



2nd Floor, North Block
Thrupps Illovo Centre
204 Oxford Road Illovo 2196

PO Box 78662 Sandton 2146
Docex 264 Randburg

e-mail: law@elawnet.co.za

website : www.gji.co.za

tel : (+27 11) 268 0287

fax : (+27 11) 268 0282

Corporate governance for multinational corporations with subsidiary companies in South Africa

Johannesburg, 15 March 2013 - A perennial issue for multinational corporations with subsidiary companies in South Africa is whether to apply the Corporate Governance policies and rules of the group to the South African subsidiary or whether King III, South Africa's corporate governance code and report applies to such subsidiaries.

Note 142 of the King III Report states that *"the holding company must recognise the fiduciary duties of the subsidiary company's directors and particularly their duty to act in the best interest of the subsidiary company at all times whether or not the director is nominated to the board of the subsidiary company by the holding company. In the case of the conflict between the duties of nominee director to a company on whose board he sits and in the interests of his principal, the duties of the director to the company of which he is a director must prevail."* This has relevance not only to the question which we are discussing in this article but also to the provisions of such director's contract both as an employee and a director (whether executive or non-executive) of the subsidiary company.

Principle 2.24 of the King III Report (in Chapter 2) provides that a governance framework should be agreed between the group and its subsidiary boards and it follows that subsidiaries do not automatically assume the policies of the holding company – even if it is a wholly owned subsidiary. The board of the subsidiary company thus needs to apply its mind to the adoption of all policies, based on what it deems to be in the best interest of the subsidiary company. Not only is this in alignment with the recommendations of the King III Report but is also supported by the statutory and fiduciary duties of directors to act in the best interest of the company.

Note 146 of the King III Report makes it clear that where the holding company is not South African, but the subsidiary is a South African company, then the South African Subsidiary should apply the principles of King III.

It frequently happens that holding companies require their subsidiary in South Africa to follow the holding company's (or group's) corporate governance policies and rules but such an approach would not be consistent with the recommendations of King III which apply to all South African companies on an "apply or explain" basis. A non-application of any of the King III recommendations could thus be explained by the subsidiary company but only after the board of the subsidiary had in fact applied its mind to the matter.

The failure to apply the King III recommendations by a subsidiary of an American – listed holding company would have implications under and in terms of Sarbanes Oxley as the listed entity in the US would be obliged to notify the authorities and its stakeholders of its non- application of the King III recommendations by its South African subsidiary.

The solution, it is respectfully submitted, is for such subsidiaries to adhere to the King III Report and Code on an "apply or explain basis" (which is in any event the way the Code and Report are to be interpreted) and to have as a policy any additional rules and regulations which the holding company or the group impose which are not addressed in King III.

It is important to note that what is set out above applies not only to a subsidiary of a foreign company but also to the formal operations in South Africa of external or foreign companies (which are entities incorporated outside South Africa), irrespective of whether it is a profit or non-profit entity. The aforementioned are sometimes referred to as a branch or external company.

Prepared by J. Michael Judin