Conflicts of interest of investor nominee directors

Investors or other stakeholders routinely participate in the governance of an investee entity through nominees, often appointing a nominee as a director to safeguard its interests through the exercise of a veto or an affirmative vote (that is the right to approve or reject an act or resolution concerning the business and governance of the investee company).

Such nominee directors are recognized under the explanation to section 149(7) of the Companies Act, 2013, which defines a nominee director as one appointed by any financial institution in pursuance of the provisions of any law for the time being in force, or of any agreement, or appointed by any government or any other person to represent its interests. Accordingly, the act acknowledges that the appointment of a nominee director is primarily to represent the interests of the person nominating such a director. However, this involves an inherent conflict, as the act does not treat nominee directors differently from other directors, particularly in the requirements of standards of duty.

The act grants general power to the directors of a company. In exercising such power, a director has a duty to act in the best interests of the company, and to prefer its interests over his/her own. Courts have held that a director of a company has a fiduciary relationship with it, implying trust and good faith towards the company. Section 166 of the act also requires a director to act inter alia in the best interests of the company, its employees, its shareholders and the community, and for the protection of the environment, and to also exercise independent judgement.

The fiduciary duties of directors and the standards of objectivity under the act may in certain situations pose difficulties for any investor nominee director as they have been appointed specifically to protect or further the interests of the investor.

In *Ionic Metalliks v Union of India* it was observed that nominee directors "can be appointed by certain shareholders, third parties through contracts, lending public financial institutions or banks, or by the central government in case of oppression or mismanagement. The extent of a nominee director's rights and the scope of supervision by the shareholders, is contained in the contract that enables such appointments, or … the relevant statutes applicable to such public financial institution or bank. However, nominee directors must be particularly careful not to act only in the interests of their nominators, but must act in the best interests of the company and its shareholders as a whole".

In *AES OPG Holding (Mauritius) and ors v Orissa Power Generation Corporation Ltd and ors* it was noted that a "conflict of interest would arise when a person owes allegiance to two or more entities or persons and is placed in a situation to take a decision which would affect the interests of all those to which or whom he owes allegiance. If directors of a company are placed in such a situation, either they should recuse themselves, or they are duty bound to take the decision that would be in the interests of the company, failing which they would be in breach of their fiduciary duties. It is more so in case of nominee directors when there is a clash of interests between the company and their nominators."

Therefore, it can be inferred that, while the primary loyalty of an investor nominee director lies with the

investor, in the case of a conflict of interest between the company and the investor, the nominee director must prefer the interests of the company, instead of acting on the instructions of the investor.

The balancing of interests in times of conflict is the obvious reasonable solution, however it is not always possible to achieve. Investor nominee directors are typically directors, officers or employees of the investor, consult with the investor and act on its behalf. The degree of duty and independence expected of an investor nominee director under law is often impractical to attain. An investor faces the risk that nominee directors complying with their fiduciary duty may support corporate actions that are against investor interests.

A practical solution is for the investor to incorporate matters to be protected by a veto in a contract with the investee company, and require that such veto matters be included in the agenda of a board meeting with prior written consent of the investor. This would permit investor nominee directors to act in accordance with their fiduciary duty while still protecting the interests of the investor.

*This insight/ article has been authored by **Mohit Gogia**, Partner and **Rachita Bhat**, Associate. They can be reached on mgogia@snrlaw.in and rbhat@snrlaw.in for any questions. It was first published by India Business Law Journal in its **October 2019 Issue**.*

S&R ASSOCIATES ADVOCATES

NEW DELHI
64 Okhla Industrial Estate
Phase III
New Delhi 110 020
Tel: +91 11 4069 8000

MUMBAI
One Indiabulls Centre
1403 Tower 2 B
841 Senapati Bapat Marg, Lower Parel
Mumbai 400 013
Tel: +91 22 4302 8000