

PRACTICE NOTES

King III Chapter 2

Guidelines for the proposal,
nomination and voting for directors

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Guidelines for the proposal, nomination and voting for directors

Introduction

Principle 2.9 recommends that directors should be appointed through a formal process.

Shareholders are ultimately responsible for the composition of the board and it is in their interest to ensure that the board is properly constituted from the viewpoint of skills and representivity. Procedures for the appointments to the board should be formal and transparent and should be a matter for the board as a whole, assisted by the nomination committee, subject to shareholder approval.

Target audience

This practice note provides guidance to the Company Secretary and nominations committee of the board on the best practice guidelines in the proposal, nomination and voting for directors.

Board appointments

Section 68 (1) of the Companies Act, 2008 (the Act) requires all directors (including any alternate directors) to be elected by the shareholders of profit companies or members of non-profit companies that are entitled to exercise voting rights in that election. The only exception is the directors appointed by persons named in the Memorandum of Incorporation (MOI), ex-officio directors, and where the board fills temporary vacancies.

The term of service of the elected directors (including any alternate directors) will be indefinite, or as set out in the MOI. From a sound governance point of view and regardless whether the Act allows it, it is not advisable for companies, other than owner-managed companies, to elect a director or alternate director to serve for an indefinite term. Shareholders should have the opportunity to continually elect new directors and/or replace any existing directors.

The rights of shareholders in the election of directors and alternate directors are important as these are part of the checks and balances built into the company structure.

In recognition of this principle, the Act requires the MOI of all profit companies, save for state-owned companies, to require shareholders to elect at least 50% of all directors and 50% of any alternate directors.

To achieve board composition that reflects effective participation by shareholders in the interest of holding directors accountable, implementing the following practice may be considered:

Proposals for nominations of directors

It is the board's duty and not that of the shareholders to nominate suitable individuals for the shareholders' consideration for election as directors or alternate directors. However, the board's role in the nomination process gives it



an opportunity not only to entrench itself in office (by only nominating current directors for consideration by shareholders) but also to only nominate those who will fit in with the current mould of thinking. The board should guard against this whilst being mindful of its duty to always act in the best interest of the company.

The board should, as part of the process of locating and considering suitable candidates for nomination, seek proposals for nominations for directors or alternate directors from the shareholders.

In the interest of an effective nomination process, sufficient time should be allowed for meaningful input by shareholders. It is therefore crucial that adequate notice is given to shareholders of the nomination process that will be followed and of the role that the shareholders are invited to play in this regard. The notice given to shareholders of the process should provide sufficient information on the manner, time and place for submissions of proposals by shareholders as well as how the board intends dealing with the proposals.

The board should conduct a 'needs assessment' to determine the skills and experience required to fill vacancies on the board and communicate the outcome of a needs assessment to the shareholders to make them aware of the skills and experience needed on the board. An evaluation of the board and its individual directors will provide valuable information to assist in this 'needs assessment'. In conveying these requirements, the board should guard against being so restrictive that it unduly limits shareholders' options.

It is recommended that each proposal of a candidate by a shareholder to the board should be accompanied by the candidate's consent to act and a detailed CV outlining the candidate's relevant experience and qualifications.

Throughout the course of the proposal process the board should advise shareholders of the names of those candidates already proposed by shareholders, whether assessed by the board or not. This will serve to keep shareholders abreast of development during the proposal period.

The creation of a forum on the company's website that enables liaison with shareholders could potentially be very useful to facilitate shareholders' involvement in the proposal process. The forum could be used to publicise the notice of the proposed process to be followed and the role of the shareholders, as referred to above. It could also be used to communicate with shareholders throughout the process. Should a company not be able to set up a shareholder liaison forum on its website or if it is not able to do so, alternative means of communicating with the shareholders should be identified by the board.

Nominations of directors

The board should determine the nominees that will be put forward for election by the persons (shareholders of profit companies or members of non-profit companies) that are entitled to exercise voting rights in that election. In so far as it serves the best interest of the company, the board should strive to be as transparent as possible concerning the reasons for its decision. However the board also should consider whether it may be not be in the best interests of the company to disclose its deliberations. Publishing reasons may for instance adversely affect the relationship of the board or the company with those not nominated; or it may give competitors insight into the company's shortcomings or key focus areas etc.



Abridged CVs of all candidates that are finally nominated by the board should be furnished to shareholders.

Again the shareholders liaison forum may prove a useful tool to communicate with shareholders in regard to the nominated candidates.

Voting for directors en bloc

If the election of two or more candidates as directors is conducted by way of one single resolution, the method of voting is referred to as *en bloc* - voting. An alternative method of voting is to conduct the election as a series of votes, each vote on the candidacy of a single individual for a single position as director.

Section 68 of the Act permits *en bloc* - voting in instances where the MOI allows it. *En bloc*-voting deprives shareholders of the opportunity to consider the merits and suitability of individual candidates and thereby dilutes accountability. The board should ensure that shareholders understand the implication of including an *en bloc* - voting provision in the MOI.

We recommend that, should shareholders decide to include an *en bloc* - voting clause in the MOI, the *en bloc* - voting clause should set out the following procedure:

- require all shareholders to agree, in a separate resolution, to the use of the *en bloc* - voting method; and
- require the moving of the resolution electing two or more directors or alternate directors. The use of the *en bloc* - voting method in terms of the *en bloc* - voting clause should be proposed as a separate resolution together with the reasons therefore.

Proportionate representation for blocks of minority shareholders

The principle that the shareholders with more than 50% of the voting rights determine the composition of the entire board is well-established.

This may no longer be the case in future, due to section 66(4)(b) of the Act, which allows for parties other than shareholders to elect directors subject to its requirements. The MOI of profit companies other than state-owned companies must require shareholders to elect at least 50% of all directors and 50% of any alternate directors. A creditor may for instance demand the right to appoint up to 50% of the directors and 50% of any alternate directors to mitigate the risk that it undertakes by extending finance to the company.

The appointment of directors or alternate directors by parties other than shareholders is a matter that must be provided for by the company's MOI as adopted by its shareholders.

A further issue to be considered is whether minority shareholders should be given rights to appoint directors or alternate directors. Clearly it would be impossible to permit every shareholder to appoint a director or alternate director to the board in proportion to the shareholder's shareholding in relation to the entire issued capital. A listed company with hundreds of shareholders is a case in point.

However, as a matter of good corporate governance, the board should consider encouraging the controlling shareholder(s) to permit minority shareholders collectively to have some board representation. The extent of this board



representation would be determined by what the appropriate maximum number of directors for the company in question should be, having regard to its size. The director(s) and/or any alternate directors "representing" the minority shareholders collectively are not permitted to take instructions from those shareholders or to represent solely their sectoral interests as doing so would be in breach of their fiduciary duties to act in the best interest of the company. If this caveat is adhered to, allowing the minority shareholders to appoint one or more directors and/or any alternate directors would contribute to the balance of power in the board.

Directors appointed by the minority shareholders have the same rights and liability as any other director, and should be treated as equals.

Conclusion

It is recommended that boards reconsider the processes that they follow with regards to the election of directors and alternate directors. Challenging allowances made by statute and the MOI and embracing increased accountability driven by ethical shareholder activism, may lead to more effective board composition.

