Conflicts of interest faced by Nominee Directors continues to be a topic of much discussion in many Boards. Most Boards tend to believe that the conflicts arise due to the potential for biased decision making, the sharing of information between parent and subsidiary in an uncontrolled manner, a high degree of government ownership which impacts on strategy and funding, and where shareholders own multiple competing interests. Conversely, Nominee Directors are becoming more vigilant as to how they should actually, and be seen to, balance the competing interests between their duty of loyalty to the company on whose Board they sit, and the nature of their appointment and expectations of the appointing shareholder. These concerns are being highlighted during annual Board evaluations in addition to ad hoc situations which arise during normal Board discourse.

To date there has been fragmented guidance by regulators and standard setters on a complete set of documents which efficiently lay out the protocol of behavior and responsibilities. However, in practice much the same framework can be adopted regardless as to whether the Nominee Director is a group executives being nominated to subsidiary/operational companies, a private equity nominee, or a nominee from major shareholders such as governments or family holdings.

Whilst most Corporate Governance Codes tend to focus on the establishment of policies and the disclosure and/or avoidance of conflicts (including the new Basel Committee Proposals released 14 October 2014), the entire Nominee Director relationship is best served using a set of documents agreed by various parties, primarily because the nominees lie within a small web of relationships that do not fully interconnect.

The most critical documents are the Nomination/Consent letter between the Appointor/Appointee, the Service Contract issued by the Company, and the Nominee Director policy approved by the Board. These may be supplemented by formal Investor Policies (as recommended by the OECD for State Owned Enterprises, or Private Equity/Institutional Investors as per their Stewardship or industry Codes) and reserved powers in the Articles and Shareholders Agreements.

In practice, Nominee Director protocol is rarely captured or committed to formally in writing, despite Nominee Directors being extremely common in the Middle East. Each situation tends to be unique and require its own format and protocol.

It is necessary to consider Nominee Director issues from a range of perspectives. (Note: For this article, we do not consider wholly owned subsidiaries who may, in some jurisdictions, adopt legal provisions in their Articles which allow protection against sub-optimal decision making in favour of the whole group.)

**Director duties at law**

It is well established in law that all Directors owe a fiduciary duty, a duty of loyalty and a duty to avoid conflicts. Courts in common law jurisdictions tend to apply a strict liability to act for the benefit of the company, regardless of the Appointor’s interests or the fairness of the outcome to the overall group. The UK case of Hawkes v Cuddy (2007 and 2009 on appeal) noted that a nominee director is permitted to have regard to the interests of
his appointer, but only to the extent that those interests are not incompatible with his duty to act in the best interests of the company. Peoples Department Stores v Wise (2004, Canada) held that nominee directors are not strictly agents of their nominators. The recent Australian case Allco Funds Management (2014) again confirmed that director’s conflicts of interest must be dealt with strictly, and decisions need to be bona fide, in the best interests of the company and for a proper purpose. It is extremely rare to hear of breach of Director duty cases in the GCC, but we would expect that it is likely that a similar approach would be adopted.

Nominee Director Appointment

Appointment generally falls into two categories – (a) “arms length” nomination of a person with little or no connection to the Appointor and usually made on the basis of skill and experience, or (b) a “close associate” or employee of the Appointor with or without consideration of adding value to the Board.

Regardless of the type of nominee, they should formally consent to their appointment, although general advance consent to nomination may be included in employment contract. Consent lies between the nominee, the Appointor, and in some cases, the regulator. Nomination/Consent letters confirm the degree of communication and the nominee’s ability to apply independent judgment, but should avoid contractually obligating their nominee into an agency relationship (where the Appointor would have a right to sue under contract if the nominee fails to follow directions). A light to moderate nominee Company Policy could suffice where only arms length nominees are appointed.

The close associate has the greater degree of conflict, particularly when they also have an employment contract with their Appointor or Group entity. A more comprehensive set of documents would apply:

- A shareholders’ agreement between the Appointor and the Company provides consensus on the process and criteria for appointment, dealing with information sharing and certain decision making protocols, although it would not normally define the conflicts.
- A corporate Appointor adopting good stewardship practices may have developed an Investor Policy which sets out its selection, expectations and treatment of nominees,
although this is generally a unilateral document with little room for negotiation by the Company.

- A very comprehensive nominee policy approved by the Company Board (see below).

- Standard employment contracts with a right to nominate, avoiding agency provisions, and additional appraisal terms.

- The Appointment Letter may have different remuneration clauses (usually nil for Group employees).

- Group nominee director policy.

**Nominee Director Policy**

This Policy is the most comprehensive document, describing the full process of nomination, appointment, duties, disclosure of instructions and conflicts, behavior and decision making, lines of enquiry, acceptable reporting, appraisal and rotation/removal of nominees. They often incorporate a mirror statement to the Investor Policies of Appointors or Group policies using aligned language.

It is logical to break the policy into parts dealing with appointment/removal, communication with Appointors (whether formally or through the nominee), behavior and decision making within the Company (including treatment of conflicts), and communication within Group entities. The proposed Basel Committee Guidelines provide useful guidance on the elements to be included.

Policy approval by the Board of the Company ensures that nominees and management have input into practical considerations, which should be balanced by the views of independent directors. In addition to providing input to the nomination process, the Nomination Committee at Group and/or Company level should have responsibility for monitoring conflicts, appraising behavior and outcomes, and reviewing the policy and associated documents.

Where the nominee is simultaneously performing functional Group roles, the policy should cover decision making and reporting lines which account for their functional area responsibilities. The Group policy is usually developed at Appointor level and mandated throughout closely held groups, with a degree of adoption by the subsidiary Company. In particular, Group nominees should restrain their reporting to functional information on a consolidated or segment basis, i.e., for the benefit of the Group decision making, and should leave governance reporting responsibility to the Appointor to the Chairman or CEO of the Company.

Typologies of common conflict situations and tables clearly indicating responsibility for a range of matters are extremely useful in practice, such as when nominees believe that important information is not being escalated appropriately or timely.

As with most corporate governance good practices, nominees and the Company should aim for a principle led and risk based approach, exercising a degree of compliance with agreed standards and protocols, but retaining a constant vigilance and flexibility for new or evolving situations which give rise to conflicts.