

Decoding the role of nominee directors in a firm

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Synopsis

Section 149(7) of the Companies Act 2013 defines nominee directors as directors nominated by financial institutions under laws or agreements, or appointed by the government or other entities to represent their interests. Nominee directors serve as non-executive board members, contributing to decision-making without involvement in the company's day-to-day affairs. The purpose of appointing nominee directors is to protect the investor's interests.

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An experienced VC or **PE investor** can bring significant benefit to the board of an investee company and help avert governance issues by appointing a nominee director to a company's board along with negotiated control and voting rights. **Nominee directors** play a vital role in ensuring the company's decisions are in the shareholders' best interest. They bridge the gap between investor and company interests, allowing investors to participate in decision-making and protect their interests.

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The Act has defined duties for directors, including nominee directors, under Section 166, which include:

- *Acting in accordance with the company's articles of association.
- *Promoting its objectives for stakeholders' benefit.
- *Exercising due care, skill and independent judgement.
- *Avoiding conflicts of interest and misuse of their position for personal gains.
- *Attend board meetings for active participation in decision-making.
- *Disclose concerns or interests in other companies, ensuring transparency in affiliations.
- *Monitor **governance practices** to ensure compliance with regulations and manage potential conflicts of interest, including related-party transactions, to maintain fairness and transparency.
- *Ensure integrity of the company's accounting and financial reporting systems, upholding accountability and trust with stakeholders.

A nominee director, though appointed by the nominating investor, must prioritise the company's best interests and fulfil their fiduciary duties. While they owe allegiance to the nominating investor and share updates with him or her, they must always prioritise the company. Sharing sensitive company information with the investor could lead to conflicts of interest and a breach of confidentiality obligations. Directors must maintain confidentiality and comply with legal and regulatory requirements.

In practice, the fiduciary duties of a nominee director often come into conflict with their duty towards the nominating investor. In other words, a nominee director has a dual role to play, which can often lead to conflicting responsibilities: first, as a representative of the nominator, and second, as a director of the company, prioritising the overall interests of the company. This conflict faced by nominee directors is not exclusive to the Indian context and is a global phenomenon.

When a nominee director encounters a situation where the interests of the nominating investor conflict with those of the company, it is crucial for the director to prioritise the company's best interests, and act in accordance with their fiduciary duty.

Nominee directors can take some actions that include:

Prioritise the investee company: They have a fiduciary duty towards the company, prioritising its welfare over any specific shareholder.

Maintain independence: They should uphold their independence, free from undue influence by the investor's interests.

Seek legal and governance guidance: When facing a conflict of interest, nominee directors should consult legal counsel or seek guidance from the company's governance structure.

Abstain from voting: In cases of conflict, they can choose to abstain from voting to avoid participating in decisions that may harm the company's best interests.

If concerns about potential liability arise and resigning from the board becomes necessary, providing reasons for the resignation is advisable. To safeguard the nominating shareholder's interests, transaction documents can include provisions such as observer rights and sufficient reserved matters even if the nominee director resigns.

The investor-appointed nominee director should always be guided by fairness and fiduciary duty, and act in the interests of the investee company and its stakeholders.

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Synopsis

The far-reaching jurisdictional scope of the AI Act, set to take effect no sooner than 2025, imposes obligations on both providers and deployers of AI systems used in or causing effects in the EU, irrespective of their location. While the Act is a trailblazer in legislating AI, it brings forth several challenges: Its risk-based classification strategy may stir debates over the categorisation of certain AI tools and the varying responsibilities of governments and companies based on identified risk levels. Risk itself is a dynamic concept.