cox.
[139] Note 47, Ian Cox.
[140] Note 51, *Hydrodam*.

CHAPTER 3
NOMINEE DIRECTORS

3.1 Introduction

In the previous chapter, the different types of directors were defined, along with their fiduciary obligations. It is apparent that irrespective of the title attached to a director or prescribed officer, the best interests of the company are paramount.

In this chapter, the focus will be on nominee directors specifically and the benefits of appointing a nominee director will be discussed. There is this underlying understanding [between the appointer and the nominee director] however, that a nominee director will act in accordance with or will support the viewpoint of his or her appointer.'[141] It is this 'understanding' that this research aims to highlight as problematic given that a director by any name (nominee or otherwise) is duty bound to act in the best interests of the company on which board he sits, with an absolute unfettered discretion, unencumbered by the interests of external stakeholders.

This chapter will then examine their 'split loyalties.' It will also discuss the nominee's potential liability for breach of fiduciary duties and if their position is any different from other directors.

Thereafter, the nominee directors right (if any) to be paid to act as director at the nominee company will be examined and whether the nominee director's employer is entitled to those director fees will also be discussed. To this end, the Supreme Court of Appeal decision of *Public Investment Corporation v Bodigelo*[142] (hereafter *Bodigelo*), will be analysed. It short, the *Bodigelo*[143] case found, in regard to non-executive director fees, that when the director is nominated onto the board of another company by his employer, the resultant director fees belong to the employer in the absence of an agreement to the contrary.

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[141] Note 81, Aherns, 118.
[142] ZASCA 2013/156, 22nd November 2013.
[143] Note 142, *Bodigelo.*

This discussion will aid the research on the benefits of appointing a nominee director or whether their appointment should be avoided and it will assist to reach a conclusion on whether the Act accommodates for the divided loyalties of a nominee director.

3.2 Nominee Directors and their appointment

In the previous chapter, the concept of a nominee director was defined. *S v Shaban*[144] concluded that a nominee director is a director lawfully elected onto the board by someone with an interest in the nominee company, such as a shareholder who controls sufficient voting power for the purpose.[145]

The Act draws a distinction between directors who are appointed and directors who are elected. It does so, so that the small company has a measure of flexibility for the critical purpose of determining exactly how directors come to occupy and lose their offices.[146] This distinction between election and appointment can be found in section 66(4)(iii). Despite the Court in *Shaban*[147] referring to a nominee director being 'lawfully **elected'** (my emphasis), a nominee director cannot join the board of directors unless the company's MOI provides for such an appointment and since it is a major stakeholder that decides to nominate such a director to the board, it is submitted that a nominee director is actually 'appointed' and not 'elected' as envisaged by the Act, to the board of directors.

From the definitions and discussion above regarding who is nominee director, there is notably nothing that suggests that nominee directors are distinct from *de jure* appointed directors. They are properly and lawfully appointed.

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[144] Note 78, *Shaban.*
[145] Note 78, *Shaban,* 651G-H.
[146] Carl Stein and Geoff Everingham 'The New Companies Act Unlocked' (2011), 224.
[147] Note 78, *Shaban.*

Ahern[148] suggests that their appointment is no different from the appointment of *de jure* directors as outlined in the Act and that a distinction needs to be drawn between **nominated** directors and **nominee** directors, [149] [my emphasis]. The former's responsibility to the nominator ends upon appointment, whereas the latter nominee directors continue to be responsible to the appointer after appointment.[150] This emphasises that nominee directors are appointed with a view to watching over their appointers interests.

3.3 Reasons for and benefits of the appointment of Nominee Directors

Internal or external stakeholders, like the major shareholders of a holding company appoint a nominee director as they have an interest in how that company or a subsidiary of the holding company conducts its affairs.[151] At times, it may be a **statutory requirement** to register a company with a resident director. For example, in Ireland, the Companies Act 2014 provides that the company may appoint a secretary and a minimum of two directors, with one the directors to be resident in a member state of the European Economic Area (EEA).[152] [153] In this instance, a nominee director becomes useful to meet statutory residency requirements.[154] However, there is no residency requirement like this in South Africa.

A nominee director is not necessarily appointed to the board of a nominee company exclusively to ensure that **maximum revenue** is generated for his appointer.[155] He could be appointed to represent employee interests so, in that instance, his conduct will be geared towards **maximising employee welfare**.[156] By way of example, employee welfare could include decisions in respect of wages, share interests, pension fund contributions, bursary programmes and conditions, overtime and or compressed work-week negotiations subject to the relevant collective agreements, and so forth.

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[148] Note 81, Ahern.
[149] Note 81, Ahern, 121.
[150] Note 81, Ahern 121.
[151] Note 81, Ahern.
[152] Section 137 of the Companies Act 2014.
[153] The EEA provides for the free movement of persons, goods, services and capital within the internal market of the European Union (EU) between its 28 member states, as well as three of the four member states of the European Free Trade Association (EFTA): Iceland, Liechtenstein and Norway. https://en.wikipedia.org/wiki/European_Economic_Area, accessed on 22nd November 2015.
[154] Dr. Mark Bussin and Elmien Smit 'Clarify your position regarding directors fees' 8th August 2014, 34. www.hrfuture.net, accessed 21st July 2015.
[155] Note 81, Deirdre M. Ahern.
[156] Note 81, Ahern 118.

In cases where shareholders and directors are not local residents or ordinarily resident in the country in which the new company is to be registered, it makes logistical sense to appoint a nominee director. The nominee director can attend to opening a corporate bank account (if this has to be done in person).[157] It seems that the nominee director would be not be the best choice and it leads to the issue of why not appoint an independent director altogether.

Kleitman[158] comments that often enough an investing entity will ensure that their interests are represented on the board of directors, for peace of mind that its funds are spent for the agreed purpose.[159] These are nominee directors and they serve as non-executive directors of the investee company, typically for so long as there are obligations outstanding to the financier.[160] In this regard, an arrangement which is regularly encountered and which is provided for in the finance documents and or the shareholders agreement is that the investee company will pay the directors fees of the nominee director to the financier instead of the nominee director.[161]

Based on the paraphrased quote above, it is apparent that a nominee director is placed on a board with an oversight function – to basically act as the eyes and ears of his appointer, and to ensure that his appointers investment is secure. Cottrell[162] explains that their appointment may be problematic as they may be tempted to look to their interests of their appointer rather instead of the company on to which board they are appointed.[163] This split loyalty will be discussed below.

Inasmuch as there are benefits to appointing a nominee director, there also inherent risks to the appointer, given that nominee directors have the same powers as any other director and are therefore capable of making 'strategic decisions related to the operations and management of the company and may also act on behalf of the company with clients, suppliers and governments without the express consent of the shareholders.'[164] This means

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[157] Note 154, Dr. Mark Bussin and Elmien Smit, 34.
[158] Yaniv Kleitman 'Who pays and receives the fees of nominee directors' Jan/Feb/March 2014 *Directorship* 8.
[159] Note 158, Kleitman, 8.
[160] Note 158, Kleitman, 8.
[161] Note 158, Kleitman, 8.
[162] Jill Cottrell 'Directors: De Jure, De Facto, or Shadow?' 1998 (28) *Hong Kong L.J.* 304.
[163] Note 162, Cottrell, 310.
[164] Note 154, Dr. Mark Bussin and Elmien Smit.

that there is a risk to the appointer that the nominee may not defer to him when making a decision and could result in acting to the prejudice of the appointer. In the event of a nominee director acting in solely in furtherance of his appointers' interests, the scope of his power is wide enough to prejudice the nominee company.

Bussin & Smit[165] explain that often, when an owner of a company wants to remain anonymous, even in an offshore company, then a nominee director is appointed as the third party officially registered as the administrator of the company. In this context, their main function is to protect the privacy of their nominator.[166] This is one of the commercial uses of a nominee director, but this in turn automatically triggers the application of the standards of conduct contained in the Act and the common law in relation to the nominee director.

3.4 Split loyalties and conflicts of interest

Nominee directors, like all directors, are bound by their fiduciary obligations. The difficulty arises when their duty to the nominee company comes into conflict with their obligation to consider the interests of their appointer. What follows will consider where a nominee director's loyalties should lie when there is a conflict of interest between his appointer's interests versus the best interests of the nominee company. Before doing this, it would be useful to this research to consider more fully what constitutes a 'conflict of interest' and what is a 'split loyalty,' as it has only been briefly touched upon in the preceding chapters.

The King III Report[167] describes a 'nominee director' without actually using the term 'nominee director' and explains his duty as well:

> Any director who is appointed to the board as the representative of a party with a substantial interest in the company, such as a major shareholder or a substantial creditor, should recognise the potential for conflict. However that director must understand that the duty to act in the best interests of the company remains paramount.[168]

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[165] Note 154, Bussin and Smit, 34
[166] Note 154, Bussin and Smit, 34
[167] Note 3, King III, Chapter 2 Boards and Directors, para 28.
[168] Note 3, King III, para 24.

Ahern[169] acknowledges that at times a nominee director is:

> naturally motivated to make decisions which are welfare enhancing for their nominator. This gives rise to a possible conflict between the duties owed by a nominee director to their appointer and the duties owed to the company, which needs to be resolved by considering whether a nominee director is entitled to take into account the interests of the appointer.[170]

This conflict situation will be explored further below.

Under the common law a director must avoid conflicts of interest, meaning that he must not have a personal interest or duty to another company or person which conflicts or may conflict with the interests of the company or with his duties to the company.[171] The Companies Act 71 of 2008 (the Act) codified directors fiduciary duties to an extent in section 76. Section 76 (3) specifically places an obligation on directors, when acting in that capacity, to exercise their powers and perform the functions of a director in good faith and further requires the director to promote the best interests of the company on which board he performs these duties.

The following dictum by Lord Denning MR in *Boulting v Association of Cinematograph Television & Allied Technicians*[172] is relevant and self-explanatory:

> A **nominee director**, that is, a director of a company who is **nominated** by a large shareholder to represent his interests. There is nothing wrong in it. It is done every day. Nothing wrong, that is, **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 a doubt unlawful. [173] **[My emphasis]**

Despite this being an English case, the principles enunciated above have been followed by our Courts and are reflected in the Act.

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[169] Note 81, Ahern.
[170] Note 81, Ahern, 119.
[171] Note 108, *Robinson*, 177
[172] [1963] 2 QB 606.
[173] Note 172, *Boulting*, 626.

The duties and expectations of nominee directors align with those expected of a *de jure* director, as nominee directors are not a class apart of director, but must act independently. In *PPWAWU National Provident Fund v Chemical, Energy, Paper, Printing, Wood and Allied Workers' Union*[174] the Court, after referring to *Fisheries*[175] held that **directors must act independently regardless of the views or decisions of those who appointed them.**

If the standards expected of a nominee director are akin to that of a *de jure* director, then the promotion of the best interests of the nominee company (the company onto whose board the nominee was placed to represent the best interests of a shareholder), must be paramount to the nominee director.

A strict approach to the duties outlined in section 76 would require a nominee director to divest himself of any conflicting interest for the benefit of the nominee company (instead of acting in his or his appointers interest), which may even include abandoning his role in a particular vote or drastically, resigning from the role.

Based on the wording of section 76 (2) and section 76 (3), it is apparent that a nominee director is expected to exercise **independent judgement**, which, put differently would mean not to adhere strictly and solely to his nominator's interests.

> The director's duty is to observe the utmost good faith towards the company, and in discharging that duty he is required to exercise an 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 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 such nominator, employer or principal.[176]

[174] 2008 (2) SA 351 (W), para 25.
[175] Note 17, *Fisheries*.
[176] Note 17, *Fisheries*, 163, para E-F.

The *Fisheries Development*[177] case bears reference, where Margo J explained that :

> A director is in that capacity 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 an 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 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 such nominator, employer or principal. He cannot therefore fetter his vote as a director, save in so far as there may be a contract for the board to vote in that way in the interests of the company, and, as a director he cannot be subject to the control of any employer or principal other than the company.[178]

This means that a nominee director cannot restrict himself to voting only in instances that benefit the appointer. In cases where there the nominee director faces a predicament to act in his appointer's interests versus that of the nominee company onto whose board he was appointed, he must exercise his discretion in favour of the nominee company.

3.5 Nominee directors and liability for breach of fiduciary duties

If a director, including a nominee director, standing in a fiduciary relationship to a nominee company, breaches such relationship of trust for his own benefit or for the benefit of another, including a subsidiary of the nominee company, then such breach will give rise to that director's liability.[179] Redmond[180] observes that a director should never delegate or contract out his discretionary powers to outsiders, in the absence of an empowering provision in the company's founding documents.[181] In South Africa a director, including nominees, are not empowered to contract out his fiduciary duties or to delegate liability for their obligations.

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[177] Note 17, *Fisheries,* para 163 D-G.
[178] Note 17, *Fisheries,* para 163D-G.
[179] Note 27, Coetzee and van Tonder, 306.
[180] Paul Redmond 'Nominee Directors.' 1987 (10) U.N.S.W.L.J. 194.
[181] Note 180, Redmond, 206.

However, a problem arises if an appointer uses a nominee director in the manner of a puppet, to do the formers bidding, but such nominee director has very little knowledge of the significance of the acts he or she performing, then the nominee directors conduct in relation to the understanding the transaction will need to be assessed.[182] Redmond is of the view that a nominee director should be held liable for any impropriety even if they were not aware of such impropriety at the time, as 'the legitimacy of the corporate model of business organisation lies in the accountability of those who wield power under it.'[183] In short, Redmond appears to be of the view that the liability of a nominee director should be no different than that of any other director, as he is ultimately accountable for the acts of the company. This research supports Redmond's contention, as it has been established above that the moment a nominee accepts appointment as a director, it triggers a fiduciary relationship with the company onto whose board he is nominated.

The Act refers to breach of duties imposed in it but the principles of the common law relating to such breach are used to assess the breach and whether he may escape liability for same. For instance, if the director alleges and proves that he acted honestly and reasonably on the strength of expert advice given to him by a committee. These provisions will be touched on below.

In South Africa, section 77 of the Act covers directors liability.

Under 77(2)(a), a director of a company may be held liable for the breach of a fiduciary duty for any loss, damages or costs sustained by the company as a consequence of any breach by the director of the duties contemplated, inter alia, in section 76 (2) or 76 (3)(a) or (b) of the Act. The Act does, however, make provision for directors to raise "honest and reasonable" behaviour on their part as a defence in these circumstances, under section 77 (9)(a). From the discussion on fiduciary duties above, which duties are contained in the Act and the common law, adopting the stance that all actions of the nominee director must be geared towards protecting his appointer's interests is not acceptable corporate governance, as it prejudices the best interests of the nominee company in favour of what is best for the appointers.

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[182] Note 180, Redmond, 207.
[183] Note 180, Redmond, 208.

Havenga[184] suggests that a nominee director should be permitted to pay specific attention to the interests of his appointer, provided that the interests of the nominee company prevail in conflict situations.[185] This research supports Havenga's suggestion as it means that the nominee director must always place the best interests of the company first.

This would absolve the nominee director from liability for breach of fiduciary duty as his actions, while *prima facie* are in the interests of his appointer, are merely ancillary or incidental to acting in the best interests of the nominee company, provided that their 'conduct accords with a genuine belief that the interests of the company were being advanced.'[186]

3.6 Remuneration of the Nominee Director – when and by whom?

According to sections 66 (8) and 66 (9) of the Act, unless the Company's memorandum of incorporation (MOI) says otherwise, a company may pay remuneration to its directors for their service as directors. The Act does not make it mandatory for companies to remunerate directors for their overall operational running of the company, as this falls under 'directors services', that is, remuneration for directors services is optional. However, this remuneration must have been passed by special resolution of the shareholders within the previous two years.[187] This indicates that director fees are not an entitlement, and that there must be consensus from the shareholders on the amount that a director should be paid for performing their management functions on the board. In the case of executive directors, shareholder approval for remunerating directors for their services as an employee is not required – only for their remuneration for performing their director function.[188]

[184] Note 1, Havenga, 310.
[185] Note 1, Havenga, 323.
[186] Note 1, Havenga, 323.
[187] Section 66 (9).
[188] Note 146, Stein and Everingham, 234.

A company is required to prepare annual financial statements (AFS) in terms of section 30 and the AFS must disclose the remuneration and benefits paid to directors.[189] Directors remuneration is not defined in Section 66, but section 30 (6) defines 'remuneration' for the purposes of sections 30 (4) and (5) as those that include amounts paid to directors as fees for services rendered by them to or on behalf of the Company[190] as well as salary, bonuses and performance related payments.[191] These sub-sections envisages a situation where the Director is also an employee because it makes provision for payment of a salary to him. However, section 66 (8) only deals with remuneration for directors for their services rendered as directors to the company on whose board they sit, except to the extent that the MOI provides otherwise.

A nominee director would not be an employee of the nominee company, and would consequently not be eligible for a salary as an employee from the nominee company. The question arises then, would the nominee director be entitled to director's fees from the nominee company; would it be payable to him either from the nominee company or his appointer. Put differently, would he be entitled to receive the directors fees and lastly, can he earn a salary as an employee of the appointer AND directors fees?

Commercial expectations of nominee directors vary[192] depending on the arrangement entered into at the time of appointment. For a nominee director to be remunerated for services as a director, this would need shareholder approval as mentioned above. The issue of whether a nominee director was entitled to the director's fees and bonuses that he claimed, came before the SCA in the *Bodigelo*[193] case where the Court ultimately held that he had failed to prove his entitlement to same in the absence of an agreement of agency. This decision will be examined in greater detail below. Nominee directors are normally non-executive directors and their remuneration for services as an employee are paid by the appointer, if he was employed by the appointer. The problem that arises is in respect of receiving director's fees, that is, fees payable for execution of duties on the nominee company as a director when the nominee director is also an employee of the appointer.

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[189] Section 30 (4)(a).
[190] Section 30 (6)(a)
[191] Section 30 (6)(b)
[192] Note 81, Aherns, 118.
[193] Note 142, *Bodigelo.*

In *Bodigelo*[194] the employee was appointed as a non-executive nominee director onto the boards of four companies, into which companies the Public Investment Corporation (PIC), his employer, invested funds.[195] His appointment as a nominee director was in view of ensuring the security of their investment.[196] One may pause to note here that as an 'employee' of PIC, he was earning a salary for performing his duties as prescribed by PIC as the Senior Manager: Private Equity and Corporate Finance.[197]

In any event, the four companies onto whose boards Bodigelo was appointed as a nominee director, paid director's fees and bonuses for the services rendered by him in his capacity as nominee director, but these were paid directly to PIC, on PIC's instructions.[198] Bodigelo sought to recover these monies (which were in excess of R2 million[199]) on the basis that he was 'entitled' to it.[200]

The SCA held that the employee bore the onus of proving that he was entitled to the director's fees, either by alleging a right to director's fees pursuant to a contract with any of the companies on whose boards he sat **or** by virtue of any employment contract with PIC.[201] His claim was actually based upon the receipt of payments in terms of an agency relationship between him and PIC.[202] The Court held that he bore the onus of proving that when the companies made payment to PIC, they did so because PIC was his agent, consequently they were to honour their obligations to him for the duties he performed.[203]

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[194] Note 142, *Bodigelo*..
[195] Note 142, *Bodigelo,* para 2
[196] Note 142, *Bodigelo,* para 2.
[197] Note 142, *Bodigelo*, para 1
[198] Note 142, *Bodigelo,* para 3.
[199] Note 142, *Bodigelo,* para 4.
[200] Note 142, *Bodigelo,* para 5.
[201] Note 142, *Bodigelo* para 8.
[202] Note 142, *Bodigelo* para 8.
[203] Note 142, *Bodigelo* para 10.

The SCA held that he failed to prove entitlement to the director's fees by virtue of an agency agreement and that he performed his duties as a nominee director in the course and scope of his employment with PIC.[204] It is respectfully submitted that the Court erred in finding that his performance of director services was in the course and scope of his employment with PIC, the appointer. The Act clearly distinguishes between remuneration for services as a director and prescribes that this must be made in accordance with a shareholders resolution.[205] The fact that the nominee companies made payment for director services (albeit directly to PIC), indicates that there was in fact a resolution in place, endorsing payment for director services. It is further submitted that in accepting the positon of a nominee director, it triggered a range of fiduciary duties owed to the nominee companies, which duties he would not have had to adhere to in the normal course of his ordinary employment as a Private Equity Manager at PIC.

Bodigelo was employed on a fixed term contract but the judgment is silent on when this contract was going to expire. It is submitted that if he was employed for the **sole** purpose of being appointed as a nominee director, then this would negate his entitlement to director's fees from the nominee companies, as his appointment was dependent on his employment, that is, the director services he rendered was in the course and scope of his employment as a PIC employee.

On the facts of the *Bodigelo* case, it is further submitted, that had his contract of employment with PIC provided that he would be entitled to the director's fees for services rendered, then he would have had a successful claim against PIC.

It seems that the SCA would expect a nominee director, who seeks to claim directors' fees, to be able to show an agreement to that effect; a provision in the MOI, or a shareholders resolution approving the payment of directors' fees to the nominee for rendering of director's services. It is submitted that performing duties as a nominee director does not create an automatic entitlement to directors' fees from the nominee company nor does it entitle payment of directors' fees from the appointer, if the appointment itself is in the course and scope of the nominees' employment at the appointer.[206]

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[204] Note 142, *Bodigelo,* para 13.
[205] Section 66 (8) read with (9).
[206] Note 142, *Bodigelo*, para 8.

While the Court did not deal with this issue specifically, it is submitted that the decision highlights the issue of the conflicts of interests that nominee directors face. Here, Bodigelo was an employee of PIC and earned a salary from PIC. He would then owe a fiduciary duty to his employer under the common law as a consequence of their employer-employee relationship and then, pursuant to his acceptance of the appointment as a nominee director, his fiduciary duties to the nominee company were triggered. From the outset, the potential for Bodigelo to be encumbered with a split loyalty between his employer and the nominee company was clear. If he had not been an employee of PIC, and PIC recruited him solely to appoint him as a nominee director, then perhaps more regard would have been had to the issue of directors' fees in his contract. A shareholders resolution would have needed to be passed to ensure his entitlement to these directors fees for services rendered as such, in keeping with section 66 (8) and section 66 (9) of the Act.

The fact that PIC could instruct the 'nominee companies' not to pay the director's fees to the nominee directors directly is indicative of the dominance that PIC had over these entities as their major investor.[207] Consequently, it is highly probable that PIC would have considerable influence over the boards of these nominee companies, which influence would be exercised by using a nominee director. This is in direct contradiction with the requirement of independent and unfettered discretion required of all directors sitting on company boards.

It is submitted that this decision makes the benefit of the acceptance of an appointment as a nominee director questionable, because if an employer wants to appoint a nominee director onto a board of company, in the absence of an assurance that such nominee would receive the director's fees pursuant to the appointment from the nominee company, it may not be an offer worth accepting. A director, irrespective of the title attached to him, owes a fiduciary duty to the company on whose board he sits and in the event of a breach of that duty, he could face personal liability for same. It follows then there is more risk to accepting an appointment of nominee director, if the appointor precludes the nominee from receiving the director's fees but the nominee director is expected to carry the burden of responsibilities attached to the role.

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[207] Note 142, *Bodigelo,* para 7.

This was a landmark decision for PIC being one of the largest investment managers in Africa today, managing assets of over R1.8 trillion.[208] Managing a mammoth portfolio like PIC's necessitated the appointment of nominee directors on several boards. Had the SCA decision gone against PIC, it would have opened the door to a flood of claims for directors fees for services as a nominee director.

3.7 Conclusion

This chapter traced the appointment of a nominee director and acknowledged their existence as a commercial reality. There are undoubted benefits of utilising nominee directors including to investor privacy; meeting statutory requirements and logistical benefits. Their independence however is questionable, given their split loyalties between their appointer and the nominee company.

In the event of a nominee director wanting to receive remuneration by way of director's fees and bonuses normally paid to directors, there needs to be an express agreement that he is entitled to same or that his appointer is collecting the fees on his behalf, to be paid over at a later, defined stage.

[208] http://www.pic.gov.za/.

CHAPTER 4
IS THERE A NEED FOR LEGISLATIVE REFORM?

4.1 Introduction

In previous chapters it was concluded that nominee directors are obliged to align their conduct with the fiduciary duties set out in the Companies Act and that in certain circumstances, they may face situations where acting in accordance with their appointer's interests impinges on what is in the best interests of the nominee company.

This chapter will consider if the partial codification of directors' fiduciary duties sufficiently accommodates the nominee directors' split loyalties and it will conclude on whether the Act should be amended to include provisions that specifically regulate the conduct of nominee directors. This is relevant to the critical issues outlined in the first chapter and will ultimately provide an answer for whether our corporate governance regime should do away with the appointment of nominee directors altogether.

However, it was also acknowledged that barring conflict situations, a nominee director is expected to give effect to or to share in the view point of his appointer. This chapter will consider if the Act ought to be amended to dispense with nominee directors altogether in favour of independent non-executive directors, as envisaged by the King III Report.[209]

4.2 Does the Act sufficiently accommodate for these split loyalties?

There are no specific provisions dealing with a nominee director's split loyalties in the Act. A lacuna in the Act exists as it does not take the nominee director's position in to account, in respect of the conflicts that they face. It is submitted that it may be better to consider a company structure without the appointment of nominee directors as the concept of a nominee director flies in the face of the obligation for them to be independent (which obligation is triggered by virtue of their appointment).

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[209] Note 3, King III.

Section 78(2) of the Act provides that any provision of an agreement, the MOI or rules of a company, or a resolution adopted by a company, which directly or indirectly purports to relieve a director of any duty or liability, or negate, limit or restrict any legal consequences arising from an act or omission that constitutes wilful misconduct or wilful breach of trust on the part of the director, is void.

However (and except to the extent that the MOI of a company provides otherwise), a company may, in terms of section 78(5) of the Act, indemnify a director in respect of any liability arising. This is except for liability arising from wilful misconduct or wilful breach of trust on the part of the director, or where a fine has been imposed as a consequence of a director having been convicted of an offence, or where a director acted recklessly, or despite knowing he or she lacked authority, or with the intent to defraud creditors, or with any other fraudulent purpose.

Section 78(7) of the Act provides that a company may (subject to its MOI) purchase insurance to protect a director against liability or expenses for which it is permitted to indemnify a director and the company against any liability for which the company is permitted to indemnify a director, or any contingency including any expenses it is permitted to advance in respect of the defending of litigation by a director, or to indemnify a director for such expenses.

From the above it is apparent that the MOI may not indemnify the nominee director (or any director) from any wilful misconduct or breach of fiduciary duties. It is foreseeable that should a nominee director wilfully act to the detriment of the nominee company, he will be held liable under this section. Should he act to the benefit of his appointer as a consequence of fulfilling his mandate to the appointer, this is not a defence under the Act. Therefore, it is submitted that the Act does not sufficiently cater for the split loyalties that nominee director's face. This makes the appointment of a nominee director questionable and perhaps the use of LID's or independent non-executive directors as suggested by the King Code, ought to be the norm instead. The appointment of a nominee however is basically to ensure the interests of the appointer are maintained. It is submitted that if LID's or independent non-executive directors are to be appointed, this would not serve the purpose of appointers. Perhaps then, it would be prudent for appointers to consider entering into an agreement with nominee directors, that should they face liability for placing their appointer's interests above the

nominee company to the detriment of the latter, then they would be indemnified from liability by the appointer. It is submitted that while this approach may 'protect' a nominee director from financial distress in the event of there being compensation or damages claims against him, the appointer cannot assist the nominee in the face of criminal prosecution or imprisonment.

If a company insists on using a nominee, a practical approach would be for appointers to set out the conduct expected of nominee directors in event of conflict situations, which would include the scenario in which a nominee director may have to resign if the conflict between his appointers' interests and that of the nominee company is too great. The problem with this approach, it is submitted, is that it can never be appropriate for the nominee director to favour the interests of his appointer, above that of the nominee company.

4.3 Conclusion

This chapter explored the three main directors' duties that may be affected if a nominee director is appointed. These are, the duty to avoid conflict of interest, the duty to exercise judgement independently and the duty to promote the success of the company.

The extent of the nominees' loyalty to the appointer was examined and it was found that a nominee director should be permitted to pay specific attention to the interests of his appointer, provided that the interests of the nominee company prevails.

The Act does not sufficiently accommodate for the split loyalties that nominee directors' face but it can be considered good governance for entities which appoint nominee directors or have nominee directors sitting on their boards to develop a policy on the conditions of their appointment and remuneration, failing which, avoid utilising them altogether.

CHAPTER 5
IS THERE A FUTURE FOR NOMINEE DIRECTORS IN SOUTH AFRICA? SOME CONCLUDING REMARKS

5.1 Introduction

This research focused on nominee directors primarily, who is a director, lawfully elected onto the board by someone with an interest in the nominee company, such as a shareholder who controls sufficient voting power for the purpose. The reasons and or benefits of appointing a nominee could be a statutory or logistical requirement, or to ensure profit maximisation or to ensure the employees interests are looked after.

There is a temptation for the nominee director to pay more attention to the appointer's interests, as opposed to the nominee company, and this is what is referred to as a split-loyalty that the nominee director faces.

The Act does not accommodate the divided loyalties of the nominee director as it, along with the common law, emphasises that need for any director, irrespective of the nature of their appointment as director, to exercise independent judgement in the best interests of the company on the board of which he sits. It does not cater for a situation where a nominee director is also a director in the appointer.

During the discussion of whether a nominee director is entitled to remuneration for performing his function as a director, it was concluded that a practical remedy regarding disputes of remuneration by way of directors fees would be to include an express provision in the MOI stipulating whether these fees would be payable and whether it would be paid to the nominee director or to his appointer and whether it will be paid by the appointer or nominee company.

While nominee directors are a commercial reality at present, the onerous obligations and consequent potential liability for breach of these obligations as directors may motivate companies to abandon the use of nominee directors and rather opt for independent executive directors in accordance with the King III Report in future. Further, the personal liability that a nominee director could face for breaching his fiduciary duties in furtherance of the interests of his appointer, could deter the nominee from accepting the appointment, combined with the possibility of not being able to receive the reward by way of directors fees for his services rendered as a nominee director.

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