

YOU'RE FIRED! THE REMOVAL OF DIRECTORS UNDER THE COMPANIES ACT 71 OF 2008

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'Given the central role of delegated management in the corporate form, it is no surprise that appointment rights — the power to select or remove directors (or other managers) — are key strategies for controlling the enterprise. Indeed, these strategies are at the very core of corporate governance.' (Henry Hansmann & Reinier Kraakman 'Agency problems and legal strategies' in Reinier Kraakman, Paul Davies, Henry Hansmann, Gerard Hertig, Klaus Hopt, Hideki Kanda & Edward Rock (eds) *The Anatomy of Corporate Law: A Comparative and Functional Approach* (2004) 26.)

I INTRODUCTION

It has been noted in the Australian context that the removal of directors is a 'sleeper topic' about which little is written (James McConvil 'Removal of directors of public companies takes centre stage in Australia: an exploration of the corporate law and governance issues' (2005) 1 *Corporate Governance LR* 191 at 192; Jean J du Plessis & James McConvil 'Removal of company directors in a climate of corporate collapses' (2003) 31 *Australian Business LR* 251 at 251). The same situation prevails in South Africa, where only a few papers have been written on the topic (See, for example, M P Larkin 'Distinctions and differences: a company lawyer looks at executive dismissals' (1986) 7 *ILJ* 248; J J du Plessis 'Besondere oorwegings van toepassing op die ontslag van besturende direkteure' (1991) 2 *JJS/TRW* 1, I Esser 'Company law and the spoliated director : *Greaves v Barnard*' (2008) 20 *SA Merc LJ* 135, John F Olson 'South Africa moves to a global model of corporate governance but with important national variations' 2010 *Acta Juridica* 219 at 237–9). This note seeks to address this deficit by examining the provisions relating to the removal of directors in the new Companies Act 71 of 2008 (the 2008 Act) as the removal of directors is an important corporate governance tool.

The note is divided into four parts. Following on from this introduction (part I), the next part (part II) focuses on the statutory removal of directors and as such, removals at common law are beyond its scope. It begins with an outline of the removal of directors in terms of s 220 of the Companies Act 61 of 1973 (the 1973 Act) then proceeds to discuss the position under the 2008 Act. The discussion of removal of directors includes an overview of the grounds and the procedural requirements for removal. It also incorporates a brief overview of the provision for court orders for the disqualification of persons from being directors, as these are, in effect, removals from office. The third part (part III) outlines the remedies available to a director who is removed from office both under the common law and statute. Part IV concludes the note.

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This note compares South African companies legislation to English, United States of America (the US), Australian and Canadian companies legislation. New Zealand companies legislation will not be considered as its provisions relating to the removal of directors are markedly different from these jurisdictions. For instance, s 105(1) of the New Zealand Companies Act, 1993 makes shareholder removals subject to the company's constitution whilst, as will be shown below, the jurisdictions considered in this note do not.

II REMOVAL OF DIRECTORS

It is important from the outset to emphasise that the new statutory provisions entail two fundamental changes to the removal of directors. First, under s 220 of the 1973 Act, an ordinary resolution of the shareholders in a general meeting suffices to remove any director, whereas under the 2008 Act shareholders can remove only directors who have been elected to the board. Ex-officio directors and directors who have been appointed to the board in terms of the memorandum of incorporation cannot be removed by shareholders. This significantly dilutes 'the shareholders' franchise' to exercise control over a company through removal of directors (for a general discussion of this franchise see Lucian A Bebchuk 'The myth of the shareholder franchise' (2007) 93 *Virginia LR* 675; John F Olson 'Professor Bebchuk's brave new world: A reply to the myth of the shareholder franchise' (2007) 93 *Virginia LR* 773). Secondly, two new modes of removal have been introduced, namely removals at the instance of the board, and removals by the Companies Tribunal (hereafter 'the Tribunal'). In addition to its impact on shareholders, the introduction of these two new modes of removal affects directors who are also majority shareholders. Under the 1973 Act a director who held a majority of shareholders' votes was 'untouchable', as he could defeat any resolution for his removal. However, under the 2008 Act such a director can nevertheless be removed by a board resolution or a Tribunal decision. This has important ramifications for family-controlled companies.

(a) *The position under the 1973 Act*

To provide some comparative background, this part of the note outlines the position under s 220 of the 1973 Act. Section 220 is similar to ss 168 and 169 of the English Companies Act, 2006 and its predecessor, s 303 of the Companies Act, 1985. Both the English and South African provisions provide that shareholders in a general meeting can remove directors by ordinary resolution provided that special notice is given of the removal and the director concerned is afforded an opportunity to make representations at the meeting at which the resolution is put to the vote. This mode of removal is available despite any provisions to the contrary in an agreement between the company and the director concerned.

Section 220(1) of the 1973 Act extends the power of shareholders to remove directors by making such removals possible despite any provisions to

the contrary in the company's memorandum or articles of association. Therefore any clauses in a company's constitution attempting to protect the director from removal, such as appointing him for life or providing that he can only be removed by special resolution, are ineffective against this mode of removal. However, the removal of a director does not derogate from his right to claim damages for breach of contract (H S Cilliers, M L Benade, J J Henning et al *Cilliers & Benade Corporate Law* 3 ed (2000) para 9.29 (hereafter *Cilliers & Benade*); M S Blackman, R D Jooste, G K Everingham, M Larkin, C H Rademeyer, J L Yeats *Commentary on the Companies Act* vol 1 (Revision Service 2007) 8–285 (hereafter *Commentary*)). Clearly the 1973 Act contemplates that shareholders have an unrestricted right to remove any director from office under this section.

However, it is possible by way of a shareholders' agreement to exclude this mode of removal. The courts have held that a shareholders' agreement precluding the removal of a director in terms of s 220 is both valid and enforceable (Jennifer A Kunst, Piet Delpont & Quintus Vorster (eds) *Henochsberg on the Companies Act* 5 ed vol 1 (Issue 24) 422(2)–423 (hereafter *Henochsberg*); *Commentary* 8–282; *Stewart v Schwab* 1956 (4) SA 791 (T); *Desai v Greyridge Investments (Pty) Ltd* 1974 (1) SA 509 (A) at 518; *Swerdlow v Cohen* 1977 (3) SA 1050 (T) at 1057; *Amoils v Fuel Transport (Pty) Ltd* 1978 (4) SA 343 (W) at 347 and *Barlows Manufacturing Co Ltd v RN Barrie (Pty) Ltd* 1990 (4) SA 608 (C) at 611–12). These shareholders' agreements may take various forms, such as pool agreements or general agreements that relate to a number of issues including directors' appointments and removals (for an example of such general agreements see *Amoils v Fuel Transport (Pty) Ltd* (supra) at 344).

Section 186(1) of the 1973 Act provides that unless the company's articles provide for a longer notice period, members must be given fourteen clear days' notice of the meeting at which the ordinary resolution for removal of a director is to be voted upon. In addition, 28 days' special notice of intention to remove the director is to be given to the company (*Cilliers & Benade* para 9.30; s 220(2) read with s 186(3)). Similar notice provisions are contained in the English and Australian legislation (s 169(1) of the (English) Companies Act, 2006 and s 203D(2) of the (Australian) Corporations Act, 2001). The company, in turn, is required to forward a copy of this notice to the director whose removal is to be sought. The director is thus in a position to prepare representations which may be made orally at the relevant general meeting. The director's statutory right to address the meeting means that a shareholders' meeting must be called, thereby excluding the possibility of passing the resolution by unanimous consent. Section 220(3) provides that directors may also prepare written responses which, if received timeously, are of reasonable length and are not defamatory, must be circulated to the shareholders prior to the meeting. Similar provisions are contained in the English and Australian legislation (s 169(3) of the (English) Companies Act, 2006; s 203D(4)(a) and s 203D(5)–(6) of the (Australian) Companies Act, 2001). These provisions enable directors to present arguments against their removal. This process also affords the shareholders an opportunity to consider the director's response in

advance of the meeting. If there was no right to make such written representations, then in circumstances where the meeting becomes heated or unruly, a director may not be able to make his case as clearly, and nor would shareholders be able to consider the director's response properly.

Although s 220 of the 1973 Act entrenches the fundamental right of shareholders to remove directors, a company can also make comprehensive provisions for the removal of directors in its articles, since s 220(7) of the 1973 Act provides that 'nothing in this section shall be construed as derogating from any power to remove a director which may exist apart from this section'. For example, the articles could provide that a director can be removed without being given special notice or without the right to address the shareholders' meeting (*Cilliers & Benade* para 9.32; *Commentary* 8-284).

In addition to the removal of directors under s 220 of the 1973 Act, it is also possible to remove a director by obtaining a court order for that director's disqualification in terms of s 219 of that Act (*Cilliers & Benade* paras 9.25-9.28; *Henochoberg* 418-20; *Commentary* 8-278). Under s 219 of the 1973 Act a court may disqualify a director in the following circumstances:

- '(a) when such a . . . director has been convicted of an offence in connection with the promotion, formation or management of a company; or
- (b) the Court has made an order for the winding-up of a company and the Master has made a report under this Act stating that in his opinion a fraud has been committed —
- . . .
- (ii) by any director or officer of the company in relation to the company since its formation; or
- (c) in the course of the winding-up or judicial management of a company it appears that any such person —
 - (i) has been guilty of an offence referred to in section 424, whether or not he has been convicted of that offence; or
 - (ii) has otherwise been guilty while an officer of the company of any fraud in relation to the company or of any breach of his duty to the company; or
- (d) a declaration has been made in respect of any person under section 424(1).'

There is however, no reported case law and it appears that s 219 'is in disuse' (*Cilliers & Benade* para 9.28). Neither *Henochoberg* (at 420-22) nor the *Commentary* (at 8-278-8-281) cite any South African case law on the section.

(b) *The position under the 2008 Act*

It is clear that this Act drew its inspiration from a number of jurisdictions, particularly Canada, Australia and the US. However, given the absence of a detailed explanatory memorandum, there is no official confirmation of the inspiration for its provisions. It would have been useful to have been informed of the source of provisions in order to know where to seek relevant case law and academic texts that may be useful in interpreting the legislation, as envisaged by s 5(2) of the Act which provides: 'To the extent appropriate, a court interpreting or applying this Act may consider foreign company law.'

The 2008 Act contains two sections in terms of which a director may be removed. Section 137(5) provides that a director of a company that is in the process of business rescue may be removed, on application to a court, by the business rescue practitioner for failure to comply with the requirements of chapter 6 of the Act or for impeding the business rescue practitioner in the performance of his duties. There are no provisions relating to the procedural aspects of such an application, and these will therefore be regulated by the rules of court. Section 71 contemplates three modes of removing directors, namely by ordinary resolution of the shareholders in a general meeting, by board resolution, and by the Tribunal. The mode of removal is dependent on the type of director whose removal is being contemplated, the number of directors on the relevant company's board, and the grounds for removal.

The categorisation of directors is based on how they were appointed to the board. The 2008 Act provides for three modes of appointing 'subsequent' directors. The word 'subsequent' is used in this context to distinguish these directors from the first directors of a company who are the incorporators of the company as envisaged in s 67(1) of the Act. First, s 66 (4)(a)(i) provides for the direct appointment and removal of directors by the specific persons who are given this power in the company's memorandum of incorporation. Secondly, s 66(4)(a)(ii) provides for ex officio directors who become directors of a company by virtue of holding some other office, title, designation or similar status. Thirdly, s 68(1) retains the concept of shareholder appointment of directors through elections. Section 66(4)(b) provides that a profit company, other than a state-owned company, which utilises one or both of the first two methods of appointment must provide for the election by shareholders of at least 50 per cent of the directors, and 50 per cent of any alternate directors. This ensures that at least half of the board is elected by shareholders.

Directors who have been appointed to the board by specific persons can be removed only by those persons, the board or the Tribunal (s 66(4)(a)(i)). Shareholder-appointed directors can be removed by any of the three modes; that is to say, by the shareholders, the board or the Tribunal. Ex officio directors can be removed only by the board or the Tribunal. Section 71(8) provides that Tribunal removals are available only where the board consists of 'less than three members', whilst s 71(3) provides that board removals are available only where the board has more than two members. Each of these types of removals is considered in turn below.

(i) *Shareholder removal of elected directors*

Section 71(1) provides as follows:

'Despite anything to the contrary in a company's memorandum of incorporation or rules, or any agreement between the company and a director, or between any shareholders and a director, a director may be removed by an ordinary resolution adopted at a shareholders meeting by the persons entitled to exercise voting rights in an election of that director subject to subsection (2).' (Emphasis supplied.)

Generally, companies can increase the percentages required to pass ordinary resolutions under the 2008 Act, but this cannot be done for ordinary resolutions for the removal of a director (see s 65(7)–(8)).

Whilst s 71(1) of the 2008 Act is similar to s 220(1) of the 1973 Act, there are two differences. First, s 71(1) of the 2008 Act refers to any agreement between any shareholders and a director and renders such agreements incapable of precluding removal from office by ordinary resolution. Such agreements are not mentioned in s 220(1)(a) of the 1973 Act which provides:

‘A company may, notwithstanding anything in its memorandum or articles or in any agreement between it and any director, by resolution remove a director before the expiration of his period of office.’

However, agreements between shareholders and directors are mentioned in s 203D(1) of the Australian Corporations Act, 2001 which may be the source of the provisions in the 2008 Act. Section 203D of the Australian Corporations Act provides that:

‘A public company may by resolution remove a director from office despite anything in:

- (a) the company’s constitution (if any); or
- (b) an agreement between the company and the director; or
- (c) an agreement between any or all members of the company and the director.’

Both s 220 of the 1973 Act and s 71(1) of the 2008 Act do not list shareholders’ agreements as one of the documents that cannot alter the consequences of the section. Therefore, it is possible to preclude removals by shareholders under s 71 through the use of shareholders’ agreements that constrain voting in favour of a director’s removal. The use of shareholders’ agreements to thwart a shareholders’ removal is unlikely to be subject to s 6 of the 2008 Act which provides:

‘(1) A court, on application by the Commission or Panel, *may declare any agreement, transaction, arrangement, resolution or provision of a company’s Memorandum of Incorporation or rules —*

- (a) *to be primarily or substantially intended to defeat or reduce the effect of a prohibition or requirement established by or in terms of an unalterable provision of this Act; and*
- (b) *void to the extent that it defeats or reduces the effect of a prohibition or requirement established by or in terms of an unalterable provision of this Act.’*
(Emphasis supplied.)

In terms of this section agreements will be declared void by a court if they are intended to defeat or minimise the effect of an unalterable prohibition or requirement. Section 71(1) does not contain an unalterable prohibition or requirement and therefore s 6 does not apply to such shareholders’ agreements.

The second difference between the 1973 and 2008 Acts is that s 71(1) of the 2008 Act restricts the shareholders’ power to remove directors by ordinary resolution to elected directors. This provision is similar to § 8.08 (b)

of the Model Business Corporation Act which provides that ‘if a director is elected by a voting group of shareholders, only the shareholders of that voting group may participate in the vote to remove him’. It is also similar to s 109(2) of the Canada Business Corporations Act, 1985 which provides:

‘Where the holders of any class or series of shares of a corporation have an exclusive right to elect one or more directors, a director so elected may only be removed by an ordinary resolution at a meeting of the shareholders of that class or series’.

The significance of these restrictions in s 71(1) of the 2008 Act is that shareholders cannot remove an *ex-officio* or directly appointed director from office and will have to rely on the board or the Tribunal to effect the removal. No grounds for removal are provided for with respect to removals by shareholders. This is because ‘directors serve at the pleasure of shareholders’ and consequently shareholders may effect removals without cause (John E Moye *The Law of Business Organisations* (2004) 166).

Procedural requirements

Section 220 (2) of the 1973 Act and s 71(2) of the 2008 Act provide that notice of the meeting at which a resolution for the removal of a director must be given to the director whose removal is sought. Thereafter, the director concerned must be afforded an opportunity to make representations (in person or through a representative) to the general meeting before a decision on the removal is made. Under the 1973 Act, 28 days’ special notice is to be given (s 220(2) read with s 186 (3)). Under the 2008 Act the director is to be given notice ‘at least equivalent to that which a shareholder is entitled to receive’ even if that director is not a shareholder (s 71(2)(a)). In a public or non-profit company, the notice period will be 15 business days and in any other company the notice period is 10 business days (s 62(1)).

South Africa’s 1973 Act, and the English and Australian companies legislation provide for the possibility of the making and circulating written representations to shareholders prior to the meeting. By contrast, the 2008 Act does not expressly provide for written representations or their circulation. This does not prevent the director concerned from preparing a written response, submitting it to the company, and requesting its circulation to shareholders or the board prior to the meeting. However, the company may refuse such a request. The provisions pertaining to written representations that are outlined above should have been carried forward into the 2008 Act and been made applicable to all types of removals in view of the benefits that they afford to directors.

(ii) *Removal by the board*

Removals at the instance of the board are neither provided for under the 1973 Act, nor in the English and Canadian companies legislation. Section 203E of the Australian Corporations Act, 2001 prohibits board removals in public companies, although they are possible in proprietary companies where they have been provided for by the company’s constitution (Stephen

Knight ‘The removal of public company directors in Australia: time for change?’ (2007) *C&S LJ* 351 at 353). The prohibition of board removals in public companies has been strongly criticised as being disadvantageous to shareholders (Knight *op cit* at 357–62; McConvill *op cit* at 198). The 2008 Act is therefore an improvement on the Australian companies’ legislation since it provides for removals by the board for all types of companies.

Section 71(3) of the 2008 Act provides:

‘If a company has more than two directors, and a shareholder or director has alleged that a director of the company —

- (a) has become —
 - (i) ineligible or disqualified in terms of section 69, *other than on the grounds contemplated in section 69(8)(a)*; or
 - (ii) incapacitated to the extent that the director is unable to perform the functions of a director, and is unlikely to regain that capacity within a reasonable time; or
- (b) has neglected, or been derelict in the performance of, the functions of director, the board, other than the director concerned, *must determine the matter by resolution, and may remove a director whom it has determined to be ineligible or disqualified, incapacitated, or negligent or derelict, as the case may be.* (Emphasis supplied.)

Whilst the removal proceedings are initiated on the basis of allegations, a director will be dismissed only if the allegations are substantiated to the board’s satisfaction. The availability of an appeal against and a review of a board’s decision on the removal of a director are discussed below under ‘Remedies’. Directors who are subjected to frivolous dismissal proceedings based on unfounded or unreasonable allegations may have remedies under the common law for defamation. Each of the grounds for the removal of a director is briefly discussed below.

Ineligibility or disqualification

The underlying premise of this ground for removal is that, at the time of appointment, the director whose removal is now being sought was both eligible and qualified for appointment. However, subsequent adverse changes to that director’s circumstances necessitate the initiation of removal proceedings. Section 71(3)(a)(i) provides that removal proceedings have to be initiated where there is an allegation that the director concerned has become ‘ineligible or disqualified in terms of section 69, *other than on the grounds contemplated in section 69(8)(a)*’ (emphasis supplied). In terms of s 69(8)(a), the grounds for disqualification are a court order prohibiting a person from being a director or declaring a person to be delinquent under s 162 of the 2008 Act or s 47 of the Close Corporations Act 69 of 1984. Therefore, it seems that if a director becomes ineligible or disqualified on any other ground, formal removal proceedings have to be instituted.

The requirements under s 71(3)(a)(i) that formal removal proceedings have to be carried out is at odds with s 69(4), which provides for the automatic loss of directorship upon subsequent ineligibility or disqualifica-

tion as follows: 'A person who becomes ineligible or disqualified while serving as a director of a company ceases to be a director immediately, subject to section 70(2)'. Section 70(2) provides that such automatic loss of office is subject to the proviso that a vacancy on the board will not arise until the expiry of the time for filing an application for review or the granting of an order by the court on such an application. Clause 43 of the Companies Amendment Bill (B40–2010) seeks to reform s 69(4) as follows: 'A person who becomes ineligible or disqualified while serving as a director of a company ceases to be *entitled to continue to act as* a director immediately, subject to section 70(2)'. It is submitted that such an amendment, if enacted, would not change the current substantive position under s 69(4), namely that a director who becomes ineligible or disqualified must cease his activities as director immediately.

Furthermore, s 71(3)(a)(i) contradicts s 69(2)(b), which provides that a person who is disqualified or ineligible must not act as a director. In the absence of a detailed explanatory memorandum, it is not clear why s 71(3)(a)(i) requires the formal removal of a director who has become ineligible or disqualified on grounds other than those provided for by s 69(8)(a). In order to seek possible reasons for this requirement, it is necessary to consider these grounds of ineligibility and disqualification.

These grounds are found in s 69(7) and s 69(8)(b). Section 69(7) provides that juristic persons, unemancipated minors and persons who do not meet a company's qualification criteria as provided for in the company's memorandum are ineligible for appointment as directors. It is worth noting that the first ground of ineligibility would bar the appointment of a juristic person in the first place, and removal therefore becomes unnecessary.

An emancipated minor who has been appointed as director could lose his emancipated status and therefore would be required to relinquish his directorship. It could be that formal removal is required in this instance, as the director concerned may wish to contest the allegation that he has lost his emancipation. The removal proceedings would afford him the opportunity to counter the allegation. However, as noted in Dennis Davis, Farouk Cassim, Walter D Geach & Tshepo Mongalo (eds) *Companies and other Business Structures in South Africa* (2009) 87, relying on *Ex parte Velkes* 1963 (3) SA 584 (C) it is doubtful whether an emancipated minor would qualify to be appointed a director in the first place (see also *Henochsberg* 414 and *Commentary* 8-270–1).

A person who initially qualified for appointment as a director of a company could conceivably lose the relevant qualification. For example, postulate that company A's memorandum of incorporation provides that only persons who are registered members of a specified professional association are qualified to be appointed as directors. Mr B, who is so registered, is appointed as director of company A. If however, Mr B's registration thereafter lapses or is revoked, he becomes ineligible to be a director of company A. Mr B will then have to be removed from office. Removal may have been required by the Act as the loss of a qualification in this manner is a factual matter which must be proven before a director loses his or her office.

Section 69(8)(b) provides that directors become disqualified if they are declared insolvent and are unrehabilitated, are prohibited from holding directorships by any public regulation, are removed from an office of trust for dishonesty, or are convicted in South Africa or elsewhere and imprisoned without the option of fine or fined more than a prescribed amount for specified offences. Formal removal proceedings would afford the director an opportunity to prove that he is not disqualified as alleged. However, as these are largely matters of fact, it is unlikely that a director would attempt to contest such ineligibility or disqualification once the ground has been established. For example, if a shareholder is able to produce proof of a relevant conviction that has not been overturned on appeal, the director concerned cannot successfully dispute the conviction.

Section 218(1) of the 1973 Act contains similar grounds for disqualification but does not expressly require the formal removal of disqualified directors. This section is understood to result in automatic loss of office of the disqualified director (*Henocheberg* at 414). In addition it is an offence to serve as a director whilst so disqualified (s 218(2)(a)) and such a director will be 'jointly and severally liable for all debts of the company incurred by the company for the period during which such person knew or could reasonably be expected to know of the disqualification' (s 218(2)(b)). It is therefore submitted that s 71(3)(a) ought to have treated s 69(8)(b) in the same manner as s 69(8)(a) by providing that it is not necessary to formally remove a director who is disqualified from being a director by s 69(8)(b).

Inability to perform a director's functions

Evidence will be required in order to substantiate a claim that a director is incapacitated to the extent that he is unable to perform the functions of a director, and is unlikely to regain that capacity within a reasonable time. However, due to its vagueness, this ground is likely to be invoked maliciously where conflicts arise between directors, shareholders and perhaps even employees.

Negligence or dereliction of duties

This is likely to be a contested ground for removal as it is closely entwined with a director's liability to the company of which he is director for breach of his duties. Further, the concept of 'negligence of directors' is particularly difficult to define, and therefore may lend itself to unscrupulous use. A finding of negligence or that the director is guilty of dereliction may lead to a claim for damages against the director concerned, as well as an application to have him placed under probation or declared delinquent under s 162. Whether or not a director has been negligent or is guilty of dereliction of duty will be determined in accordance with the criteria laid down in s 76 of the Act, which codifies standards for directors' conduct and in accordance with the common law. A full discussion of the breach of directors' duties and of s 162 is beyond the scope of this note. (For discussions of directors' duties under the 2008 Act see Natasha Bouwman 'An appraisal of the modification

of the director's duty of care and skill' (2009) 21 *SA Merc LJ* 509; Julie Cassidy 'Models for reform: the directors' duty of care in a modern commercial world' (2009) 20 *Stellenbosch LR* 373; and J S McLennan 'Directors' fiduciary duties and the 2008 Companies Bill' 2009 *TSAR* 184. For a discussion of s 162 see Eric Levenstein 'The delinquent director: company law' 2010 (September) *Without Prejudice* 21.)

Procedural requirements

It is noteworthy that board removals can be initiated by a single director or shareholder (Olson op cit at 238). This affords significant protection to minority shareholders whose attempts to remove a director by ordinary resolution may be thwarted by majority shareholders. A board that receives a request from a shareholder or director to begin proceedings to remove a director under s 71(3) cannot refuse to consider such a request. This is because s 71(3) provides that, upon receipt of such a request the board 'must determine the matter by resolution'. Section 71(4) requires that such a resolution must be considered at a meeting to which the director whose removal is sought is invited and afforded an opportunity to respond as detailed below. Therefore, even if the board is of the opinion that the request is groundless, it is required to call a meeting in accordance with s 71(4).

Section 71(4) provides that a director whose removal is in issue must be given notice of the meeting, plus a copy of the relevant resolution accompanied by a statement of reasons for resolution which is detailed enough to enable him to formulate a response. Whilst the English and Australian companies legislation make provision for notice to be given to directors they do not go as far as stating that sufficiently detailed reasons must accompany the notice. In requiring this, the 2008 Act protects directors by ensuring that they are in a position to mount a response to the case for their removal. Where the director concerned is also an employee, these provisions ensure the fairness of a hearing that may lead to a dismissal. In that sense, the legislation also protects companies by requiring them to ensure fair hearings. In contrast to the statutory procedures relating to a shareholder removal discussed above, the notice period for removals by a board is not stipulated. It is unclear why this is so. It would have been more consistent to provide for the same notice periods for all types of removals. In the absence of such provisions, the notice given to a director should be of reasonable length to enable the director concerned to formulate a considered response to the statement of reasons. This position is supported by s 73(4), which requires that proper notice of board meetings, determined by a board in accordance with a company's memorandum of incorporation, must be given to directors. Finally, the courts have emphasised the need for meaningful notice of board meetings to be given to directors (see for example *SABC v Mpofo* 2009 (4) All SA 169 (GSJ) paras 37–41). Therefore, in the interests of certainty and in cognisance of statutory and case law requirements pertaining to notice of board meetings, minimum notice periods for board meetings at which removals are to be decided upon, ought to have been prescribed.

The director whose removal is being sought must be given a reasonable opportunity to make a presentation personally or through a representative at the board meeting before the resolution for his removal is voted upon (s 74(1)(b)). As was noted above, directors are not afforded the opportunity to submit written responses for circulation to the board prior to the meeting.

After considering the merits of the resolution for removal and the relevant director's case against the removal, the board may decide that a removal is appropriate. Section 71(3) provides that the board 'may remove a director whom it has determined to be ineligible or disqualified, incapacitated, or negligent or derelict, as the case may be' (emphasis supplied). On a literal reading of this section the board may choose to retain a director it has found to be incapacitated, negligent or who is guilty of dereliction of duty. However, in reality the board would be hard pressed to find acceptable justification for the retention of an incapacitated director or a director who has been grossly negligent or derelict in the execution of his functions; it is more likely that it will determine that a removal is required. In exercising its discretion, the board could retain directors it has found to be negligent or who are guilty of dereliction of duty to a minimal extent. The creation of such discretion immediately raises concerns about improperly motivated board decisions. However, these concerns ought to be allayed by the fact that the members of board will be in breach of their own duties to the company if they make a decision to remove or retain a director that is not reasonably justifiable as being in the interests of the company.

(iii) *Removal by the Tribunal*

The purpose of s 71(8) seems to be the provision of an alternative mode of removal for companies where removals by the board are unavailable. This is evident from the restriction of removals by the Tribunal to companies that have only one or two directors and the restriction of removals by the board to companies that have at least three directors (s 71(8) and s 71(3) respectively). In every other respect removals by the Tribunal are the same as removals by the board. Sections 71(8)(b)–(c) provide that any shareholder or director may apply to the Tribunal to make a determination whether a director should be removed on the grounds listed in s 71(3). These are the same grounds on which a removal by the board must be based. In addition, all the procedural requirements and the rights to apply for a review that apply to removals by the board are extended to removals by the Tribunal.

Removals by an enforcement or administrative agency are not unique to South Africa. Canadian provincial securities legislation provides for the removal of directors by securities commissions (Jasmine Girgis 'Corporate directors' disqualification: the new Canadian regime?' (2009) 46 *Alberta LR* 677 at 698–9; for example see s 127 of the Ontario Securities Act, 1990, s 198 of the Alberta Securities Act, 2000, and s 161 of the British Columbia Securities Act, 1996). Similarly, s 206F of the Australian Corporations Act gives the Australian Securities and Investments Commission (ASIC) powers to disqualify a director for a maximum period of five years. Such a

disqualification is, in effect, a removal from office. The grounds for such disqualification are improper or illegal 'conduct in relation to the management, business or property of any corporation' and 'whether the disqualification would be in the public interest'. The section also empowers the ASIC to consider other factors, if it deems it to be appropriate.

In addition to such removals by administrative or enforcement bodies, the United States and Canada also have judicial removals. In the United States judicial removals are provided for by s 8.09 of the Model Business Corporations Act, which has been incorporated into the companies legislation of at least thirty states (Olga N Sirodova-Paxson 'Judicial removal of directors: Denial of directors' license to steal or shareholders' freedom to vote?' (1998–1999) 50 *Hastings LJ* 97). It is worth noting that the three jurisdictions of Delaware, New York and California have all provided for judicial removals (s 225(c) of the *Delaware General Corporation Law* Title 8, ch 1 of the *Delaware Code*; s 304 of the *California Corporations Code*; and s 706(d) of the *New York Business Corporation Law*). The essence of these statutory provisions is that shareholders may apply directly to a court for the removal of a director. Similarly Canadian companies' legislation also provides for judicial removal as part of the 'oppression remedy' (Girgis *op cit* at 679; s 241 of the *Canada Business Corporations Act*, 1985). Under the *Australian Corporations Act*, 2001 there is no express provision for judicial removal of directors. However ss 206C, 206D and 206E provide for judicial disqualifications of directors which effectively remove the affected directors from office.

Section 71 of the 2008 Act does not provide for judicial removal at the first instance without initial efforts to secure a removal by the board or Tribunal. Rather, judicial removal is achieved through an application for the review of a board or Tribunal decision. Reviews are discussed below. In addition, indirect judicial removal of directors may be achieved through an application to place a director under probation or to be declared a delinquent under s 162. Under s 162(5) of the 2008 Act, a director will be declared a delinquent in any of the following circumstances. These are, if the director:

1. consented to serve as a director, or acted as a director while ineligible or disqualified to do so without court permission or in circumstances not covered by s 69(12);
2. acted in contravention of an order of probation in terms of *Companies Act*, 2008, or s 47 of the *Close Corporations Act*, 1984;
3. breached his directors duties;
4. has repeatedly been personally subject to a compliance notice or similar enforcement mechanism, for substantially similar conduct, in terms of any legislation;
5. has at least twice been personally convicted of an offence, or subjected to an administrative fine or similar penalty, in terms of any legislation; or
6. within a period of five years, was a director of one or more companies or managing member of one or more close corporations, or controlled or participated in the control of a juristic person, irrespective whether

concurrently, sequentially or at unrelated times, that were convicted of an offence, or subjected to an administrative fine or similar penalty, in terms of any legislation.

Section 162 (7) provides that a court may place a director under probation if he

1. was present at a meeting and failed to vote against a resolution despite the inability of the company to satisfy the solvency and liquidity test;
2. otherwise acted in a manner materially inconsistent with the duties of a director;
3. acted in, or supported a decision of the company to act in, a manner that is oppressive or unfairly prejudicial to a shareholder or director; or
4. within any period of 10 years of the coming into force of the 2008 Act has been a director of more than one company, or a managing member of more than one close corporation, which failed to fully pay all of its creditors or meet all of its obligations in the absence of an approved Business Rescue Plan or a compromise with creditors.

(iv) *Review of board and Tribunal decisions*

Section 71 provides for applications to court for a review of a board or Tribunal decision pertaining to the removal of a director. A review is available both where the board or Tribunal has decided to remove a director (s 71(5) as read with s 71(8)(c)) and where a decision has been made to retain a director (s 71(6) as read with s 71(8)(c)). Each of these scenarios is discussed in turn below.

Review of a decision to remove a director

After a board or the Tribunal removes a director from office, that the director or person who had directly appointed him to the board has 20 business days to take the matter on review to court (s 71(5) as read with s 71(8)(c)). As noted above, s 70(2) provides that a removal by the board does not create a vacancy on the board until the later of the expiry of the time for filing an application for review or the granting of an order by the court on such an application. This provision is not extended to removals by the Tribunal. It is submitted that such an extension ought to have been made for clarity and consistency. However, even in the absence of such an extension, in practice it would be imprudent for a company to attempt to appoint a replacement director before the period for filing a review has expired. There is no provision for the orders that may be handed down by a court pursuant to an application for a review under s 71(5).

Review of a decision to retain a director

After a board or Tribunal decision to retain a director on the board, any director who voted in favour of the resolution to remove the director concerned, or any shareholder who has voting rights that are exercisable in the election of that director, can take the matter to court on 'review'

(s 71(6)(a) as read with s 71(8)(c)). A review in its strict sense connotes an enquiry into the procedural aspects of a decision whilst an appeal goes to the merits of the matter though it is limited to the evidence adduced at the first hearing of the matter (I Ellis & M Dendy ‘Civil procedure: High court’ in W A Joubert (founding editor) *The Law of South Africa* volume 3(1) 2 ed (2007) para 394). However, a close reading of s 71(6)(b) shows that what is intended is not a review but an appeal. This section provides that

‘the court, on application in terms of paragraph (a), may —

- (i) confirm the determination of the board; or
- (ii) remove the director from office, *if the court is satisfied that the director is ineligible or disqualified, incapacitated, or has been negligent or derelict* (emphasis supplied).

Clearly, a court could only be ‘satisfied’ that the director is ineligible or disqualified, incapacitated, or has been negligent or is guilty of dereliction of duty, by considering the merits of the matter.

Where a matter is so taken on review, the court may either confirm or reverse the board or Tribunal’s determination (s 71(6)(b) as read with s 71(8)(c)). Where the court confirms the board’s determination the applicant must bear the legal costs of the company and any other party (s 71(7)). A similar provision is not extended to the confirmation of the Tribunal’s decision.

III REMEDIES PURSUANT TO DISMISSAL

A director who is removed from office in terms of s 71 of the 2008 Act and s 220 of the 1973 Act has several remedies. First, a director who has a fixed term appointment but is removed from office by an ordinary resolution of the shareholders before the expiry of that term, may have a claim for damages against the company for breach of contract (*Cilliers & Benade* op cit para 9.31). Section 220(7) of the 1973 Act provides:

‘Nothing in this section shall be construed as depriving a person removed thereunder of compensation or damages which may be payable to him in respect of the termination of his appointment as director or of any appointment terminating with that of director.’

Much in the same vein, s 71(9) of the 2008 Act provides:

‘Nothing in this section deprives a person removed from office as a director in terms of this section of any right that person may have at common law or otherwise to apply to a court for damages or other compensation for —

- (a) loss of office as a director; or
- (b) loss of any other office as a consequence of being removed as a director.’

Hence, both statutes provide for the possibility of a director claiming damages for the loss of another office or appointment due to his removal as a director. For example, under s 71(9)(b) a director who held ex-officio directorships in any other company by virtue of his directorship in the company from which he has been removed, can claim damages for loss of the ex-officio directorships as well.

Under the common law, a director's claim for damages for loss of office will only be successful if he was on a fixed term contract which has been prematurely terminated and he has not given the company cause to terminate the contract by reason of his breach of that contract (*Commentary* at 8-286; *Henochsberg* at 422). This position is extended to statutory removals by s 220(7) of the 1973 Act and s 71(9) of the 2008 Act. Where the director has committed a breach, for which he is removed by the shareholders, board or the Tribunal, he is not entitled to damages or compensation. Where there has been no breach by the director, but the director has been removed nonetheless by shareholders in terms of the Companies Acts of 1973 and 2008, such a director is entitled to damages. The quantum of damages depends on whether there was an agreement between the company and director for compensation for premature loss of office. Where such an agreement has been concluded, it will determine the amount payable. Where there was no such agreement, the director would have to prove his damages (*Henochsberg* at 422). Such damages would consist of lost salaries and (where applicable) commission, compensation for reductions in pensions and life policy cover, and for insurance premiums which would have been paid by the company for the director (*Commentary* at 8-285n7).

Secondly, the removal of a director who is also an employee and whose employment is dependent on his directorship will constitute a dismissal qua employee. This principle was recently confirmed in *SA Post Office Ltd v Mampeule* [2009] 8 BLLR 792 (LC) para 28 where Ngalwana AJ, giving the judgment of the court, said:

'In my view any act by the employer which results, directly or indirectly, in the termination of the employee's contract of employment constitutes a dismissal within the meaning of section 186(1)(a). That is why the LRA recognises the concept of constructive dismissal (section 186(1)(e) of the LRA). I do not want to be understood as saying what happened here constitutes constructive dismissal. I am not saying that. The point I make is that a dismissal does not come about only when the employer tells the employee "you're fired". Thus, when the Minister removed the respondent from the applicant's board of directors, thereby triggering an automatic and simultaneous termination of his contract of employment with the applicant, she effectively dismissed him. With that there can be no quarrel'.

(See also *PG Group (Pty) Ltd v Mbambo NO & others* [2005] 1 BLLR 71 (LC) para 22-25; Michael Beaumont 'Executive directors — Are they employees?' (2005) 7(1) *Beaumont Express* 6 at 7-8; Michael Beaumont 'Loss of directorship — Does this amount to a dismissal?' (2009) 11(9) *Beaumont Express* 168; B P S van Eck and S Lombard 'Dismissal of executive directors: comparing principles of company law and labour law' 2004 *TSAR* 20).

An executive director may resign from a directorship but still retain employment by the company. A simultaneous termination of that director's employment would constitute a dismissal (See *Amazwi Power Products (Pty) Ltd v Turnbull* [2008] 9 BLLR 817 (LAC), discussed in Michael Beaumont 'Resignation as a director — Does this also end the employment relationship?' (2008) 10(10) *Beaumont Express* 190).

A director who is so dismissed as a result of a removal or resignation from the board is entitled to the protection afforded by the Labour Relations Act 66 of 1995. The procedural and substantive fairness of the dismissal will depend on the facts of the matter. Generally, a substantively fair dismissal is one based on a fair reason relating to the employee's conduct or capacity or the employer's operational requirements (D du Toit, D Woolfrey, D Bosch, S Godfrey, J Rossouw, S Christie, C Cooper, G Giles & C Bosch *Labour Relations Law: A Comprehensive Guide* 5 ed (2006) 394, for the current 'own opinion' approach to evaluating fairness see *Fidelity Cash Management Service v CCMA & others* [2008] 3 BLLR 197 (LAC) paras 93–5). In cases of unfair dismissal, the most appropriate remedy is usually an award of damages as the courts have stated that the remedy of reinstatement is unlikely to be granted (*PG Group (Pty) Ltd v Mbambo NO & others* (supra) para 29).

Thirdly, the 2008 Act provides for reviews after successful or failed removals as outlined above.

IV CONCLUSION

The 2008 Act has introduced a number of substantive and procedural changes to the law relating to the removal of directors. It has two sets of provisions relating to such removals. First, s 137(5) provides for a court application for the removal of a director by a business rescue practitioner, for non-compliance with chapter 6 of the Act or for impeding the practitioner's work. Secondly, s 71 provides for removals by shareholders, boards and the Tribunal in contrast to s 220 of the 1973 Act that provided only for removals by shareholders. The introduction of removals by boards and the Tribunal is attributable to the adoption of the provisions of United States, Canadian and Australian companies' legislation.

The first distinction between the three types of removal provided for by the 2008 Act relates to when they may be employed. Removal of directors by shareholders is limited to elected directors whilst removal by the board and Tribunal may be used for any category of directors. Removal of directors by a board is applicable only where the company concerned has at least three directors; in all other cases, removal must be referred to the Tribunal. No grounds for removal are stipulated in the 2008 Act for removals by shareholders. The same grounds are stipulated in the 2008 Act for removal by the board and the Tribunal. These grounds relate to ineligibility, disqualification and an inability to perform in accordance with a director's duties.

Procedurally, there is a distinction between removal by shareholders, on the one hand, and removal by the board and the Tribunal, on the other hand. Directors are required to be given notice and an opportunity to orally present a case for their retention at a shareholders' or board meeting or Tribunal hearing where their dismissal is to be decided upon. However, the notice periods are prescribed for removal by shareholders while there is no prescription for removal by the board or the Tribunal. In the interests of certainty and consistency, the duration of notice periods ought to have been

prescribed for all three types of removals. The 2008 Act omits the special notice periods that were required by the 1973 Act and the provisions relating to written representations by directors. The omission of the special notice periods cannot be faulted as it streamlines the procedure whilst maintaining protection for both the director and company.

The procedure is thus much faster. However, the omission of the provisions relating to the submission and circulation of written responses by directors is, it is submitted, unfortunate. It deprives directors, who are sought to be removed, of the opportunity to make and present a written case for their retention. It also deprives the persons who are deciding on the removal of the opportunity to consider the possibility of retention prior to the meeting. An oral presentation may not be effective in a meeting which may become heated or unruly. However, as s 71 expressly requires that the concerned director be given a 'reasonable opportunity' to make an oral presentation to the shareholders, board or Tribunal before a decision on his removal is made, it seems that directors still retain a meaningful right of representation.

The 2008 Act fundamentally alters the powers of removal of shareholders by limiting them to elected directors and placing *ex-officio* and directly appointed directors beyond shareholders' powers of removal. *Ex-officio* and directly appointed directors may only be removed by a board or Tribunal. This change is indicative of an underlying policy shift from majority shareholder supremacy to a more balanced outlook that enables boards and the Tribunal to also remove directors. This shift in balance is advantageous for minority shareholders as they are now able (indirectly) to remove a director through board or Tribunal processes as an allegation by a single shareholder is sufficient to instigate removals. However, it is disadvantageous to majority shareholder directors, who under the 1973 Act cannot be removed, who are now exposed to removals by the board or the Tribunal. This more balanced policy approach is comparable to the position in the United States, Canada and Australia where board, judicial and enforcement removals are provided for. However, as noted by Olson (*op cit* at 237–9) there are important distinctions between the South African position and these other jurisdictions. For instance, the 2008 Act does not require that shareholder removals be for cause, whilst United States law requires that such dismissals be for cause where there is a staggered board or where cumulative voting is permitted (see s 141(k)(1)–(2) of the Delaware General Corporation Law, by way of example). Clearly such differences are due to the divergent nature of boards and voting practices in the two jurisdictions and it would have been imprudent to import such provisions into South Africa. It therefore seems that the 2008 Act only incorporates appropriate provisions from other jurisdictions. In view of the care that has been taken to craft a suitable statutory removal regime for South Africa, it seems that the regime is likely to work well.

However, to ensure the success of the regime, two key uncertainties need to be clarified. The first of these relates to the failure to stipulate notice

periods for removals by the board and Tribunal. The second relates to the distinction between directors disqualified under s 69(8)(a), on the one hand, and s 69(8)(b), on the other hand, created by s 71(3)(a)(i). Directors disqualified under s 69(8)(a) automatically lose their office, whilst directors disqualified under s 69(8)(b) do not and have to be formally removed from office. This requirement for formal removal is at odds with s 69(4), which provides for automatic loss of office upon disqualification without distinguishing between s 69(8)(a) and (b). As noted in the discussion above, the reasons for this distinction in s 71(3)(a)(i) are unclear and it appears that the distinction ought not to have been made. Unfortunately, the Companies Amendment Bill B40–2010 does not seek to clarify these uncertainties, but as the amendment process is ongoing (at the time of writing) hopefully it will incorporate the necessary amendments in the near future.




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