A CRITICAL ANALYSIS OF THE REMOVAL OF DIRECTORS BY THE BOARD OF DIRECTORS AND THE JUDICIARY UNDER THE COMPANIES ACT 71 OF 2008

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"A CRITICAL ANALYSIS OF THE REMOVAL OF DIRECTORS BY THE BOARD OF DIRECTORS AND THE JUDICIARY UNDER THE COMPANIES ACT 71 OF 2008"

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SUMMARY

Section 71(3) of the Companies Act 71 of 2008 has introduced into South African company law a provision which for the first time permits the board of directors to remove another director from office in certain specific instances. A further significant innovation in the Companies Act 71 of 2008 is contained in section 162, which empowers a court to make an order declaring a director delinquent or placing him under probation in specific instances. The effect of section 162 is that a court is empowered to remove a director from the board of directors. The focus of this thesis is the removal of directors from office by the board of directors and by the judiciary. The thesis explores the underpinning philosophy of the statutory provisions relating to the removal of directors from office. It also examines the impact of the power given to the board of directors and to the courts to remove a director from office. The grounds and the procedures for the removal of directors by the board of directors and the judiciary are examined. The fiduciary duties applicable to directors in removing a director from the board of directors are also explored. In addition, this thesis examines the removal of directors holding multiple positions or capacities in relation to a company, such as an employee or a shareholder with loaded voting rights. The remedies which may be relied on by a director who has been removed from office by the board of directors are examined. Recommendations are made to strengthen and improve the provisions in the Companies Act 71 of 2008 relating to the removal of directors from office by the board of directors and the judiciary. Amendments to the Companies Act 71 of 2008 are suggested to remove ambiguities; to guard against the abuse of sections 71(3) and 162; to improve the grounds and procedures for the removal of directors by the board of directors and the judiciary, and to enhance the remedies that may be relied on by a director who has been removed from office by the board of directors.

Key Terms:

Removal of directors from office; Balance of power between directors and shareholders; Ineligibility; Disqualification; Fiduciary duties; Automatic termination clauses; Loaded voting rights; Delinquent directors; Directors under probation; Suspending a delinquency order; Setting aside a probation order; Damages and compensation for loss of office

OPSOMMING

Artikel 71(3) van die Maatskappywet 71 van 2008 het ’n bepaling tot Suid-Afrikaanse maatskappyreg toegevoeg wat die direksie vir die eerste keer in staat stel om ’n ander direkteur in sekere spesifieke gevalle uit sy of haar amp te verwyder. ’n Verdere belangrike vernuwing in die Maatskappywet 71 van 2008 word in artikel 162 vervat, wat ’n hof magtig om ’n bevel uit te vaardig wat ’n direkteur misdadig verklaar of hom of haar in spesifieke gevalle aan ’n proeftydperk onderwerp. Die effek van artikel 162 is dat ’n hof by magte is om ’n direkteur uit die direksie te verwyder. Die fokus van hierdie tesis is die verwydering van direkteure uit hul ampte deur die direksie en die regbank. Die tesis verken die onderliggende filosofie van die statutêre bepalings wat met die verwydering van direkteure uit hul ampte verband hou. Dit ondersoek ook die impak van die bevoegdheid wat aan die direksie en die howe verleen word om ’n direkteur uit sy of haar amp te verwyder. Die gronde en prosedures vir die verwydering van direkteure deur die direksie en die regbank word ondersoek. Die fidusiêre pligte van toepassing op direkteure by die verwydering van ’n direkteur uit die direksie word ook verken. Daarbenewens ondersoek hierdie tesis die verwydering van direkteure wat veelvuldige posisies of hoedanighede met betrekking tot ’n maatskappy beklee, soos ’n werknemer of aandeelhouer met gelaaide stemregte. Die regsmiddele waarop ’n direkteur, wat deur die direksie uit sy of haar amp verwyder is, kan steun, word ondersoek. Aanbevelings word gemaak om die bepalings in die Maatskappywet 71 van 2008, wat met die verwydering van direkteure uit hul ampte deur die direksie en regbank verband hou, te versterk en te verbeter. Wysigings aan die Maatskappywet 71 van 2008 word voorgestel om dubbelsinnighede uit te skakel; om teen die misbruik van artikels 71(3) en 162 te waak; om die gronde en prosedures vir die verwydering van direkteure deur die direksie en die regbank te verbeter, en om die regsmiddele waarop ’n direkteur wat deur die direksie uit sy of haar amp verwyder is kan steun, te versterk.

NGAMAFUPHI

ISigaba 71(3) Somthetho weZinkampani 71 ka 2008 sewuze wangenisa emithethweni yezinkampani zaseNingizimu Afrika, umthetho ongowokuqala ovumela ibhodi labaqondisi ukuthi libe namandla wokugudluza omunye umqondisi esikhundleni sakhe ngaphansi kwezimo ezithile. Olunye ushintsho olusha kuMthetho wama-71 weZinkampani ka 2008 uqukethwe yiSigaba 162, wona ugunyaza inkantolo ukuthi ikhiphe umyalelo owazisa umqondisi ngokuthi unecala noma obeka umqondisi ngaphansi kophenyo, phecelezi "*probation*" ngesinye isikhathi. Inhloso yeSigaba 162 wukunikeza inkantolo igunya lokugudluza umqondisi kwibhodi labaqondisi. Impokophelo yale thisisi wukugudluzwa kwabaqondisi, bagudluzwe yibhodi labaqondisi kanye nomthetho/nobulungisa. Ithisisi ihlola ifilosofi yemithetho ekhishiwe emayelana nokugudluzwa kwabaqondisi ezikhundleni zabo, Kanti futhi ihlola umthelela wamandla anikezwe ibhodi labaqondisi kanye nezinkantolo ukuthi zigudluze umqondisi esikhundleni. Izizathu kanye nengqubo elandelwayo mayelana nokugudluzwa kwabaqondisi yibhodi labaqondisi kanye nomthetho nazo ziyahlolwa. Imisebenzi emayelana nokuthembeka eyenziwa ngabaqondisi ukugudluza umqondisi kwibhodi labaqondisi nayo iyacwaningwa Ngaphezu kwalokhu, le thisisi .iphenya ukugudluzwa kwabaqondisi abaqokwe ezikhundleni eziningi noma abanegunya elithize ngokwengqubo yenkampani, enjengesisebenzi, phecelezi "*employee*" noma umabelwa-mashezi onamalungelo amaningi okuvota, phecelezi, "*loaded with voting rights*". Izeluleko ezingasetshenziswa wumqondisi ogudluzwe esikhundleni sakhe yibhodi labaqondisi nazo ziyahlolwa. Izincomo nazo ziyenziwa ngenhloso yokuqinisa kanye nokuthuthukiswa kwamandla oMthetho we-71 weZinkampani ka 2008, mayelana nokugudluzwa kwabaqondisi ezikhundleni yibhodi labaqondisi kanye nomthetho. Izinguquko zoMthetho wama-71 weZinkampani ka 2008 ziqonde ukususa izixakaxaka, ukulwa nokudlelezelwa kweSigaba 71(3) kanye no 162, ukuthuthukisa izizathu kanye nezingqubo zokugudluzwa kwabaqondisi yibhodi labaqondisi kanye nomthetho, ukuqinisa izindlela zokulungisa ezingasetshenziswa wumqondisi osegudluziwe esikhundleni yibhodi labaqondisi.

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TABLE OF ABBREVIATIONS

ACLC	Australian Company Law Cases
ACSR	Australian Corporations and Securities Reports
ASIC	Australian Securities and Investments Commission
ASX	Australian Securities Exchange
BCC	British Company Law Cases
BCLC	Butterworths Company Law Cases (UK)
CCMA	Commission for Conciliation, Mediation and Arbitration
CIPC	Companies and Intellectual Property Commission
CLR	Commonwealth Law Reports
CRISA	Code for Responsible Investing in South Africa
DGCL	Delaware General Corporation Law
DLR	Dominion Law Reports (Canada)
DTI	Department of Trade and Industry
EWCA	England and Wales Court of Appeal
EWHC	High Court of England and Wales
FCA	Federal Court of Australia
FCAFC	Federal Court of Australia Full Court
FLR	Federal Law Reports
HKLRD	Hong Kong Law Reports and Digest
JSE	Johannesburg Stock Exchange
LRA	Labour Relations Act 66 of 1995
MBCA	Revised Model Business Corporation Act 1984
NAB	National Australia Bank Limited
NSWSC	Supreme Court of New South Wales (Australia)
NSWCA	New South Wales Court of Appeal (Australia)
NZLR	New Zealand Law Reports

OECD	Organisation for Economic Co-operation and Development
SABC	South African Broadcasting Corporation SOC Limited
SASR	South Australian State Reports
SCC	Supreme Court of Canada
SLR	Scottish Law Reporter
TASSC	Supreme Court of Tasmania
UK	United Kingdom
USA	United States of America
WASC	Western Australia Supreme Court
WLR	Weekly Law Reports

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CHAPTER 1 INTRODUCTION

1. **INTRODUCTION**
2. **REMOVAL OF DIRECTORS FROM OFFICE**
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1. INTRODUCTION

The Companies Act 71 of 2008, as amended ("the Companies Act") which came into force on 1 May 2011, introduced into South African law a provision which for the first time permits the board of directors to remove another director from office. This provision is contained in section 71(3) of the Companies Act, and it permits the board of directors to remove a director from office in instances where a company has more than two directors and a shareholder or director alleges that a director of the company has become ineligible or disqualified to be a director, or has become 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 has neglected or has been derelict in the performance of the functions of a director.

Previously, under section 220 of the Companies Act 61 of 1973, only the shareholders were statutorily empowered to remove a director from the board of directors.[1] The novel power conferred by section 71(3) of the Companies Act on the board of directors of a company to remove a director from office in certain circumstances shifts the balance of power between the board of directors and the shareholders in that the shareholders no longer enjoy the exclusive power to remove directors from office.

[1] See on s 220 of the Companies Act 61 of 1973 *Stewart v Schwab* 1956 (4) SA 791 (T); *Swerdlow v Cohen and Others* 1977 (3) SA 1050 (T); *Amoils v Fuel Transport (Pty) Ltd* 1978 (4) SA 343 (W); *Barlows Manufacturing Co Ltd and Others v RN Barrie (Pty) Ltd and Others* 1990 (4) SA 608 (C); *James North (Zimbabwe) (Pvt) Ltd v Mattinson* 1990 (2) SA 229 (ZHC); J Du Plessis "Praktiese Aspekte Aangaande die Ontslag van Maatskappydirekteure" 511-516; J Du Plessis "Die Nywerheidshof, Werknemers en Direkteure" 119-122; Kunst, Delport & Vorster *Henochsberg on the Companies Act* 422(2)–424 (the previous edition of *Henochberg on the Companies Act* 61 of 1973); Beuthin & Luiz *Beuthin's Basic Company Law* 209-211; Esser "Company Law and the Spoliated Director" 135; Beuthin "A Director Firmly in the Saddle" 489; MJ Oosthuizen "Swerdlow v Cohen and Others 1977 1 SA 178 (W)" 165-169 and Masinire "A Critical Analysis of the Role and Protection of Shareholders in the Removal of Directors in the South African Companies Act 71 of 2008" 1988-1990.

A further significant innovation in the Companies Act is contained in section 162, which empowers a court to make an order declaring a director delinquent or under probation under various grounds.[2] The effect of an order of delinquency is that a person is disqualified from being a director of a company.[3] A delinquency order may be unconditional and subsist for the lifetime of the director or it may be conditional and subsist for seven years or longer, as determined by the court.[4] The effect of an order of probation is that a person may not serve as a director except to the extent permitted by the order.[5] A probation order generally subsists for a period not exceeding five years.[6] Like an order of delinquency an order of probation may be subject to such conditions as the court considers appropriate.[7] The effect of section 162 is that a court is empowered to remove a director from the board of directors, if any of the grounds contemplated in the section are applicable.

Section 71(5) further allows the judiciary a say in the removal of a director from office. A director who was removed from office or a person who appointed that director may apply to court to review a decision of the board of directors to remove a director from office. Furthermore, if the board of directors has decided not to remove a director from office, any director who voted otherwise on the resolution or a shareholder with voting rights entitled to be exercised in the election of that director may, in terms of section 71(6), apply to court to review the board's decision. The court may either confirm the determination of the board of directors not to remove the director from office or it may itself remove the director from office.[8]

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[2] *Kukama v Lobelo & Others* 2012 JDR 0663 (GSJ); *Lobelo v Kukama* 2013 JDR 1434 (GSJ); *Msimang NO and Another v Katuliiba and Others* [2013] 1 All SA 580 (GSJ); *Rabinowitz v Van Graan and Others* 2013 (5) SA 315 (GSJ); *Grancy Property Limited v Gihwala* 2014 JDR 1292 (WCC); *Gihwala and Others v Grancy Property Limited and Others* 2017 (2) SA 337 (SCA); *Lewis Group Limited v Woollam* 2017 (2) SA 547 (WCC).

[3] Section 69(8)(*a*) of the Companies Act. See further *Rabinowitz v Van Graan and Others* 2013 (5) SA 315 (GSJ) para 20; *Grancy Property Limited v Gihwala* 2014 JDR 1292 (WCC) para 159 and *Lewis Group Limited v Woollam* 2017 (2) SA 547 (WCC) para 5.

[4] Section 162(6) of the Companies Act.

[5] Section 69(5) of the Companies Act.

[6] Section 162(9)(*b*) of the Companies Act.

[7] Section 162(10) of the Companies Act.

[8] Section 71(6)(*b*) of the Companies Act.

The Companies Tribunal is also empowered to remove a director from office in those companies which have fewer than three directors.[9] In such companies the board of directors may not remove a director from office but a director or a shareholder of the company may apply to the Companies Tribunal to make a determination on the removal of the director.[10] The Companies Tribunal must exercise its functions in accordance with the Companies Act, and must perform its functions impartially and without fear, favour or prejudice, and in as transparent a manner as is appropriate having regard to the nature of the specific function.[11] In carrying out its functions, the Companies Tribunal may have regard to international developments in the field of company law.[12]

A further method under which a director may be removed from office by a court is contained in section 137(5) of the Companies Act, in terms of which a director of a company that is under business rescue may be removed from office by a court upon the application of a business rescue practitioner.[13] The grounds under which such an application may be instituted are that

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[9] Section 71(8) of the Companies Act.

[10] Section 71(8)(*a*) and (*b*) of the Companies Act. The Companies Tribunal was established in terms of s 193(1) of the Companies Act. It is an independent organ of state which is subject only to the Constitution of the Republic of South Africa, 1996 ("the Constitution") and the law, and has jurisdiction throughout South Africa (s 193(1)(*a*) and (*b*) of the Companies Act). Among the functions of the Companies Tribunal are to adjudicate any application that may be made to it in terms of the Companies Act and to assist in the resolution of disputes as contemplated in Part C of Chapter 7 of the Companies Act (dealing with the voluntary resolution of disputes) (s 195(1)(*a*) and (*b*)). The Companies Tribunal must also perform any other function assigned to it under the Companies Act or any law mentioned in Schedule 4 of the Companies Act. Some examples of the laws mentioned in Schedule 4 are the Close Corporations Act 69 of 1984, the Share Blocks Control Act 59 of 1980, the Co-operatives Act 69 of 1984, the Trade Marks Act 194 of 1993, the Copyright Act 98 of 1978, the Patents Act 57 of 1978, the Designs Act 195 of 1993 and the Protection of Businesses Act 99 of 1978.

[11] Sections 193(1)(*c*) and (*d*).

[12] Section 193(3)(*a*).

[13] Business rescue proceedings, as defined in s 128(1)(*b*) of the Companies Act, are designed to facilitate the rehabilitation of a company that is financially distressed by providing for the temporary supervision of the company and of the management of its affairs, business and property. Business rescue proceedings entail a temporary moratorium on the rights of claimants against the company or in respect of property in its possession, and the development and implementation of a plan to rescue the company. Under the business rescue plan, the company's affairs, business, property, debt and other liabilities and equity are restructured. The aim of business rescue is to maximise the likelihood of the company continuing in existence on a solvent basis. If this is not possible, an alternative object of business rescue is to restructure the company so as to produce a better return for the company's creditors or shareholders than would result from the immediate liquidation of the company. Chapter 6 of the Companies Act regulates business rescue proceedings. For a general discussion of business rescue proceedings see Loubser *Some Comparative Aspects of Corporate Rescue in South African Company Law* (Unpublished LLD Thesis); Delport *Henochsberg on the Companies Act 71 of 2008* 442-536(8F); FHI Cassim "Business Rescue and Compromises" in FHI Cassim et al *Contemporary Company Law* 860-925; Delport *New Entrepreneurial Law* 217-237 and FHI Cassim "Business Rescue and Compromises" in Loubser & Mahony *Company Secretarial Practice* 26-1-26-45.

the director in question has failed to comply with a requirement of Chapter 6 of the Companies Act, or by an act or omission has impeded or is impeding the business rescue practitioner in the performance of his powers and functions, the management of the company by the practitioner, or the development or implementation of a business rescue plan.[14]

The *Memorandum on the Objects of the Companies Bill, 2008* states that clause 71 of the Bill (now the Companies Act) provides "a more certain and nuanced scheme for the removal of directors from office".[15] With regard to the application to declare a director delinquent or to place him under probation under section 162 of the Companies Act, the *Memorandum on the Objects of the Companies Bill, 2008* provides as follows:

> "A major innovation of the draft is the introduction of a regime allowing for a court, on application, to declare a director either delinquent (and thus prohibited from being a director) or under probation (and restricted to serving as a director within the conditions of that probation). The core of the regime is set out in clause 162, as one of the remedies available to shareholders and other stakeholders to hold directors accountable."[16]

These innovations to South African company law are the focus of this thesis. The removal of a director by the judiciary under section 162 is a "major innovation", as stated by the *Memorandum on the Objects of the Companies Bill, 2008*.[17] The removal of directors by the Companies Tribunal is also examined, albeit briefly. The removal of directors by the shareholders, which was permitted by the Companies Act 61 of 1973 and which is a study on its own, is not dealt with in this thesis.[18] However, where relevant to this thesis, the removal of directors by the shareholders will be discussed. The removal of a director from office by a court

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[14] Section 137(5) of the Companies Act. The right of a practitioner to apply to court for an order removing a director from office is in addition to any right of a person to apply to a court for an order contemplated in s 162 to declare a director delinquent or to place him under probation (s 137(6) of the Companies Act).

[15] *Memorandum on the Objects of the Companies Bill, 2008*, Companies Bill [B 61D-2008] para 8.

[16] *Memorandum on the Objects of the Companies Bill, 2008*, Companies Bill [B 61D-2008] para 8.

[17] *Memorandum on the Objects of the Companies Bill, 2008*, Companies Bill [B 61D-2008] para 8.

[18] For a discussion on the removal of directors by the shareholders under ss 71(1) and 71(2) of the Companies Act, see Delport *Henochsberg on the Companies Act 71 of 2008* 273-274(3); Ncube "You're Fired! The Removal of Directors under the Companies Act 71 of 2008" 33-51; R Cassim "Governance and the Board of Directors" in FHI Cassim et al *Contemporary Company Law* 441-452; FHI Cassim "The Division and Balance of Power" 151-168; Masinire "A Critical Analysis of the Role and Protection of Shareholders in the Removal of Directors in the South African Companies Act 71 of 2008" 1988-1995 and Esser & Havenga "Directors and Other Officers" in Loubser & Mahony *Company Secretarial Practice* 8-17.

upon the application of a business rescue practitioner is likewise beyond the scope of this thesis and is not addressed in this study.[19]

2. REMOVAL OF DIRECTORS FROM OFFICE

2.1 Removal of Directors by the Board of Directors

The rationale of permitting directors to be removed from office is to enhance the accountability of directors.[20] But the power given to directors to remove a director from the board must not be abused and it must be restrained. While there may be merit in vesting a company's board of directors with this power, questions inevitably arise as to whether the concern of removal from office by the board would stifle the actions of a director in managing the company's affairs and whether the power to remove might be abused. This thesis will examine whether sections 71(3) and 71(4) of the Companies Act may be strengthened in order to guard against the abuse of the board's power to remove directors from office.[21]

The grounds and the procedures for the removal of directors by the board of directors are examined.[22] The removal of directors under the Australian Corporations Act, 2001 ("the Australian Corporations Act of 2001"), the United Kingdom ("UK") Companies Act, 2006 ("the UK Companies Act of 2006"), the United States of America ("USA") Revised Model Business Corporation Act 1984 (the "MBCA")[23] and the Delaware General Corporation

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[19] For a discussion on the removal of a director by a court on the application of a business rescue practitioner under s 137(5) of the Companies Act, see Loubser *Some Comparative Aspects of Corporate Rescue in South African Company Law* (Unpublished LLD Thesis) 112-113; Delport *Henochsberg on the Companies Act 71 of 2008* 482(56)-482(57); FHI Cassim "Business Rescue and Compromises" in FHI Cassim et al *Contemporary Company Law* 887 and FHI Cassim "Business Rescue and Compromises" in Loubser & Mahony *Company Secretarial Practice* 26-27.

[20] *Unocal Corp v Mesa Petroleum Co* 493 A.2d 946 (Del., 1985) at 959; *Aronson v Lewis* 473 A.2d 805 (1984) at 811. See chapter 2, para 4 where this is discussed further.

[21] See chapter 3, paras 3, 6 and 8.

[22] See chapter 3, paras 6 and 8.

[23] The MBCA first appeared in a completed form in 1950. It was intended not to become a uniform corporation law but to serve as a drafting guide for the various States in the USA. Eventually the MBCA became the pattern for large parts of the corporation statutes in most States in the USA, notable exceptions being Delaware, California and New York. The MBCA is revised from time to time by the Committee on Corporate Laws of the American Bar Association Section of Business Law. This committee has remained committed to keeping the MBCA an enabling statute. Many States amend their corporate statutes to adopt the latest revisions made to the MBCA from time to time. The first complete revision to the MBCA appeared in the Revised Model Business Corporation Act (1984). In certain instances developments to the MBCA have lagged behind those made in Delaware, while at

Law (Title 8, Chapter 1 of the Delaware Code) of the USA State of Delaware (the "DGCL")[24] are reviewed and compared with the provisions of the Companies Act, with a view to ascertaining what guidance may be obtained from these sources with regard to the removal of directors by the board of directors under the (South African) Companies Act. In addition, the relevant corporate legislation in some of those States in the USA which permit directors to remove a director from the board of directors will be reviewed. The legal principles enunciated in case law based on the Companies Act 61 of 1973, and applicable common law principles, will be referred to where relevant.

2.2 Fiduciary Duties and Removal of Directors

When the shareholders of a company consider the removal of a director from office in terms of section 71(1) of the Companies Act[25] they may exercise their vote to do so in any way they please because it is well established that their right to vote is a proprietary right which they are entitled to exercise in whatever way they desire.[26] Accordingly, a resolution by the shareholders to remove a director from office may not be impeached on the ground that it was not passed in good faith and in the interests of the company.[27]

In contrast, when the board of directors exercises the power to remove a director from office it must do so *bona fide* in the best interests of the company and not for ulterior reasons.[28] This is

other times the MBCA amendments have moved ahead of those made in Delaware (Ferber *Corporation Law* 18-19; Cox & Hazen *Corporations* 34-35; Bainbridge *Corporate Law* 9; Olson & Briggs "The Model Business Corporation Act and Corporate Governance: An Enabling Statutes Moves Towards Normative Standards" 31-32).

[24] Refer to para 3 below where the selection of these jurisdictions is motivated.

[25] In terms of s 71(1) of the Companies Act, 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 s 71(2). Section 71(2) sets out the procedures that must be followed before the shareholders may consider such a resolution.

[26] *Pender v Lushington* (1877) 46 ChD 317 at 319. As Lord Jessel MR put it (at 321), a shareholder "has a right to say, whether I vote with the majority or with the minority, you shall record my vote; that is a right of property belonging to my interest in this company, and if you will not, I shall institute legal proceedings to compel you. It seems to me that such an action could be maintained, without any technical difficulty." See further *Re HR Harmer Ltd* [1959] 1 WLR 62 at 82; *Sammel and Others v President Brand Gold Mining Co Ltd* 1969 (3) SA 629 (A) at 680; *Desai and Others v Greyridge Investments (Pty) Ltd* 1974 (1) SA 509 (A) at 519; *Kuwait Asia Bank EC v National Mutual Life Nominees Ltd* [1991] 1 AC 187 (PC) at 221; *CDH Invest NV v Petrotank South Africa (Pty) Ltd and Another* [2018] 1 All SA 450 (GJ) para 44 and chapter 4, para 2.

[27] Blackman et al *Commentary on the Companies Act* 8-285.

[28] *Lee v Chou Wen Hsien* [1984] 1 WLR 1202 at 1206; *Liwszyc and Another v Smolarek and Others* (2005) 55 ACSR 38 at 46-47; Blackman et al *Commentary on the Companies Act* 8-285. On the fiduciary duties of directors

because the exercise of this power is subject to the general fiduciary obligation owed by directors to their company. The relationship between a director and his company is one of the well-established examples of commercial fiduciary relationships accepted in South African law.[29] Directors who exercise their power to remove a director for an improper purpose or for ulterior reasons may be held to be in breach of their fiduciary duties.[30] However, in the leading UK case of *Lee v Chou Wen Hsien*[31] the Privy Council held that while each director who concurs in the removal of a director must act in accordance with what he believes to be in the best interests of the company, it does not follow that a director sought to be removed would continue to remain a director simply because one or more of the directors had acted from an ulterior motive in removing that director. In light of this decision, this study will examine the fiduciary duties of the board of directors in removing a member from the board of directors, and the consequences if such fiduciary duties are breached by the board of directors.[32] The fiduciary duties of directors will only be dealt with in this investigation to the extent that they are relevant to the power of directors to remove a director from office.

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to act in the best interests of the company see *Shuttleworth v Cox Brothers & Co (Maidenhead) Ltd* [1927] 2 KB 9; *Re Smith & Fawcett Ltd* [1942] Ch 304 at 306; *Charterbridge Corporation Ltd v Lloyd's Bank* [1970] Ch 62; *Regentcrest plc (in liquidation) v Cohen* [2001] 2 BCLC 80 at 105; *Extrasure Travel Insurances Ltd v Scattergood* [2003] 1 BCLC 598 (ChD) at 618-619; *Liwszyc and Another v Smolarek and Others* (2005) 55 ACSR 38 at 46-47; *Da Silva and Others v CH Chemicals (Pty) Ltd* 2008 (6) SA 620 (SCA) para 18 and chapter 4 para 3.1.

[29] See Havenga "Breach of Directors' Fiduciary Duties: Liability on what Basis" 366; *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168; *S v De Jager and Another* 1965 (2) SA 616 (A); *S v Hepker* 1973 (1) SA 472 (W) at 475; *Bellairs v Hodnett and Another* 1978 (1) SA 1109 (A); *Atlas Organic Fertilizers (Pty) Ltd v Pikkewyn Ghwano (Pty) Ltd and Others* 1981 (2) SA 173 (T); *Sibex Construction (SA) (Pty) Ltd v Injectaseal CC & Others* 1988 (2) SA 54 (T); *Howard v Herrigel & Another NNO* 1991 (2) SA 660 (A) at 678; *Da Silva and Others v CH Chemicals (Pty) Ltd* 2008 (6) SA 620 (SCA); *Omar v Inhouse Venue Technical Management (Pty) Ltd and Others* 2015 (3) SA 146 (WCC) paras 59-61 and *Mthimunye-Bakoro v Petroleum and Oil Corporation of South Africa (SOC) Ltd and Another* 2015 (6) SA 338 (WCC).

[30] See *Punt v Symons & Co Ltd* [1903] 2 Ch 506; *Piercy v Mills* [1920] 1 Ch 77; *Hogg v Cramphorn Ltd* [1967] Ch 254; *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821 (PC) and *Extrasure Travel Insurances Ltd v Scattergoo*d [2003] 1 BCLC 598 (ChD) at 618 on the fiduciary duty of directors to exercise their powers for a proper purpose.

[31] [1984] 1 WLR 1202 at 1206.

[32] See chapter 4, paras 3 and 4.

2.3 The Removal of Directors Holding Multiple Positions in a Company

When a director who is removed from office is also a full time employee of the company, the provisions of the Labour Relations Act 66 of 1995 ("the LRA") must be considered.[33] The validity of an automatic termination clause in the service contract of a director is examined.[34] An automatic termination clause typically states that the termination of board membership leads to the automatic and simultaneous termination of a director's employment by the company.[35] It will also be examined whether a reverse automatic termination provision, which provides for the automatic termination of a directorship upon the occurrence of an event, is valid.[36]

A further consideration to be taken into account when removing a director from the board of directors, is whether the director is also a shareholder of the company. Under section 71(1) of the Companies Act shareholders may remove a director from office by an ordinary resolution. Under section 37(2) of the Companies Act each issued share has associated with it one general voting right except to the extent provided otherwise by the Companies Act or determined by or in terms of the company's Memorandum of Incorporation in accordance with section 36 of the Companies Act. Under section 37(5)(*a*) of the Companies Act, subject to any other law, a company's Memorandum of Incorporation may establish for any particular class of shares preferences, rights, limitations or other terms that confer special, conditional or limited voting rights. Thus it is possible for a shareholding-director to have loaded votes and for additional voting rights to be attached to certain shares held by him.[37] This research will examine whether

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[33] *Amazwi Power Products (Pty) Ltd v Shelly Turnbull* [2008] JOL 22089 (LAC) para 15; *Mpofu v South African Broadcasting Corp Limited (SABC) and Others* (2008/18386) [2008] ZAGPHC 413 (16 September 2008); *Wicks v SA Independent Services (Pty) Ltd and Another* [2010] JOL 25715 (WCC); *Chillibush v Johnston* [2010] 6 BLLR 607 (LC); *SA Post Office Ltd v Mampeule* [2010] 10 BLLR 1052 (LAC); Van Eck & Lombard "Dismissal of Executive Directors: Comparing Principles of Company Law and Labour Law" 20.

[34] See chapter 5, para 2.2.

[35] This is discussed further in chapter 5, para 2.2.

[36] See chapter 5, para 2.3.

[37] *Bushell* v *Faith* [1970] AC 1099 (HL); Beuthin "A Director Firmly in the Saddle" 489; Anon "'Weighted' Votes Again" D17-D20; Anon "'Weighted' or 'Loaded' Votes in Private Companies" D5-D16. The expression "loaded voting rights" or "weighted votes" is used to describe the device whereby certain shares are given additional voting strength above that enjoyed by other shares which, in every other respect, are identical to their participation in the company (Anon "'Weighted' or 'Loaded' Votes in Private Companies" D5). In essence, loaded voting rights or weighted votes are voting rights that are disproportionate to shareholdings (FHI Cassim "The Division and Balance of Power" 164.) Loaded voting rights may apply generally to all resolutions or they may be confined

a shareholding-director who holds shares with loaded votes would validly be able to prevent his removal from office by ensuring that the loaded votes are cast against the ordinary resolution to remove him from office.[38]

2.4 Judicial Removal of Directors

As was mentioned above, the Companies Act empowers courts to remove directors under a review in terms of section 71(6). Under this provision, if the board of directors of a company has determined that a director is not ineligible, disqualified, incapacitated or has not been negligent or derelict (as the case may be) any director who voted otherwise on the resolution or any holder of voting rights entitled to be exercised in the election of that director, may apply to court to review the board's determination.[39] The court may confirm the determination of the board of directors not to remove the director in question from office, or the court may remove the director from office if it is satisfied that the director is ineligible, disqualified, incapacitated or has been negligent or derelict.[40] This thesis will examine the court's powers to remove a director from office under section 71(6) and will consider whether section 71(6) may be improved and enhanced.[41]

As previously stated, a further significant innovation in the Companies Act is contained in section 162, which empowers a court, under various grounds, to declare a director delinquent or to place him under probation.[42] The effect of section 162 of the Companies Act is that a court is empowered to remove a director from the board of directors, if any of the grounds contemplated in section 162 are applicable. This research will examine to what extent the power given to the courts to declare a director delinquent or to place him under probation and hence to remove him from office usurps the power traditionally given to shareholders to

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to resolutions on specific matters (Anon "'Weighted' or 'Loaded' Votes in Private Companies" D5). Loaded votes would be exercisable when voting takes place on a poll, and not when voting takes place on a show of hands.

[38] See chapter 5, para 3.

[39] Section 71(6)(*a)* of the Companies Act.

[40] Section 71(6)(*b*) of the Companies Act.

[41] See chapter 6, para 2.

[42] See para 1 above.

remove directors.[43] It will also examine the judicial removal of directors in the UK, Australia and the USA. The procedures and grounds for judicial removal in these foreign jurisdictions are compared with such procedures and grounds under the (South African) Companies Act with a view to ascertaining whether section 162 of the Companies Act may be strengthened and improved.[44]

In terms of section 162(11) of the Companies Act, a person who has been declared delinquent by a court or is subject to an order of probation may apply to a court to have the order of delinquency suspended and substituted with an order of probation, at any time more than three years after the order of delinquency was made.[45] Such a person may also apply to a court to set aside an order of delinquency at any time more than two years after it was suspended, or to set aside an order of probation at any time more than two years after it was made.[46] An application to court to suspend an order of delinquency or to set aside an order of probation may not, however, be brought if a director had consented to serve as a director or had acted in the capacity of a director while ineligible or disqualified, or, while being under an order of probation he had acted as a director in a manner that contravened that order, as contemplated in sections 162(5)(*a*) and (*b*) of the Companies Act.[47] This thesis examines the application to court to suspend an order of delinquency or to set aside an order of probation in terms of section 162(11) of the Companies Act. It compares section 162(11) of the Companies Act with the equivalent provisions in the UK Companies of 2006 and the Australian Corporations Act of 2001 in order to ascertain whether section 162(11) of the Companies Act may be improved and enhanced.

[43] See chapter 2, para 6.

[44] See chapter 6, para 3 where this topic is discussed.

[45] See chapter 6, para 3.11 where this is discussed.

[46] Section 162(11)(*b*). See chapter 6, para 3.11 where this is discussed.

[47] Section 162(11).

2.5 Remedies Available to a Director who has been Removed from Office

Under the Companies Act a director who has been removed from office by the board of directors has certain remedies available to him.

After a director has been removed from office by the board of directors under section 71(5) of the Companies Act, he may apply to a court of law within twenty business days to review the board's determination. Alternatively, a person who appointed that director in terms of the Memorandum of Incorporation as contemplated in section 66(4)(*a*)(i),[48] if applicable, may institute such an application.[49]

A further remedy available to a director who has been removed from office is that, under section 71(9) of the Companies Act, he may apply to a court of law for damages (or other compensation) for the loss of office as a director or for the loss of any other office as a consequence of being removed as a director.[50] Thus, where a company has appointed a director for a fixed period and that period has not expired at the time the director is removed from office, or the company has not agreed to compensate a director in the event of his removal from office, the affected director may claim damages (or other compensation) from the company.[51]

A director who has been removed from office by the board of directors may also rely on the oppression remedy in section 163 of the Companies Act if he is able to establish that his removal from office by the board of directors was oppressive, unfairly prejudicial or unfairly disregarded his interests.[52] In the event that a director has unlawfully suffered reputational damage as a result of his removal from office, or his attempted removal from office, he may,

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[48] Section 66(4)(*a*)(i) of the Companies Act makes provision for a company's Memorandum of Incorporation to provide for the direct appointment and removal of one or more directors by any person who is named in or determined in terms of the Memorandum of Incorporation.

[49] See chapter 4, para 4.1 and chapter 7, para 2 where s 71(5) is discussed.

[50] See chapter 7, para 3 where this remedy is discussed.

[51] *Southern Foundries (1926) Ltd v Shirlaw* [1940] AC 701; *Read v Astoria Garage* (*Streatham*) *Ltd* [1952] 2 All ER 292; *De Villiers v Jacobsdal Saltworks* (*Michaelis & De Villiers*) (*Pty*) *Ltd* 1959 (3) SA 873 (O); Blackman et al *Commentary on the Companies Act* 8-285.

[52] See chapter 7, para 4 where the oppression remedy is discussed.

under the common law, have a right to institute a delictual action for defamation against the board of directors.[53]

This thesis will examine the above remedies which may be relied on by a director who has been removed from office by the board of directors.[54] The remedies provided to directors who have been removed from office by the board of directors under the UK Companies Act of 2006 and the Australian Corporations Act of 2001 are compared with a view to ascertaining whether the remedies under the (South African) Companies Act may be improved and enhanced.

From the above it is clear that the key research questions to be answered in this thesis are:

- What is the extent and impact of the power given to the board of directors and to the courts to remove a director from office?

- What are the grounds and procedures under which a director may be removed from office under section 71(3) of the Companies Act, and how do they measure up to the equivalent provisions under the Australian Corporations Act of 2001, the UK Companies Act of 2006, the MBCA and the DGCL? Is there scope to strengthen and improve the provisions of South African company law on the removal of directors by the board of directors?

- Whether, and which, fiduciary duties of directors apply when the board removes a director from office under section 71(3) of the Companies Act, and what are the consequences of directors breaching their fiduciary duties in removing a director from office?

- What considerations must be taken into account when the board of directors removes from office a director who is also an employee of the company, or is a director who holds shares with loaded votes?

[53] See chapter 7, para 5 where the defamation action is discussed.

[54] See chapter 7 where these remedies are discussed.

- What are the grounds and procedures under which a director may be removed from office by a court under sections 71(6) and 162 of the Companies Act, and how do they measure up to the equivalent provisions under the Australian Corporations Act of 2001, the UK Companies Act of 2006, the MBCA and the DGCL? Is there scope to improve and enhance the provisions of South African company law on the removal of directors by the courts and what recommendations flow from the research?

- What remedies may be relied on by a former director who has been removed from office by the board of directors?

3. METHODOLOGY

This study involves a comparative analysis[55] of the South African legal provisions on the removal of directors with those contained in the UK, Australia and the USA.

The above jurisdictions have been selected for specific reasons. The provisions of the UK Companies Act of 2006 on the removal of directors will be discussed because South African company law is historically based on the English company law system and the company law in both these jurisdictions was recently reviewed.[56] Australian company law, which is

[55] Zweigert and Kötz define comparative law as "intellectual activity with law as its object and comparison as its process" (Zweigert & Kötz *An Introduction to Comparative Law* 2). There are two approaches to comparative law: a macro-comparison and a micro-comparison. A macro-comparison is a study of two or more entire legal systems (for example English law and Australian law) while a micro-comparison is a comparison of specific areas of law or aspects of two or more legal systems (for example, the fiduciary duties of directors) (Samuel *An Introduction to Comparative Law Theory and Method* 50; De Cruz *Comparative Law in a Changing World* 233). In undertaking a comparative legal methodology, one often has to undertake both a macro-comparison and a micro-comparison at the same time, that is, one has to study the procedures by which the rules are in fact applied in order to understand why a foreign system solves a particular problem in the way it does (Zweigert & Kötz *An Introduction to Comparative Law* 5). The object of comparative legal research is to decide which rule or principle is best (Harding & Őrűcű (eds) *Comparative Law in the 21st Century* xii). A comparative legal approach gives one the opportunity to stand back from one's own legal system and look at it more critically, and such an approach may also provide a warning of possible difficulties and may offer suggestions for further developments (Geoffrey Wilson "Comparative Legal Scholarship" in McConville and Chui *Research Methods for Law* 87).

[56] The reforms made to the UK Companies Act of 2006 are significant. The Company Law Review, which provides the essential blueprint for the UK Companies Act of 2006, was launched in March 1998, with the aim of modernising company law (see DTI Company Law Reform White Paper, Cm 6456, March 2005 at 3). The Company Law Reform White Paper sets out four crucial objectives of the company law reform. These are to enhance shareholder engagement and a long term investment culture; to ensure better regulation and a "think small first" approach to remove unnecessary burdens on small companies; to make it easier to set up and run a company and to provide flexibility for the future (DTI Company Law Reform White Paper, Cm 6456, March 2005 at 3). The UK Companies Act of 2006 repeals virtually the whole of the UK Companies Act of 1985. The new Act received Royal Assent on 8 November 2006, but the provisions of the new Act came into effect in stages (see

historically largely based on UK company law, will also be reviewed in order to ascertain whether any useful guidelines may be deduced which are relevant to South African law.[57]

Certain States in the USA have given the board of directors the power to remove directors, and it will accordingly be beneficial and informative to investigate the scope of such powers.[58] The State of Delaware is generally regarded as having the most developed corporate law in the USA and as being the most important corporate jurisdiction which serves as domicile to the majority of public companies in the USA,[59] and accordingly this study will examine the corporate law

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s 1300 of the UK Companies Act of 2006). The new Act is very lengthy, comprising 1 300 sections and 16 Schedules.

[57] The Australian Corporations Act of 2001 commenced on 15 July 2001. Before 1901 each of the Australian colonies had company legislation which was based on the UK Companies Act, 1862. When they ceased to be colonies in 1901 and became States they continued to be responsible for company legislation. Until 1961 each jurisdiction remained responsible for its own company legislation. Many of the basic ideas in the UK legislation persisted in each State's legislation but divergences developed in some States. By the end of the 1980s the Federal Government recognised that a national company law was needed in Australia. The Australian Corporations Act of 2001 is a federal statute which applies uniformly in Australia. There is no longer a separate company law which applies in each State (see Ford, Ramsay & O'Connor *Australian Corporations Legislation 2011* xi-xiii for a detailed discussion on the background to the Australian Corporations Act of 2001). While company law in Australia is historically based on the company law in the UK and strongly resembles UK company law in fundamental respects, present-day company law in Australia under the Australian Corporations Act of 2001 is less dependent on the company law in the UK (Bruner *Corporate Governance in the Common-Law World: The Political Foundations of Shareholder Power* 66; Austin & Ramsay *Ford, Austin and Ramsay's Principles of Corporations Law* para 1.020 at 2). Certain features of Australian company law take forms closely resembling corporate law in the USA. For example Australian company law has a business judgment rule which is modelled on USA law (s 180(2)). Section 198A(1) of the Australian Corporations Act of 2001, which provides that the "business of a company is to be managed by or under the direction of the directors", is worded similarly to s 8-01(b) of the MBCA (see Bruner *Corporate Governance in the Common-Law World: The Political Foundations of Shareholder Power* 66-77 for a detailed comparison of the Australian company law principles with those of the USA and the UK). The provisions on the removal of directors in the Australian Corporations Act of 2001 differ in some respects from the model adopted in the UK Companies Act of 2006. For instance, the Australian Corporations Act of 2001 confines the statutory right of shareholders to remove directors to public companies only (s 203D of the Australian Corporations Act of 2001). It does not permit directors of a public company to remove directors from office (see s 203E of the Australian Corporations Act of 2001). There is no Explanatory Memorandum to account for these variations (see further Austin & Ramsay *Ford, Austin and Ramsay's Principles of Corporations Law* para 7.240 at 289). These provisions are discussed in chapter 3 para 2.2. The Australian Corporations Act of 2001 is administered by a national regulatory authority, the Australian Securities and Investments Commission ("ASIC"), while the Australian Securities Exchange prescribes standards for companies listed on the Australian Stock Exchange.

[58] The USA has a federal system where federal law is enacted by the United States Congress while State law is enacted by individual State legislatures. Each State has its own legal system and judiciary which is separate from the federal system. Generally, State law provides for corporate law matters, which are regulated by the fifty States. There are in certain instances fundamental differences between the laws of the various States. Generally, the State where a corporation is incorporated governs the choice of law for matters relating to the internal affairs of the corporation (see Pinto "Corporate Governance: Monitoring the Board of Directors in American Corporations" 322; Bainbridge *Corporate Law* 10-11; Kershaw *Company Law in Context* 213 and Bruner *Corporate Governance in the Common-Law World: The Political Foundations of Shareholder Power* 37-38 where the federalised government in the USA is discussed further).

[59] Bebchuk "The Case for Increasing Shareholder Power" 844; Knight "The Removal of Public Company Directors in Australia: Time for Change?" 366; Bainbridge *Corporate Law* 9. Most public corporations in the

in Delaware on the removal of directors. However, corporate law in Delaware will not be the only focus of the consideration of USA corporate law on the removal of directors, and this study will further investigate the relevant legislation in selected other States which permit directors to remove a director from the board of directors.[60]

A comparative legal approach is appropriate for this investigation in order to assess how the South African legal provisions relating to the removal of company directors measure up against the equivalent provisions in the foreign jurisdictions considered, and to ascertain whether and how the South African legal provisions in this regard may be improved. This approach is reinforced by section 5(2) of the Companies Act which provides that, to the extent appropriate, a court interpreting or applying the Companies Act may consider foreign company law.[61] Besides, large portions of the Companies Act are derived from these foreign jurisdictions. In *Nedbank Ltd v Bestvest 153 (Pty) Ltd; Essa and Another v Bestvest 153 (Pty) Ltd and Others*[62] the High Court remarked that company law in South Africa has for many decades tracked the English system and taken its lead from the relevant English Companies Act and jurisprudence, but section 5(2) of our Companies Act now encourages our courts to look further afield and to have regard in appropriate circumstances to other corporate law jurisdictions (be they American, European, Asian or African) in interpreting the Companies Act.

Chapter 2 of this thesis explores the underpinning philosophy of the removal of directors from office. It examines the impact of the power given to the board of directors and to the courts to remove a director from office, and the extent to which the balance of powers between the shareholders and the directors has shifted from the balance of powers which prevailed under the Companies Act 61 of 1973.

USA that change their corporate domicile choose to reincorporate in Delaware (Cox & Hazen *Corporations* 35). Some reasons for this are because there is a large body of case law interpreting the DGCL, which provides certainty on corporate law matters; Delaware has a separate court devoted predominantly to corporate law cases (the Court of Chancery); the judiciary has much expertise and experience in corporate law matters, and the judges tend to render their decisions quite quickly (Cox & Hazen *Corporations* 139-140; Bainbridge *Corporate Law* 9).

[60] For instance the States of Ohio, Massachusetts and Indiana permit directors to remove a director from the board of directors. See chapter 3, para 2.4 for an evaluation and discussion of the removal of directors in these and other USA States.

[61] Section 39(1) of the Constitution provides that a court, tribunal or forum must consider international law and may consider foreign law, when interpreting the Bill of Rights.

[62] 2012 (5) SA 497 (WCC) para 26.

Chapter 3 examines the grounds for the removal of a director by the board of directors under section 71(3) of the Companies Act, as well as the procedures to remove a director. The chapter compares the grounds to remove a director and the procedures to do so under the (South African) Companies Act with the equivalent provisions under the UK Companies Act of 2006, the Australian Corporations Act of 2001, the MBCA, the DGCL and various other States of the USA.

The focus of chapter 4 is the fiduciary duties applicable to directors in removing a director from the board of directors. The leading decision in *Lee v Chou Wen Hsien*,[63] dealing with the fiduciary duties of directors in removing directors from office in the UK, is evaluated.

Chapter 5 discusses the removal from office of directors holding multiple positions or capacities in relation to a company. The removal of directors who are employees and shareholders holding loaded voting rights is discussed.

The judicial removal of directors is canvassed in chapter 6. This chapter examines sections 71(6) and 162 of the Companies Act. It explores the grounds under which a court may declare a director to be delinquent or place him under probation. This chapter further compares the judicial removal of directors under the (South African) Companies Act with the judicial removal of directors under the UK Company Directors Disqualification Act 1986, the Australian Corporations Act of 2001, the MBCA, the DGCL and various other States of the USA.

Chapter 7 examines the remedies which are available to a director who has been removed by the board of directors under the Companies Act. A comparison is made with the remedies available to directors who have been removed from office under the UK Companies Act of 2006 and the Australian Corporations Act of 2001.

Finally, chapter 8 draws some conclusions and makes recommendations on the removal of directors by the board of directors and the judiciary under the Companies Act, taking into

[63] [1984] 1 WLR 1202.

account developments in the foreign jurisdictions considered. Some amendments to the current legislation are proposed.

4. REFERENCE TECHNIQUES

For purposes of convenience, company directors will be referred to in this study in the masculine form and they will be assumed to include the feminine form. The same meaning should be denoted to the words "company" and "corporation".

Authorities are referred to in footnotes in an abbreviated form. The bibliography at the end of this thesis contains the full references of every cited source next to the abbreviated form used in the footnotes.

Authors are referred to in footnotes by reference to their surnames only, save that where there is a reference to more than one author with the same surname the initials of the respective authors are referred to.

The full citation of court cases is provided every time reference is made to the particular case. Court cases are cited in footnotes in chronological order rather than jurisdictional order. In the footnotes, the abbreviation "para" is used for "paragraph" and "s" is used for "section".

The law is stated as it was on 31 March 2018.

CHAPTER 2 REMOVAL OF DIRECTORS: PHILOSOPHICAL UNDERPINNINGS

1. INTRODUCTION

This chapter examines the division of powers between directors and shareholders. It explores the reason why shareholders have traditionally been given the right to remove directors from office. It then examines the extent and impact of the power given to the board of directors under the Companies Act to remove directors from office, and of the equivalent power given to courts. It is argued that the conferral of this power on the board of directors has shifted the balance of power and the dynamics between the directors and the shareholders. Some suggestions are made on how to moderate the shift in the balance of power between the shareholders and the directors. Finally, this chapter highlights some factors which the judiciary ought to consider before exercising its discretion to remove a director from office.

2. THE DIVISION OF POWERS BETWEEN DIRECTORS AND SHAREHOLDERS

The powers of a company are divided between the board of directors and the shareholders in a general meeting or a shareholders' meeting, and each organ has its own separate sphere of authority.[1] Until the end of the nineteenth century it was generally accepted that the general meeting was the personification of the company and the supreme organ of the company, and that the directors were simply its agents subject to the control of the company (i.e. shareholders) in general meeting.[2] Since the powers conferred upon the directors (as the agents) were thought of as having been conferred upon them by the shareholders (as the principals), it was deduced that the directors were subject to the control of the shareholders in general meeting.[3] The implication of this view was that the shareholders could at any time by ordinary resolution give the directors instructions on how they were to exercise their powers of management.[4]

This view of the superiority of the shareholders appears to be derived from the influence of elements of the law of partnership.[5] Historically, in 1837, there were two principal

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[1] *Automatic Self Cleansing Filter Syndicate Company Limited v Cuninghame* [1906] 2 Ch 34; *Gramophone and Typewriter Ltd v Stanley* [1908] 2 KB 89; *Salmon v Quin and Axtens Ltd* [1909] 1 Ch 311 (CA); *John Shaw & Sons (Salford) Ltd v Shaw* [1935] 2 KB 113 (CA) at 134; *Scott v Scott* [1943] 1 All ER 582; *Cape United Sick Fund Society and Others v Forrest and Others* 1956 (4) SA 519 (A); *Wessels & Smith v Vanugo Construction (Pty) Ltd* 1964 (1) SA 635 (O) at 637; *Van Tonder v Pienaar* 1982 (2) SA 336 (SE) at 341; *Breckland Group Holdings Ltd v London and Suffolk Properties Ltd and Others* [1989] BCLC 100; *Ben-Tovim v Ben-Tovim and Others* 2001 (3) SA 1074 (C) at 1085-1086; *Massey and Another v Wales and Others* (2003) 177 FLR 1 at 12; Goldberg "Article 80 of Table A of the Companies Act, 1948" 177; Blackman "Article 59 and the Distribution of Powers in a Company" 286; Sullivan "The Relationship between the Board of Directors and the General Meeting in Limited Companies" 569; Pretorius et al *Hahlo's South African Company Law through the Cases* 207 and 336; Cilliers & Benade *Corporate Law* 85; Mongalo "The Emergence of Corporate Governance as a Fundamental Research Topic in South Africa" 180-186; Bainbridge *Corporate Law* 72-75; Blackman et al *Commentary on the Companies Act* 7-13, 7-15 and 7-20-2–7-25; R Cassim "Governance and Shareholders" in FHI Cassim et al *Contemporary Company Law* 355; Austin & Ramsay *Ford, Austin and Ramsay's Principles of Corporations Law* para 7.061 at 238 and para 7.070 at 241; Hannigan *Company Law* 183-186; Esser & Delport "Shareholder Protection Philosophy in terms of the Companies Act 71 of 2008" 8-10.

[2] *Isle of Wight Railway Co v Tahourdin* (1883) 25 ChD 320 (CA); Cilliers & Benade *Corporate Law* 85; Blackman et al *Commentary on the Companies Act* 7-14; Keay "Company Directors Behaving Poorly: Disciplinary Options for Shareholders" 657; Davies & Worthington *Gower Principles of Modern Company Law* 358.

[3] Aickin "Division of Power between Directors and General Meeting as a Matter of Law, and as a Matter of Fact and Policy" 449; Blackman et al *Commentary on the Companies Act* 7-14.

[4] Davies & Worthington *Gower Principles of Modern Company Law* 358-359.

[5] Aickin "Division of Power between Directors and General Meeting as a Matter of Law, and as a Matter of Fact and Policy" 449.

vehicles used to conduct businesses on a large scale – the corporation and the joint stock company.[6] The corporation existed in terms of a Royal Charter[7] or an Act of Parliament[8] and had a separate legal existence, while the joint stock company was simply a large partnership and did not enjoy a separate legal existence.[9] Joint stock companies were the more important vehicle and courts applied the principles of partnership in regulating them.[10] The application of partnership principles to joint stock companies, however, posed difficulties because typical joint stock companies had hundreds of members, and it was clear that there was no personal relationship between the members, as is the case in a partnership.[11] In order to address these problems the Joint Stock Companies Act of 1844[12] was enacted. This was the first Companies Act to provide for incorporation by registration, and it empowered the Registrar of Joint Stock Companies to incorporate a company whose documents were registered with him.[13] This Act limited the size of partnerships, thus forcing large joint stock ventures to adopt a corporate form.[14] Nevertheless, courts continued to invoke partnership principles to resolve company law matters and a company was still regarded as a peculiar kind of partnership.[15] The status

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[6] See Grantham "The Doctrinal Basis of the Rights of Company Shareholders" 557 where these two vehicles are discussed.

[7] Companies incorporated by a Royal Charter were known as "chartered companies." The members contributed capital to form the companies "joint stock" which was then managed by governors or directors appointed by the members (see French, Mayson & Ryan *Mayson, French & Ryan on Company Law* 7) (a new edition of this work has been published but it was not available to me at the time of writing this thesis).

[8] Parliament could create a body corporate by an enactment which referred specifically to that body corporate (French, Mayson & Ryan *Mayson, French & Ryan on Company Law* 7).

[9] Grantham "The Doctrinal Basis of the Rights of Company Shareholders" 557-558; French, Mayson & Ryan *Mayson, French & Ryan on Company Law* 7.

[10] Grantham "The Doctrinal Basis of the Rights of Company Shareholders" 558.

[11] Grantham "The Doctrinal Basis of the Rights of Company Shareholders" 558.

[12] 7 & 8 Vict. c.110.

[13] Kershaw *Company Law in Context* 489. Registration took place in two stages, a provisional registration and a complete registration. The system was revised by the Joint Stock Companies Act of 1856 which introduced a single stage registration system (see French, Mayson & Ryan *Mayson, French & Ryan on Company Law* 8).

[14] Grantham "The Doctrinal Basis of the Rights of Company Shareholders" 558.

[15] See for example *Re Yenidje Tobacco Ltd* [1916] 2 Ch 426 (CA) where the UK Court of Appeal, in deciding whether it was just and equitable that a private company be wound up, decided the matter on the basis of the principles which apply to a partnership. The court rationalised its approach on the ground that the company was in substance a partnership in the guise of a private company (at 431-432). See further

of shareholders in company law at the time was that they were the ultimate proprietor of the company, and they had the right to manage the company and to have the company run for their exclusive benefit.[16]

The superiority of the shareholders was enunciated in one of the first cases dealing with the relative positions of the general meeting and the directors, namely *Isle of Wight Railway Co v Tahourdin*.[17] In this case the directors called a shareholders' meeting on a requisition by the shareholders, but the notice of the meeting issued by the directors did not provide for all the objects of the requisitionists. The requisitionists notified the directors that they would not attend the shareholders' meeting called by the directors, and subsequently issued a notice calling their own meeting. The directors applied for an injunction restraining the requisitionists from calling their own meeting. The court *a quo* granted the injunction but the UK Court of Appeal reversed the decision, and discharged the injunction. The UK Court of Appeal, per Cotton LJ, proclaimed that the company's shareholders in general meeting "undoubtedly [had] a power to direct and control the board in the management of the affairs of the company."[18]

Isle of Wight Railway Co v Tahourdin[19] concerned a company established by an Act of Parliament and subject to the provisions of the Companies Clauses Consolidation Act of 1845. Section 90 of that Act provided that the directors had powers of management and superintendence of the affairs of the company and that the exercise of such powers was subject to the control and regulation of any general meeting specially convened.[20] It follows that the above quoted statement by Cotton LJ was a reference not to the powers of the general meeting in general but a reference to the powers of control expressly

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Hill "Visions and Revisions of the Shareholder" 42-43 for a discussion of the partnership model of the corporation in the nineteenth century.

[16] Grantham "The Doctrinal Basis of the Rights of Company Shareholders" 559; Hill "Visions and Revisions of the Shareholder" 42-43. See further Sealy "Directors' 'Wider' Responsibilities – Problems Conceptual, Practical and Procedural" 165.

[17] (1883) 25 ChD 320 (CA).

[18] *Isle of Wight Railway Co v Tahourdin* (1883) 25 ChD 320 (CA) at 331-332.

[19] (1883) 25 ChD 320 (CA).

[20] See further *Automatic Self Cleansing Filter Syndicate Company Limited v Cuninghame* [1906] 2 Ch 34 at 46 where the Chancery Division discussed s 90 of the Companies Clauses Consolidation Act of 1845.

conferred on the shareholders by the Companies Clauses Consolidation Act of 1845. Nevertheless, on the strength of *Isle of Wight Railway Co v Tahourdin*[21] the view was held that in relation to all companies, including those incorporated under the then Companies Act of 1862, the position was the same as that prevailing under the Company Clauses Consolidation Act of 1845 and that a company in general meeting had the power to direct and control the board of directors in relation to the conduct of the company's affairs.[22]

After the nineteenth century, however, there was a fundamental shift in the perception of the relationship between the general meeting and the directors. The notion that shareholders had the right to override decisions of management or that the company was conducted for the exclusive benefit of the shareholders was rejected.[23] The general rule developed into one which provided that, unless expressly empowered to do so by the constitution of the company, the shareholders in general meeting could not control the directors' exercise of their powers, nor exercise the powers conferred on the directors.[24] Insofar as *Isle of Wight Railway Co v Tahourdin*[25] held that the directors are bound by the instructions of the shareholders' meeting in carrying out their functions, this case was no longer regarded as good law.[26]

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[21] (1883) 25 ChD 320 (CA).

[22] See Aickin "Division of Power between Directors and General Meeting as a Matter of Law, and as a Matter of Fact and Policy" 451.

[23] See Grantham "The Doctrinal Basis of the Rights of Company Shareholders" 560-578 where the gradual attenuation of the rights of shareholders is traced in detail.

[24] *Automatic Self Cleansing Filter Syndicate Company Limited v Cuninghame* [1906] 2 Ch 34; *Gramophone and Typewriter Ltd v Stanley* [1908] 2 KB 89; *Salmon v Quin and Axtens Ltd* [1909] 1 Ch 311 (CA); *John Shaw & Sons (Salford) Ltd v Shaw* [1935] 2 KB 113 (CA) at 134; *Scott v Scott* [1943] 1 All ER 582; *Breckland Group Holdings Ltd v London and Suffolk Properties Ltd and Others* [1989] BCLC 100; Goldberg "Article 80 of Table A of the Companies Act, 1948" 177; Blackman "Article 59 and the Distribution of Powers in a Company" 286; Sullivan "The Relationship between the Board of Directors and the General Meeting in Limited Companies" 569; Blackman et al *Commentary on the Companies Act* 7-15 and 7-20-2–7-25.

[25] (1883) 25 ChD 320 (CA).

[26] See Cilliers & Benade *Corporate Law* 85 and Pretorius et al *Hahlo's South African Company Law through the Cases* 212.

In the seminal case of *Automatic Self Cleansing Filter Syndicate Company Limited v Cuninghame*[27] the question before the UK Court of Appeal was whether the shareholders in a shareholders' meeting had the power to direct the course of action to be pursued by the directors (that is, that certain assets of the company be sold) or whether the directors could refuse to do what the shareholders in a shareholders' meeting directed them to do. The constitution of Automatic Self-Cleansing Filter Syndicate Company Limited empowered the company to sell its undertaking to another company having similar objects. The directors of the company were empowered to sell or otherwise deal with any of the company's property on such terms as they might think fit. A resolution was passed by the shareholders of the company for the sale of the company's assets on certain terms to a new company formed for the purpose of acquiring such assets, and directing the directors to carry the sale into effect. The directors were of the opinion that the sale of the company's assets on the proposed terms would not benefit the company. The directors accordingly refused to carry the sale into effect. The UK Court of Appeal held that, on the construction of the constitution of the company, which provided that the management of the business and control of the company were to be vested in the directors, the directors could not be compelled to comply with the resolution of the shareholders.[28] The UK Court of Appeal distinguished this case from *Isle of Wight Railway Co v Tahourdin*[29] on the basis that the Companies Clauses Act of 1845 was not applicable to the case before it and it was therefore not bound by the dictum of *Isle of Wight Railway Co v Tahourdin*.[30] The court emphatically rejected the notion that directors are merely agents of the general meeting, susceptible to direction by the general meeting on any matter.[31]

In *Gramophone and Typewriter Ltd v Stanley*[32] the UK Court of Appeal approved the dictum in *Automatic Self Cleansing Filter Syndicate Company Limited v Cuninghame*[33]

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[27] [1906] 2 Ch 34.

[28] *Automatic Self Cleansing Filter Syndicate Company Limited v Cuninghame* [1906] 2 Ch 34 at 45.

[29] (1883) 25 ChD 320 (CA).

[30] (1883) 25 ChD 320 (CA). See *Automatic Self Cleansing Filter Syndicate Company Limited v Cuninghame* [1906] 2 Ch 34 at 46.

[31] *Automatic Self Cleansing Filter Syndicate Company Limited v Cuninghame* [1906] 2 Ch 34 at 42-43.

[32] [1908] 2 KB 89 at 98.

[33] [1906] 2 Ch 34.

and asserted that shareholders cannot, even by a majority at a general meeting, interfere with the exercise of powers placed in the hands of the directors by the constitution of the company. Buckley LJ stressed that directors are not servants to obey directions given by the shareholders and they are not agents appointed by and bound to serve the shareholders as their principals.[34] Instead, Buckley LJ proclaimed that directors are persons who may by the regulations be entrusted with the control of the business and who may be disposed of that control only by the alteration of the company's constitution.[35]

Despite these authorities the matter was not fully settled. In *Marshall's Valve Gear Co v Manning, Wardle & Co Ltd*[36] a different view was adopted. The Chancery Division, per Neville J, asserted that the prevailing principle was that, in the absence of any contract to the contrary, the majority of the shareholders in a company had the ultimate control of its affairs and could assert their rights in a shareholders' meeting.[37] In spite of this judgment, the UK Court of Appeal in *Salmon v Quin and Axtens Ltd*[38] reverted to its previously held position and adopted the mainstream view enunciated in *Gramophone and Typewriter Ltd v Stanley*[39] that directors are persons who may by the regulations be entrusted with the control of the business and who may be disposed of that control only by the alteration of the company's constitution. The UK Court of Appeal in *Salmon v Quin and Axtens Ltd*[40] opined that any other construction would be disastrous because it "might lead to an interference by a bare majority very inimical to the interests of the minority who had come into the company on the footing that the business should be managed by the board of directors." The dictum of *Marshall's Valve Gear Co v Manning, Wardle & Co Ltd*[41] was not referred to in *Salmon v Quin and Axtens Ltd*[42] but counsel for the plaintiff

[34] *Gramophone and Typewriter Ltd v Stanley* [1908] 2 KB 89 at 105-106.

[35] *Gramophone and Typewriter Ltd v Stanley* [1908] 2 KB 89 at 106.

[36] [1909] 78 LJ Ch 46.

[37] *Marshall's Valve Gear Co v Manning, Wardle & Co Ltd* [1909] 78 LJ Ch 46 at 49.

[38] [1909] 1 Ch 311 (CA) at 319.

[39] [1908] 2 KB 89 at 106.

[40] [1909] 1 Ch 311 (CA) at 319-320.

[41] [1909] 78 LJ Ch 46.

[42] [1909] 1 Ch 311 (CA).

criticised this latter decision as being inconsistent with the principles established in *Automatic Self Cleansing Filter Syndicate Company Limited v Cuninghame*[43] and *Gramophone and Typewriter Ltd v Stanley*.[44]

Thereafter the relationship between the board of directors and the general meeting was regarded as having been settled by the UK Court of Appeal.[45] The relationship between directors and shareholders is succinctly described by the UK Court of Appeal in *John Shaw & Sons (Salford) Ltd v Shaw*[46] as follows:

> "A company is an entity distinct alike from its shareholders and its directors. Some of its powers may, according to its articles, be exercised by directors; certain other powers may be reserved for the shareholders in a shareholders' meeting. If powers of management are vested in the directors, they and they alone can exercise these powers. The only way in which the general body of the shareholders can control the exercise of the powers vested by the articles in the directors is by altering their articles or, if opportunity arises under the articles, by refusing to re-elect the directors of whose actions they disapprove. They cannot themselves usurp the powers which by the articles are vested in the directors any more than the directors can usurp the powers vested in the articles in the general body of shareholders."

In *Scott v Scott*[47] the Chancery Division found that the division of authority between the shareholders and directors is important even in the case of family companies. The court found that a resolution of shareholders purporting to interfere with the management of directors was invalid.[48] The Privy Council emphasised in *Howard Smith Ltd v Ampol*

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[43] [1906] 2 Ch 34.

[44] [1908] 2 KB 89. See *Salmon v Quin and Axtens Ltd* [1909] 1 Ch 311 (CA) at 315.

[45] See Aickin "Division of Power between Directors and General Meeting as a Matter of Law, and as a Matter of Fact and Policy" 458.

[46] [1935] 2 KB 113 (CA) at 134. See *James North (Zimbabwe) (Pvt) Ltd v Mattinson* 1990 (2) SA 229 (ZHC) at 237 where the Zimbabwe High Court approved of this dictum.

[47] [1943] 1 All ER 582.

[48] See *Scott v Scott* [1943] 1 All ER 582 at 584-585. By passing ordinary resolutions the majority shareholders attempted to declare interim dividends and have the company's financial affairs investigated by outside auditors. The court held that the resolutions were invalid on the basis that they were attempts by the company in general meeting to usurp the powers of the financial direction of the company, which under the articles rested solely in the hands of the directors. For an analysis of the relationship between the board of directors and the general meeting and a defence of the dictum in *Marshall's Valve Gear Co v Manning, Wardle & Co Ltd* [1909] 78 LJ Ch 46 see Goldberg "Article 80 of Table A of the Companies Act, 1948" 177 and Sullivan "The Relationship between the Board of Directors and the General Meeting in Limited Companies" 569. See also Blackman "Article 59 and the Distribution of Powers in a Company" for a further analysis of the distribution of powers in a company.

Petroleum Ltd[49] that the majority of shareholders cannot control directors in the exercise of their management powers while they remain in office. In *Breckland Group Holdings Ltd v London and Suffolk Properties Ltd and Others*[50] the Chancery Division proclaimed that the jurisdiction to conduct the business of the company was vested in the board of directors, and that the shareholders in a shareholders' meeting could not intervene.

With regard to the distribution of power between the board of directors and the shareholders South African law has been influenced by the position adopted by the UK courts. For instance, with regard to a friendly association with legal personality under common law, the Appellate Division in *Cape United Sick Fund Society and Others v Forrest and Others*[51] approved and applied the principle of the division of powers between managing bodies and a meeting of members. The Appellate Division further approved of the principles established in *Salmon v Quin and Axtens Ltd*[52] and *John Shaw & Sons (Salford) Ltd v Shaw*.[53] In *Wessels & Smith v Vanugo Construction (Pty) Ltd*[54] the court stated, with reference to and with approval of *Scott v Scott*,[55] that it has already been held that an article in the constitution of a company which provided that the business of the company shall be managed by the directors, entailed that the entire management of the company rests solely in the hands of the directors. The court consequently asserted

[49] [1974] AC 821 (PC) at 837.

[50] [1989] BCLC 100 at 106.

[51] 1956 (4) SA 519 (A). The members of the Cape United Sick Fund Society had requested the board of management of the society to convene a special general meeting to consider certain resolutions which had the effect of conferring power on a body other than the board of management, of empowering a body other than the board of management to obtain legal advice, and of suspending the payment of *honoraria* to members of the board of management. The board of management refused to convene such a meeting. The members of the society issued a declaration claiming an order directing the board to convene such a meeting or alternatively authorising the members to call the meeting in the name of the society. The society and the members of the board excepted to the declaration as disclosing no cause of action in that under the society's constitution it would not be competent for the special general meeting to pass the proposed resolution, or, if the resolutions were passed, they would have no force or effect. The Appellate Division held that all the resolutions proposed to be moved would be *ultra vires* the constitution of the society, and that the board was accordingly entitled to refuse to convene the meeting.

[52] [1909] 1 Ch 311 (CA) at 319.

[53] [1935] 2 KB 113 (CA) at 134. See *Cape United Sick Fund Society and Others v Forrest and Others* 1956 (4) SA 519 (A) at 540.

[54] 1964 (1) SA 635 (O) at 637.

[55] [1943] 1 All ER 582.

that any resolution by the company in a shareholders' meeting purporting to interfere with this management, was invalid.[56] In *Van Tonder v Pienaar*[57] the court relied on and agreed with *John Shaw & Sons (Salford) Ltd v Shaw*[58] that if powers of management are vested in the directors they and they alone can exercise them.

More recently, in *LSA UK Ltd (formerly Curtainz Ltd) and Others v Impala Platinum Holdings Ltd and Others*[59] the Supreme Court of Appeal approved of the general position enunciated in *John Shaw & Sons (Salford) Ltd v Shaw*.[60] The court reiterated that the board of directors and the general meeting are both organs of the company, each having its own original powers, and that the directors do not receive their powers as agents of the company.[61] Accordingly, the court reasoned, in the absence of a contrary provision in the constitution of the company, even a unanimous general meeting may not supersede the directors' powers.[62] The Supreme Court of Appeal remarked that it is possible for the board and the general meeting to have concurrent powers, but opined that courts are disinclined to treat managerial and executive powers as concurrent and, unless the constitution provides otherwise, they are exercisable exclusively by the directors.[63] In *Ben-Tovim v Ben-Tovim and Others*[64] on the issue of the division of powers between the board of directors and the shareholders, the court acknowledged that the "pendulum of the division of powers between the general meeting and the board of directors has through the years swung from the general meeting as the supreme organ to prominence of the articles of association."

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[56] *Wessels & Smith v Vanugo Construction (Pty) Ltd* 1964 (1) SA 635 (O) at 637.

[57] 1982 (2) SA 336 (SE) at 341.

[58] [1935] 2 KB 113 (CA) at 134.

[59] 2000 JDR 0187 (SCA).

[60] [1935] 2 KB 113 (CA) at 134.

[61] *LSA UK Ltd (formerly Curtainz Ltd) and Others v Impala Platinum Holdings Ltd and Others* 2000 JDR 0187 (SCA) at 38.

[62] *LSA UK Ltd (formerly Curtainz Ltd) and Others v Impala Platinum Holdings Ltd and Others* 2000 JDR 0187 (SCA) at 38.

[63] *LSA UK Ltd (formerly Curtainz Ltd) and Others v Impala Platinum Holdings Ltd and Others* 2000 JDR 0187 (SCA) at 38.

[64] 2001 (3) SA 1074 at 1085-1086.

Under the (South African) Companies Act 46 of 1926[65] and the Companies Act 61 of 1973 directors did not have original powers and their power had to be delegated to them by the shareholders in the then articles of association of the company. A typical provision in the articles of association under the Companies Act 61 of 1973 was to the effect of Article 59 of the Table A (Articles for a public company having a share capital) or Article 60 of Table B (Articles for a private company having a share capital) which stated as follows:

> "The business of the company shall be managed by the directors who may pay all expenses incurred in promoting and incorporating the company, and may exercise all such powers of the company as are not by the Act, or by these articles, required to be exercised by the company in general meeting, subject to these articles, to the provisions of the Act, and to such regulations, not inconsistent with the aforesaid articles or provisions, as may be prescribed by the company in general meeting, but no regulation prescribed by the company in general meeting shall invalidate any prior act of the directors which would have been valid if such regulation had not been made."

From the above article it is evident that under the Companies Act 61 of 1973 the power to manage the company's affairs had to be delegated to the board of directors by the shareholders in general meeting or by the articles of association of the company. If no powers were granted to the board of directors through the articles of association the board would be powerless to act and the company could act only through its shareholders.[66] The shareholders thus empowered the board of directors.[67]

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[65] See Article 83 of Table A (Regulations for Management of a Company Limited by Shares) contained in Schedule 1 of the Companies Act 46 of 1926. A company limited by shares was a company which had the liability of its members limited by the memorandum of association to the amount (if any) unpaid on the shares respectively held by them (s 5(a) of the Companies Act 46 of 1926). The model articles in Table A could also have been adopted by companies limited by guarantee (being associations formed for purposes not for gain) and by unlimited companies (which were companies which did not have any limit on the liability of its members) (s 5 of the Companies Act 46 of 1926). Article 83 of Table A of the Companies Act 46 of 1926 was worded very similarly to Article 59 of Table A and Article 60 of Table B of the Companies Act 61 of 1973. See further Henochsberg *Henochsberg on the Companies Act* 482; Cilliers & Benade *Corporate Law* 86; Pretorius et al *Hahlo's South African Company Law through the Cases* 207 and 336; Kunst, Delport & Vorster *Henochsberg on the Companies Act* 327; Delport *Henochsberg on the Companies Act 71 of 2008* 250(3) and Havenga "Directors' Exploitation of Corporate Opportunities and the Companies Act 71 of 2008" 262.

[66] See Kershaw *Company Law in Context* 191-192.

[67] Kershaw *Company Law in Context* 192.

Section 66(1) of the Companies Act has now firmly swung the pendulum towards the board of directors as the supreme organ of the company. The section represents a fundamental change in the philosophy and approach of the balance of power between the directors and shareholders. The section provides as follows:

> "The business and affairs of a company must be managed by or under the direction of its board, which has the authority to exercise all of the powers and perform any of the functions of the company, except to the extent that this Act or the company's Memorandum of Incorporation provides otherwise."[68]

With the enactment of section 66(1) of the Companies Act original power to manage the business and affairs of the company has, for the first time, been given to the board of directors by statute. The power of the directors is now original and is no longer a power delegated by the shareholders through the constitution of the company.[69] As the Western Cape High Court in *Pretorius v PB Meat (Pty) Ltd*,[70] *Navigator Property Investments (Pty) Ltd v Silver Lakes Crossing Shopping Centre (Pty) Ltd and Others*[71] and *Kaimowitz v Delahunt and Others*[72] affirmed, in terms of the Companies Act, the ultimate power in a company is now with the board of directors, and not with the shareholders (unless otherwise provided in the Companies Act or the Memorandum of Incorporation of the company). Since the board's power is derived from statute and not the constitution of the

[68] In large companies it would not be practically possible for the directors to manage every aspect of the day-to-day business of the company and some management powers would most likely be delegated by the board of directors. For this reason the words "be managed by or under the direction of its board" have been inserted in s 66(1) of the Companies Act and in other equivalent provisions in foreign jurisdictions. See for example s 198A of the Australian Corporations Act of 2001, s 8-01(b) of the MBCA and s 141(a) of the DGCL, which all incorporate the phrase "under the direction of" the board of directors. See further *AWA Ltd v Daniels t/a Deloitte Haskins & Sells and Others* (1992) 7 ACSR 759 at 865-866 and Cilliers & Benade *Corporate Law* 137.

[69] See further on s 66(1) of the Companies Act *Kaimowitz v Delahunt and Others* 2017 (3) SA 201 (WCC) paras 12-13; Delport *Henochsberg on the Companies Act 71 of 2008* 250(1)-262(5); Havenga "Directors' Exploitation of Corporate Opportunities and the Companies Act 71 of 2008" 262; Delport *New Entrepreneurial Law* 103-104; Esser & Delport "Shareholder Protection Philosophy in terms of the Companies Act 71 of 2008" 8-10; Esser & Havenga "Directors and Other Officers" in Loubser & Mahony *Company Secretarial Practice* 8-2 and JS Oosthuizen & Delport "Rectification of the Securities Register of a Company and the Oppression Remedy" 244.

[70] (1057/2013) [2013] ZAWCHC 89 para 25.

[71] [2014] JOL 32101 (WCC) para 31.

[72] 2017 (3) SA 201 (WCC) para 12.

company, as was previously the case, it is now to a lesser extent subject to shareholder control.[73]

The UK Companies Act of 2006 does not contain a provision conferring management power or decision-making power on the board of directors. Instead, it is left to the constitution of the company to determine the distribution of decision-making power between the board of directors and the shareholders.[74] In terms of Article 3 of the Model Articles for Private Companies Limited by Shares and Article 3 of the Model Articles for Public Companies, subject to the articles, the directors are responsible for the management of the company's business, for which purpose they may exercise all the powers of the company. Article 4 confers on shareholders the power to direct the board of directors what to do or what to refrain from doing by passing a special resolution. The regulation of the internal affairs of the company in UK company law whereby the company regulates its internal affairs by means of rules laid down in the company's constitution is known as the contractarian model or as "English model companies" or as "memorandum and articles" model of companies.[75] The constitution of this type of corporation is regarded as a contract among all of the shareholders and the company itself.[76] The fact that it is left to the articles of association to determine the distribution of decision-making power between the board of directors and the shareholders, indicates

[73] Havenga "Directors' Exploitation of Corporate Opportunities and the Companies Act 71 of 2008" 262. In *Mbethe v United Manganese of Kalahari (Pty) Ltd* 2016 (5) SA 414 (GJ) para 62 in the context of a discussion on the derivative action, the court remarked that a company derives its power to commence litigation from s 66(1) of the Companies Act. The court commented that the power conferred on the board of directors by s 66(1) to manage the business and affairs of a company includes the power to decide whether to embark upon litigation.

[74] See Articles 3 and 4 of the Model Articles for Private Companies Limited by Shares and the Model Articles for Public Companies, found in Schedules 1 and 3 respectively of the Companies (Model Articles) Regulations 2008 (which came into force on 1 October 2009). The Model Articles automatically form the articles of association for companies formed under the UK Companies Act of 2006 which, on their formation, either do not register their own articles of association with the Registrar of Companies under that Act, or, if articles are registered, they do not exclude or modify the Model Articles in whole or in part (see s 20 of the UK Companies Act of 2006).

[75] Welling, Smith & Rotman *Canadian Corporate Law: Cases, Notes & Materials* 114; Kershaw *Company Law in Context* 85-93; JS Oosthuizen & Delport "Rectification of the Securities Register of a Company and the Oppression Remedy" 232-233.

[76] See s 33(1) of the UK Companies Act of 2006 which states that the provisions of a company's constitution bind the company and its members to the same extent as if they were covenants on the part of the company and of each member to observe those provisions. See further Welling, Smith & Rotman 115; Davies & Worthington 65 and Bruner *Corporate Governance in the Common-Law World: The Political Foundations of Shareholder Power* 35-36.

that in the UK the originating power of the company lies with the shareholders acting in general meeting, and not with the directors, and it is, accordingly, a shareholder-centric approach.[77] The directors are not given managerial powers by the statute but such powers must come from the shareholders by way of a delegation of authority.[78] The shareholders may alter the initial distribution of power which was delegated to the board of directors by the articles of association by passing a special resolution to amend the articles of association.[79] This swings the balance of power in the UK in favour of the shareholders, rather than with the board of directors.

The (South African) Companies Act has clearly moved away from the approach adopted in the Companies Act 61 of 1973 and in the UK regarding the distribution of power to the board of directors. It follows the approach adopted in the USA. A long standing principle of corporate law in the USA is that the power to manage the company is conferred on the board of directors by statute. Section 8-01(b) of the MBCA[80] states that corporate powers are exercised by or under the authority of the board of directors and that the business and affairs of the corporation are managed by or under the direction of its board of directors. This approach is director-centric and is known as the division of powers model because the statute expressly divides powers between shareholders and directors.[81] This approach does however retain flexibility in respect of the constitution in

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[77] Cools "The Real Difference in Corporate Law between the United States and Continental Europe: Distribution of Powers" 738-739; Kershaw *Company Law in Context* 191; Bruner *Corporate Governance in the Common-Law World: The Political Foundations of Shareholder Power* 32; JS Oosthuizen & Delport "Rectification of the Securities Register of a Company and the Oppression Remedy" 232-233.

[78] Welling, Smith & Rotman *Canadian Corporate Law: Cases, Notes & Materials* 114-115; Kershaw *Company Law in Context* 191-192; Bruner *Corporate Governance in the Common-Law World: The Political Foundations of Shareholder Power* 36.

[79] See s 21 of the UK Companies Act of 2006, which states that a company may amend its articles of association by special resolution.

[80] Refer to para 2.1 of chapter 1 where the "MBCA" is defined. Section 8.01(b) of the MBCA states as follows: "Except as may be provided in an agreement authorized under section 7.32, and subject to any limitation in the articles of incorporation permitted by section 2.02(b), all corporate powers shall be exercised by or under the authority of the board of directors, and the business and affairs of the corporation shall be managed by or under the direction, and subject to the oversight, of the board of directors."

[81] See Welling, Smith & Rotman *Canadian Corporate Law: Cases, Notes & Materials* 116-117; Bruner *Corporate Governance in the Common-Law World: The Political Foundations of Shareholder Power* 36-65 and Davies & Worthington *Gower Principles of Modern Company Law* 59 for a further discussion of this model.

that default rules may be changed by the company's constitution.[82] Likewise, section 141(a) of the DGCL[83] states that the business and affairs of every corporation shall be managed by or under the direction of a board of directors (except as otherwise provided in its certificate of incorporation). In *Aronson v Lewis*[84] the Supreme Court of Delaware emphasised that a cardinal precept of the DGCL is that directors, rather than shareholders, manage the business and affairs of the corporation.

Under the Australian Corporations Act of 2001 the management of the business of a company is a matter for the company's directors, and shareholders do not possess the power to make management decisions.[85] Section 198A(1) of the Australian Corporations Act of 2001 states that the "business of a company is to be managed by or under the direction of the directors."[86] It should be noted however that section 198A is a replaceable rule, meaning that it may be ousted or modified by the constitution of the company.[87] In

[82] The default rules may be changed in terms of an agreement authorised under s 7.32 of the MBCA or in terms of any limitation in the articles of incorporation permitted by s 2.02(b) of the MBCA. Section 7.32 of the MBCA deals with shareholder agreements and permits such an agreement to restrict the discretion or powers of the board of directors. In terms of s 2.02(b)(iii) of the MBCA the articles of incorporation may set forth provisions not inconsistent with the law regarding defining, limiting, and regulating the powers of the corporation, its board of directors and shareholders.

[83] Refer to para 2.1 of chapter 1 where the "DGCL" is defined. Section 141(a) of the DGCL states as follows: "The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation. If any such provision is made in the certificate of incorporation, the powers and duties conferred or imposed upon the board of directors by this chapter shall be exercised or performed to such extent and by such person or persons as shall be provided in the charter."

[84] 473 A.2d 805 (1984) at 811.

[85] The Court of Appeals of New South Wales in *Massey and Another v Wales and Others* (2003) 177 FLR 1 at 12 proclaimed that where the constitution of a company provides that the business of the company is to be managed by the directors, the general meeting generally has no power to make management decisions or to control or direct the board of directors in the management of the company.

[86] Despite the presence of s 198A(1) in the Australian Corporations Act of 2001, this statute is shareholder-centric to a large degree, as is the position under the company law in the UK, on which Australian company law is historically rooted (for a further discussion of the approach adopted in Australia see Bruner *Corporate Governance in the Common-Law World: The Political Foundations of Shareholder Power* 66-77; Austin & Ramsay *Ford, Austin and Ramsay's Principles of Corporations Law* para 1.020 at 1-2 and chapter 1, note 57).

[87] See s 135 of the Australian Corporations Act of 2001 on replaceable rules. In terms of s 135(2) a provision of a section or subsection that applies to a company as a replaceable rule may be displaced or modified by the company's constitution. A company's constitution and any replaceable rules that apply to the company have effect as a contract between the company and each member, between the company and each director and company secretary, and between a member and each other member, under which each person agrees to observe and perform the constitution and rules insofar as they apply to that person (s 140(1) of the Australian Corporations Act of 2001). A failure to comply with the replaceable rules as

terms of section 198A(2) of the Australian Corporations Act of 2001 the powers of the directors may be curtailed by the Australian Corporations Act of 2001 or by the company's constitution.[88]

In accordance with the approach adopted under section 8.01(b) of the MBCA and section 198A(2) of the Australian Corporations Act of 2001, the powers given to directors by section 66(1) of the (South African) Companies Act may be curtailed by the Companies Act or by the Memorandum of Incorporation of the company. The Memorandum of Incorporation may be amended by the shareholders by means of a special resolution or by means of any different requirements set out in the Memorandum of Incorporation.[89] The shareholders are thus not without power but are able to curtail the powers of the board of directors in the Memorandum of Incorporation and to amend it by means of a special resolution or by complying with any other requirements set out in the Memorandum of Incorporation regarding its amendment. There are, however, limitations to the exercise of this power by the shareholders in that (i) a special resolution to amend the Memorandum of Incorporation must be proposed by shareholders entitled to exercise at least ten per cent of the voting rights that may be exercised on the resolution;[90] (ii) the threshold for passing a special resolution may be increased in terms of section 65(10) of the Companies Act;[91] and (iii) in terms of section 16(2) of the Companies Act more onerous requirements to amend a company's Memorandum of Incorporation may be specified in the Memorandum of Incorporation than that specified in section 16(1)(*c*)(i).

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they apply to a company is not of itself a contravention of the Australian Corporations Act of 2001 (s 135(3)). Section 141 of the Australian Corporations Act of 2001 lists the provisions that apply as replaceable rules.

[88] Section 198A(2) of the Australian Corporations Act of 2001 states as follows: "The directors may exercise all the powers of the company except any powers that this Act or the company's constitution (if any) requires the company to exercise in general meeting."

[89] In terms of s 16(1) of the Companies Act a company's Memorandum of Incorporation may be amended (i) in compliance with a court order; (ii) in the manner contemplated in s 36(3) and (4) of the Companies Act; or (iii) at any other time if a special resolution to amend it is proposed by the board of directors or shareholders entitled to exercise at least ten per cent of the voting rights that may be exercised on such a resolution. In terms of s 16(2) of the Companies Act a company's Memorandum of Incorporation may provide different requirements than those set out in s 16(1)(*c*)(i) with respect to proposals for amendments.

[90] Section 16(1)(*c*)(i)(*bb*).

[91] Under s 65(10) of the Companies Act a company's Memorandum of Incorporation may permit a different percentage of voting rights to approve any special resolution or one or more different percentages of voting rights to approve special resolutions concerning one or more particular matters.

Thus while the shareholders have the power to curtail the powers of the board of directors in the Memorandum of Incorporation and to amend the Memorandum of Incorporation in order to do so, there are some limitations to the exercise of this power by the shareholders.

To sum up, under the (South African) Companies Act, since the power to manage the business and affairs of the company is derived from statute and not from the constitution of the company and no longer has to be delegated by the shareholders to the board of directors, the power of the directors is subject to shareholder control to a much lesser extent than was the case under the Companies Act 61 of 1973.[92] The (South African) Companies Act has moved away from the contractarian model adopted in the UK to the division of power model adopted in the USA and Australia in that the allocation of powers is sourced in legislation, save where it is changed by the constitution of the company.[93] It is evident that under the Companies Act the balance of power has shifted away from the shareholders and that it now lies in favour of the board of directors.

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[92] FHI Cassim "The Duties and Liability of Directors" in FHI Cassim et al *Contemporary Company Law* 507; Havenga "Directors' Exploitation of Corporate Opportunities and the Companies Act 71 of 2008" 262.

[93] *Kaimowitz v Delahunt and Others* 2017 (3) SA 201 (WCC) para 13; Delport *Henochsberg on the Companies Act 71 of 2008* 250(3); MF Cassim "Formation of Companies and the Company Constitution" in FHI Cassim et al *Contemporary Company Law* 124; Esser & Delport "Shareholder Protection Philosophy in terms of the Companies Act 71 of 2008" 9; JS Oosthuizen & Delport "Rectification of the Securities Register of a Company and the Oppression Remedy" 244. It is arguable that to some extent the Companies Act has adopted a hybrid model in that it does retain certain elements of the contractarian model (see JS Oosthuizen & Delport "Rectification of the Securities Register of a Company and the Oppression Remedy" 245). For instance, s 15(6) of the Companies Act, which is analogous to s 33(1) of the UK Companies Act of 2006, provides that a company's Memorandum of Incorporation and any rules of the company are binding between the company and each shareholder. Section 15(6) of the Companies Act goes further than s 33(1) of the UK Companies Act of 2006 in that it provides that the company's Memorandum of Incorporation is also binding between or among the shareholders of the company, and between the company and each director or prescribed officer of the company or any other person serving the company as a member of a board committee, in the exercise of their respective functions within the company. The fact that the power of the board of directors is now sourced in the Companies Act does not mean that the statute does not confer any powers on the shareholders of the company. For example, s 71(1) of the Companies Act confers on shareholders the power to remove directors from office by means of an ordinary resolution, without cause, and despite anything to the contrary in the company's Memorandum of Incorporation or any agreement between the company and a director or between any shareholders and a director. This power is reflective of the shareholder-oriented governance system of the UK (see Bruner *Corporate Governance in the Common-Law World: The Political Foundations of Shareholder Power* 29-30. For a further discussion on the division of powers between the directors and shareholders under the Companies Act see FHI Cassim "The Division and Balance of Power" 152-168 and Esser & Delport "Shareholder Protection Philosophy in terms of the Companies Act 71 of 2008" (2016) 79 *THRHR* 1 at 8-14).

3. THE SEPARATION OF OWNERSHIP AND CONTROL

In many small private companies the directors and the shareholders are often the same persons. In larger companies though, as famously documented by Berle and Means in their landmark study in 1932,[94] ownership and control of companies do not vest in the same persons. Berle and Means argue that ownership and control of a large company are split in that the control of a company vests in the hands of the managers of the company, being the board of directors, while "ownership" of the company vests in the shareholders.[95] The effect of the split in ownership and control is that a large body of shareholders has been created who exercise virtually no control over the wealth that they have contributed to the enterprise, while the ownership interest held by the controlling group, being the directors, is only a very small fraction of the total ownership of the company.[96]

It is important to note at the outset that it is misleading to describe the shareholders as the "owners" of the corporation. Shareholders do not "own" a company – instead they own shares in the company, which provides them with certain legal rights. The property and

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[94] Berle & Means *The Modern Corporation and Private Property*.

[95] Berle & Means *The Modern Corporation and Private Property* 4. The divorce of ownership from control is the central theme in this classic work, of Berle and Means. Written in 1932, Berle and Means envisaged that over time there would be an increase in the size of the modern corporation and the concentration of the economy, leading to an increasing dispersion of share ownership and increasing separation of ownership and control. See further Marks "The Separation of Ownership and Control" 692; Hill "Visions and Revisions of the Shareholder" 39; Bainbridge *Corporate Law* 72-75; Mitchell, O'Donnell & Ramsay "Shareholder Value and Employee Interests: Intersections between Corporate Governance, Corporate Law and Labor Law" 425-431; Esser & Havenga "Shareholder Participation in Corporate Governance" 74; Steyn & Stainbank "Separation of Ownership and Control in South African-Listed Companies" 316; French, Mayson & Ryan *Mayson, French & Ryan on Company Law* 433-434; Austin & Ramsay *Ford, Austin and Ramsay's Principles of Corporations Law* para 7.061 at 238 and Davies & Worthington *Gower Principles of Modern Company Law* 412-413.

[96] Berle & Means *The Modern Corporation and Private Property* 5. On the separation of ownership and control see generally Sullivan "The Relationship between the Board of Directors and the General Meeting in Limited Companies" 579; Fama & Jensen "Separation of Ownership and Control" 301; Pinto "Corporate Governance: Monitoring the Board of Directors in American Corporations" 317-346; Ferran *Company Law and Corporate Finance* 116-118; Marks "The Separation of Ownership and Control" 692; Hill "Visions and Revisions of the Shareholder" 39; Mongalo "The Emergence of Corporate Governance as a Fundamental Research Topic in South Africa" 179-186; Bainbridge *Corporate Law* 72-75; Esser & Havenga "Shareholder Participation in Corporate Governance" 74; Steyn & Stainbank "Separation of Ownership and Control in South African-Listed Companies" 316; Austin & Ramsay *Ford, Austin and Ramsay's Principles of Corporations Law* para 7.061 at 238; French, Mayson & Ryan *Mayson, French & Ryan on Company Law* 433-434; Hannigan *Company Law* 183-186 and Esser & Delport "Shareholder Protection Philosophy in terms of the Companies Act 71 of 2008" 8-10.

assets of the company belong to the company itself and not to the shareholders.[97] While a shareholder may be financially interested in the success or failure of a company because he is entitled to a share in the distribution of the surplus assets when a company is liquidated, this does not mean that he has any right or title to any assets of the company.[98] It may be that in small private companies where one shareholder or a very small number of shareholders hold the shares in the company, such shareholders would exercise much more control over the company compared to a public company where the shareholding is widely dispersed. Nonetheless it would be both factually and legally incorrect to refer to even these shareholders as "owners of a company".[99] The "shareholder / ownership" model was the basis of Berle and Means' work and much of the work that succeeded it, and this model continues to command much support in practice.[100] For purposes of this thesis the metaphor of shareholders as the "owners" of the company will be used but one must bear in mind that the metaphor is not legally or factually accurate because the owners of the capital of the company are not the owners of the company itself.

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[97] *Dadoo Ltd v Krugersdorp Municipal Council* 1920 AD 530 at 550-551; *Macaura v Northern Assurance Co Ltd* [1925] AC 619 (HL (Ir)); *Stellenbosch Farmers' Winery Ltd v Distillers Corporation (SA) Ltd* 1962 (1) SA 458 (A) at 471-472; *The Maritime Trader* [1981] 2 Lloyd's Rep 153; *Francis George Hill Family Trust v South African Reserve Bank* 1992 (3) SA 91 (A) at 102; *The Shipping Corporation of India Ltd v Evdomon Corporation* 1994 (1) SA 550 (A) at 565-566; *Hughes v Ridley* 2010 (1) SA 381 (KZP) para 22; *Prest v Prest and Others* [2013] 1 All ER 795 para 101. See further Grantham "The Doctrinal Basis of the Rights of Company Shareholders" 562-564; Sirodoeva-Paxson "Judicial Removal of Directors: Denial of Directors' License to Steal or Shareholders' Freedom to Vote?" 122; Roach "The Paradox of the Traditional Justifications for Exclusive Shareholder Governance Protection: Expanding the Pluralist Approach" 9-10; Ferber *Corporation Law* 20; Cox & Hazen *Corporations* 8; Esser & Havenga "Shareholder Participation in Corporate Governance" 75; Dignam *Hicks & Goo's Cases and Materials on Company Law* 100-101; Kershaw *Company Law in Context* 46; Birds et al *Boyle and Birds' Company Law* 53-54; French, Mayson & Ryan *Mayson, French & Ryan on Company Law* 434; Davies & Worthington *Gower Principles of Modern Company Law* 35 and Hannigan *Company Law* 45-46.

[98] *Stellenbosch Farmers' Winery Ltd v Distillers Corporation (SA) Ltd* 1962 (1) SA 458 (A) 471-472.

[99] Stout "The Mythical Benefits of Shareholder Control" 804; Mongalo "The Myth of Director Appointment by Shareholders and Shareholder Activism in Listed Companies" 98; Lipton & Savitt "The Many Myths of Lucian Bebchuk" 754.

[100] Ferran *Company Law and Corporate Finance* 131-132. See generally Stigler & Friedland "The Literature of Economics: The Case of Berle and Means" 237; Marks "The Separation of Ownership and Control" 692; Hill "Visions and Revisions of the Shareholder" 39; Bratton "Berle and Means Reconsidered at the Century's Turn" 737-741; Mongalo "The Emergence of Corporate Governance as a Fundamental Research Topic in South Africa" 184-186; Esser & Havenga "Shareholder Participation in Corporate Governance" 74; Steyn & Stainbank "Separation of Ownership and Control in South African-Listed Companies" 316; French, Mayson & Ryan *Mayson, French & Ryan on Company Law* 433-434; Austin & Ramsay *Ford, Austin and Ramsay's Principles of Corporations Law* para 7.061 at 239 and Davies & Worthington *Gower Principles of Modern Company Law* 412-413.

It is important to understand what is meant by "control" in the context of a discussion on the "separation of ownership and control". As Herman notes, control relates to power.[101] Literal control is the power to make the key decisions of a company, while the power to constrain is the power to limit certain decision choices.[102] The power to constrain may be negative in its exercise but it is a form of control because it shapes decisions made by restricting the scope of choice.[103]

There are various categories of "control". For example, control through almost complete ownership of common shares is where a single individual or a small group of associates own all or practically all the shares in the company.[104] The shareholders in this instance have control over the company by virtue of having the legal powers of ownership and by the ability to make use of these powers and, in particular, being in a position to elect, remove and dominate the management of the company.[105] Ownership and control are thus combined in the same hands.[106] Majority control is another type of control, and it entails ownership of a majority of the shares in the company, which gives the individual or small group of individuals, substantial legal powers of control.[107] Of course, majority control may be curbed by the minority shareholding, but where the minority shareholding is widely dispersed majority ownership may entail undiminished actual control.[108] The concentration of control in this instance means that the minority have lost most of the powers of control over the company of which they are part owners.[109] Management control is where ownership of a company is so widely distributed that no individual or

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[101] Herman *Corporate Control, Corporate Power* 19.

[102] Herman *Corporate Control, Corporate Power* 19.

[103] Herman *Corporate Control, Corporate Power* 19.

[104] Berle & Means *The Modern Corporation and Private Property* 70.

[105] Berle & Means *The Modern Corporation and Private Property* 70. See further Stigler & Friedland "The Literature of Economics: The Case of Berle and Means" 247-248 and French, Mayson & Ryan *Mayson, French & Ryan on Company Law* 433-434.

[106] Berle & Means *The Modern Corporation and Private Property* 70.

[107] Berle & Means *The Modern Corporation and Private Property* 70-71.

[108] Berle & Means *The Modern Corporation and Private Property* 71.

[109] Berle & Means *The Modern Corporation and Private Property* 71.

small group has even a minority interest which is large enough to dominate the affairs of the company.[110] Thus no shareholder is in a position by virtue of his shares alone to place any pressure upon the management of the company.[111] It is clear from the above categories of "control" that control is not necessarily a function of ownership and that it may be regarded as a separate and separable factor.[112]

For decades, large public companies have been issuing increasing numbers of shares in order to raise capital for growth and expansion, which has had the effect of causing fragmentation of share ownership in public companies.[113] Shareholders in large public companies have also become widely dispersed or geographically scattered.[114] In general, the larger the company, the greater the probability that its ownership will be diffused among a multitude of individuals.[115] Thus ownership and wealth have come to lie less and less in one person.[116]

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[110] Berle & Means *The Modern Corporation and Private Property* 84; Bratton "Berle and Means Reconsidered at the Century's Turn" 758.

[111] Berle & Means *The Modern Corporation and Private Property* 84. Two other categories of control identified by Berle and Means are control through a legal device, and minority control. Berle and Means identify the legal device of pyramiding as conferring control, which involves the owning of a majority of the shares of one company which in turn holds a majority of the shares of another company. This process may be repeated a number of times, and by introducing two or three intermediate companies each of which is legally controlled through ownership of a majority of its shares by the company higher in the series, complete legal control of a large operating company may be maintained by a very small ownership interest. In other words, the owner of a majority of the shares at the apex of the pyramid could have almost as complete control of the entire property of the company as a sole owner would have even though his ownership interest is less than one per cent of the whole (see Berle & Means *The Modern Corporation and Private Property* 72-73 and Stigler & Friedland "The Literature of Economics: The Case of Berle and Means" 247). Minority control exists when a small group hold a sufficient share interest to be in a position to dominate a company through their share interest. The control rests upon the ability of the minority to attract from dispersed owners proxies which are sufficient when combined with their substantial minority interest to control a majority of the votes at the election of directors (Berle & Means *The Modern Corporation and Private Property* 80; Stigler & Friedland "The Literature of Economics: The Case of Berle and Means" 247).

[112] Berle & Means *The Modern Corporation and Private Property* 118. See further on control Stigler & Friedland "The Literature of Economics: The Case of Berle and Means" 247; Bratton "Berle and Means Reconsidered at the Century's Turn" 758; French, Mayson & Ryan *Mayson, French & Ryan on Company Law* 433-434; Austin & Ramsay *Ford, Austin and Ramsay's Principles of Corporations Law* para 7.061 at 238 and Esser & Delport "Shareholder Protection Philosophy in terms of the Companies Act 71 of 2008" 7-8.

[113] FHI Cassim "The Division and Balance of Power" 152.

[114] Mongalo "The Emergence of Corporate Governance as a Fundamental Research Topic in South Africa" 184; FHI Cassim "The Division and Balance of Power" 152.

[115] Berle & Means *The Modern Corporation and Private Property* 52.

[116] Berle & Means *The Modern Corporation and Private Property* 69.

As Berle and Means explain, ownership of wealth without appreciable control, and control of wealth without appreciable ownership, appear to be the logical outcome of corporate development.[117] This has the effect that no single shareholder or group of shareholders is able to exercise effective control over the directors. In a large public company, and particularly a listed company, each shareholder generally owns only a small fraction of the shares in a company, which means that no one shareholder is in a position to exert control of the company by way of voting in shareholders' meetings.[118] Thus the power and responsibility of ownership is in effect transferred to a separate group in whose hands lies control.[119]

A further effect of the large numbers of shareholders in a company, shareholders being widely dispersed, and fragmented shareholding, is that the links of the shareholders with the management of their companies have become more remote. This had inevitably led to passivity on the part of the shareholders.[120] In most jurisdictions it is too costly and difficult for shareholders to become active in a company.[121] The cost to an individual shareholder to monitor management would normally exceed the benefit to that shareholder, and whilst other shareholders may also benefit from such actions they would do so at the expense of the monitoring shareholder (known as the "free-rider" problem).[122] Shareholders often believe that their votes will have little impact on the outcome of the

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[117] Berle & Means *The Modern Corporation and Private Property* 69.

[118] Mongalo "The Emergence of Corporate Governance as a Fundamental Research Topic in South Africa" 184.

[119] Berle & Means *The Modern Corporation and Private Property* 68.

[120] Mongalo "The Myth of Director Appointment by Shareholders and Shareholder Activism in Listed Companies" 98. See further Olson "Professor Bebchuk's Brave New World: A Reply to 'The Myth of the Shareholder Franchise'" 783-785; Esser & Havenga "Shareholder Participation in Corporate Governance" 74; Davies & Worthington *Gower Principles of Modern Company Law* 413; Hannigan *Company Law* 141-145 and Esser & Delport "Shareholder Protection Philosophy in terms of the Companies Act 71 of 2008" 24-28.

[121] Keay "Company Directors Behaving Poorly: Disciplinary Options for Shareholders" 659-660; FHI Cassim "The Division and Balance of Power" 152.

[122] In other words, those shareholders who are not involved in actively monitoring the management of the company get a "free ride." See Pinto "Corporate Governance: Monitoring the Board of Directors in American Corporations" 326; Ferran *Company Law and Corporate Finance* 117; Marks "The Separation of Ownership and Control" 69 and Esser & Havenga "Shareholder Participation on Corporate Governance" 79 on the free-rider concept.

vote and they lack an incentive to become active.[123] A further implication of fragmented shareholding and shareholder apathy is that no one shareholder will be in a position to exercise control of the company by way of voting in general meetings because most shareholders would be minority shareholders.[124] The ultimate effect of shareholder apathy is that it undermines appropriate levels of managerial compliance.[125]

The process of separation of ownership and control has been aptly summed up by Herman[126] who states as follows:

> "With larger corporate size comes a greater dispersion of stock ownership, a steady reduction in the power and interest of the shareholder, and gradual enhancement of managerial authority, that is, a separation of ownership from control."

The separation of ownership from control creates a condition where the interest of owners and managers may, and often do, diverge.[127] The central question, as advocated by Berle and Means, is whether we have any justification for assuming that those in control of a modern corporation will also choose to operate it in the interests of the owners.[128] The answer to this question would depend on the degree to which the self-interest of those in control may run parallel to the interests of ownership, and, insofar as they differ, the checks on the use of power.[129] Bebchuk argues that in public companies with dispersed ownership the interests of management do not fully overlap with those of shareholders, and management cannot be automatically relied on to take actions that would serve shareholder interests.[130] In such a situation, directors would be able to favour their own personal desires even though doing so may conflict with shareholder interests in

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[123] Olson "Professor Bebchuk's Brave New World: A Reply to 'The Myth of the Shareholder Franchise'" 784.

[124] Mongalo "The Myth of Director Appointment by Shareholders and Shareholder Activism in Listed Companies" 98-99.

[125] R Cassim "Corporate Governance" in FHI Cassim et al *Contemporary Company Law* 498.

[126] Herman *Corporate Control, Corporate Power* 5.

[127] Berle & Means *The Modern Corporation and Private Property* 6; Eisenberg "The Structure of Corporation Law" 1471-1472.

[128] Berle & Means *The Modern Corporation and Private Property* 121.

[129] Berle & Means *The Modern Corporation and Private Property* 121.

[130] Bebchuk "The Case for Increasing Shareholder Power" 850.

maximising the economic value of the company.[131] Also, directors are relatively autonomous with a wide range of discretion to make decisions, which may lead to corporate managers having an interest in maintaining and enhancing their positions even at the expense of shareholders.[132]

As a consequence of the separation of ownership and control the directors of a large company enjoy managerial autonomy – they have at their disposal substantial sums of money invested by shareholders and the manner in which they use that money is for them to decide without close scrutiny from the shareholders.[133] Separation of ownership and control gives the directors scope to use the money invested by the shareholders more for their own benefit rather than for the benefit of the shareholders, to neglect giving due attention to the management of such sums of money, or to refrain from expending their maximum effort on behalf of the shareholders, known as managerial shirking.[134] Where there are low standards of managerial accountability, abuse of power, mismanagement and negligence may prevail over good governance unless mechanisms are devised to prevent such conduct from occurring.[135]

The separation of ownership and control creates a potential divergence between the interests of shareholders and directors and leads to the problem that the directors do not necessarily act in the best interests of the shareholders when they manage a company.[136] This goal divergence problem is referred to as the "agency problem" or as "agency costs".[137] In large companies the principals are not capable of exercising day-to-day

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[131] Daniels & Halpern "Too Close for Comfort" 14.

[132] Eisenberg "The Structure of Corporation Law" 1471-1472.

[133] Ferran *Company Law and Corporate Finance* 117.

[134] See Eisenberg "The Structure of Corporation Law" 1471-1472; Daniels & Halpern "Too Close for Comfort" 14; Ferran *Company Law and Corporate Finance* 117; Roach "The Paradox of the Traditional Justifications for Exclusive Shareholder Governance Protection: Expanding the Pluralist Approach" 12 and Bainbridge "Director Primacy and Shareholder Disempowerment" 1740.

[135] Mongalo "The Myth of Director Appointment by Shareholders and Shareholder Activism in Listed Companies" 98.

[136] Esser & Havenga "Shareholder Participation in Corporate Governance" 76.

[137] From an economic perspective shareholders are regarded as the "principals" and directors are regarded as the "agents". From a legal perspective the relationship of a director to a company is in some respects analogous to that of an agent, but this description is not entirely accurate in law. Directors are analogous to agents in that they act for the benefit of another person, being the company, and when they contract on

control over the affairs of the company. Accordingly they appoint directors to act as their agents, but, because the ownership of a company is separated from its control, the interests of the principals and the agents are not identical. Conflicts arise between the directors and shareholders because a shareholder desires the director to make decisions that will increase the share value, but the director would prefer to expand the business of the company and his own remuneration, which may not necessarily increase the value of the shares. Thus the directors may well pursue activities which benefit themselves rather than the shareholders of the company. For instance, in public companies, directors may focus on personal gains rather than on shareholder gains, or on short-term goals which would be to their advantage rather than on long-term goals which are more likely to be to the benefit of shareholders.[138] The issue which arises is how to provide the agents, being the directors, with incentives to induce behaviour which will be beneficial to the principals, being the shareholders.[139]

In order to limit the activities of the agent which serve to favour his own interests, the principal will establish appropriate incentives for the agent, and incur monitoring costs which are aimed at limiting the aberrant activities of the agent.[140] Monitoring comprises

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behalf of the company they do not incur liability unless they act outside their power or expressly or impliedly assume liability. In *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168 at 216-217 the then Appellate Division stated that while it is true that the board of directors is the agent of the company to manage its affairs each individual director is not as such an agent of the company (see further *Ferguson v Wilson* (1866) 2 Ch App 77 at 89; Blackman et al *Commentary on the Companies Act* 8-9 and Davies & Worthington *Gower Principles of Modern Company Law* 358). Notably under the Companies Act directors are given original powers by virtue of s 66(1) (discussed in para 2 above) and this detracts from the agency principal analogy.

[138] See further on the agency problem Jensen & Meckling "Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure" 309; Fama & Jensen "Separation of Ownership and Control" 301; Ferran *Company Law and Corporate Finance* 118; Marks "The Separation of Ownership and Control" 696-698; Roach "The Paradox of the Traditional Justifications for Exclusive Shareholder Governance Protection: Expanding the Pluralist Approach" 11; Shields, O'Donnel & O'Brien "The Bucks Stop Here: Private Sector Executive Remuneration in Australia" A Report prepared for the Labor Council of New South Wales (2003) available at http://www.researchgate.net/publication/242042789 at 13 (accessed on 5 April 2016); Mongalo "The Emergence of Corporate Governance as a Fundamental Research Topic in South Africa" 186; Mitchell, O'Donnell & Ramsay "Shareholder Value and Employee Interests: Intersections between Corporate Governance, Corporate Law and Labor Law" 425-434; Williams "Disqualifying Directors: A Remedy Worse than the Disease" 217-220; Esser & Havenga "Shareholder Participation in Corporate Governance" Bainbridge *Corporate Law* 75; Kershaw *Company Law in Context* 171-188; Steyn & Stainbank "Separation of Ownership and Control in South African-Listed Companies" 317; French, Mayson & Ryan *Mayson, French & Ryan on Company Law* 432; Austin & Ramsay *Ford, Austin and Ramsay's Principles of Corporations Law* para 7.061 at 239.

[139] Marks "The Separation of Ownership and Control" 696.

[140] Jensen & Meckling "Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure" 308.

measuring or observing the behaviour of the agent as well as efforts on the part of the principal to control the behaviour of the agent.[141] For instance, shareholders seek to negotiate contracts with the directors which minimise their loss of control and which protect the company's competitive interests.[142] Companies may for example make as much of the directors' remuneration contingent on the performance of the company and on the dividends given to the shareholders.[143] Thus, in an effort to align the interests of the directors and shareholders, companies may pay cash bonuses to directors if the share price increases, or they may utilise share options which give directors the right to acquire shares from the company at a specified price, which would be lower than the market price of the shares.[144] These monetary incentives are examples of agency costs. The rationale of these incentives is that if directors have a direct personal interest in the company being profitable their personal interests will be aligned with those of the shareholders and the conflict of interest between them will be reduced.[145] To put it simply, agency costs in a corporate environment are designed to deal with the inevitable conflicts of interests between the directors and the shareholders, and comprise the costs of techniques that shareholders use to prevent the directors from prioritising their interests over the interests of shareholders, as well as the costs incurred in monitoring the performance of the directors to prevent the directors putting their own interests above those of the shareholders.[146] Agency costs are factored into the price that investors in a company are

[141] Jensen & Meckling "Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure" 308. See further Marks "The Separation of Ownership and Control" 698-710 where some of these incentives are discussed, and Esser & Havenga "Shareholder Participation in Corporate Governance" 75.

[142] Ferran *Company Law and Corporate Finance* 119-120; Shields, O'Donnel & O'Brien "The Bucks Stop Here: Private Sector Executive Remuneration in Australia" A Report prepared for the Labor Council of New South Wales (2003) available at http://www.researchgate.net/publication/242042789 at 13 (accessed on 5 April 2016).

[143] Shields, O'Donnel & O'Brien "The Bucks Stop Here: Private Sector Executive Remuneration in Australia" A Report prepared for the Labor Council of New South Wales (2003) available at http://www.researchgate.net/publication/242042789 at 13 (accessed on 5 April 2016).

[144] Ferran *Company Law and Corporate Finance* 119; Shields, O'Donnel & O'Brien "The Bucks Stop Here: Private Sector Executive Remuneration in Australia" A Report prepared for the Labor Council of New South Wales (2003) available at http://www.researchgate.net/publication/242042789 at 13 (accessed on 5 April 2016).

[145] Ferran *Company Law and Corporate Finance* 119-120.

[146] Birds et al *Boyle and Birds' Company Law* 14.

willing to pay for their shares.[147] Thus if the agency costs are lower investors will be willing to pay a higher price.[148]

The concept of separation of ownership and control as advocated by Berle and Means in 1932 has been strongly influential in analysing the structure and inner workings of a company. However, in modern times certain qualifications may have to be made to this concept. For instance, it may be too simplistic to assume that there is necessarily complete separation of ownership and control in all large public companies, such as where the founders of a company retain a large proportion of the company's share capital after the company has been listed and are thus still able to exercise control over the company in their capacity as shareholders.[149] Herman argues that Berle and Means overstated the loss of power of the shareholders and the separation and discretion of managers.[150]

A further qualification to Berle and Means' thesis is the fact that not all shareholders today are small private investors. There has been a significant increase in the number of institutional investors. "Institutional investors" are defined in the King IV Report on Corporate Governance for South Africa 2016 ("King IV Report")[151] as follows:

> "Any juristic person or institution referred to in the definition of financial institution in section 1 of the Financial Services Board Act, No 97 of 1990,[152] to the extent that

[147] Ferran *Company Law and Corporate Finance* 118.

[148] Ferran *Company Law and Corporate Finance* 118.

[149] Ferran *Company Law and Corporate Finance* 117-118.

[150] Herman *Corporate Control, Corporate Power* 258.

[151] King IV Report, Glossary of Terms, at 10. The King IV Report came into effect on 1 November 2016 and it replaces the King Report on Governance for South Africa 2009 ("the King III Report") in its entirety.

[152] A "financial institution" is defined in s 1 of the Financial Services Board Act 97 of 1990 as meaning the following:

(i) any pension fund organisation registered in terms of the Pension Funds Act 4 of 1956 or any person referred to in s 13B of that Act administering the investments of such a pension fund or the disposition of benefits provided for in the rules of such a pension fund;
(ii) any friendly society registered in terms of the Friendly Societies Act 25 of 1956 or any person in charge of the management of the affairs of such a society;
(iii) a collective investment scheme as defined in s 1 of the Collective Investment Schemes Control Act 45 of 2002, a manager, trustee, custodian or nominee company registered or approved in terms of that Act, and an authorised agent of such a manager;
(iv) any "external authorised user", "external central securities depository", "external clearing house", "external clearing member", "external exchange", "external participant" or "external trade repository", or any person referred to in paragraphs *(a)* to *(h)* and *(j)* of the definition of "regulated person", as defined in the Financial Markets Act 19 of 2012;

> these juristic persons or institutions are the holders of beneficial interest in the securities of a company. It includes retirement funds and insurance companies as well as the custodians, nominees and service providers who act under mandate in respect of any investment decisions and investment activities exercised in relation to these securities."

Institutional investors may hold a sufficiently large shareholding in a company to be able to influence directors directly, and therefore to have a potentially strong monitoring role.[153] If institutional investors were to act together and share agency costs they would be a powerful monitor of the performance of directors.[154] The King IV Report regards institutional investors as being highly influential on the basis that the types of investment decisions which they make and the manner in which they exercise their rights as shareholders either reinforces or weakens good governance in the companies in which they invest.[155] A further effect of the influence of active institutional investors is that they

(v) any "long-term insurer" as defined in s 1(1) of the Long-term Insurance Act 52 of 1998 and any "short-term insurer" as defined in s 1(1) of the Short-term Insurance Act 53 of 1998;
(vi) any "independent intermediary" or "representative" contemplated in the Short-term Insurance Act 53 of 1998 and the Long-term Insurance Act 52 of 1998;
(vii) any "Lloyd's underwriter" as defined in s 1(1) of the Short-term Insurance Act 53 of 1998 and referred to in s 56 of that Act;
(viii) any "authorised financial services provider" or "representative" as defined in s 1(1) of the Financial Advisory and Intermediary Services Act 37 of 2002;
(ix) any "credit rating agency" as defined in s 1 of the Credit Rating Services Act 24 of 2012;
(x) a bank as defined in s 1(1) of the Banks Act 94 of 1990, a mutual bank as defined in s 1(1) of the Mutual Banks Act 124 of 1993, or a co-operative bank as defined in s 1(1) of the Co-operative Banks Act 40 of 2007, which deals with trust property as a regular feature of its business;
(xi) any other person who or which deals with trust property as a regular feature of his or its business, but who is not registered, licensed, recognised, approved or otherwise authorised to deal so in terms of any Act, other than the Companies Act, the Close Corporations Act 69 of 1984 and the Trust Property Control Act 57 of 1988; and
(xii) any person that performs an activity regulated under a law referred to above.

[153] Austin & Ramsay *Ford, Austin and Ramsay's Principles of Corporations Law* para 7.061 at 239. See generally on institutional investors Pinto "Corporate Governance: Monitoring the Board of Directors in American Corporations" 344-345; Pretorius et al *Hahlo's South African Company Law through the Cases* 337; Hill "Visions and Revisions of the Shareholder" 61-78; Karmel "Should a Duty to the Corporation be imposed on Institutional Shareholders?" 1; Esser & Havenga "Shareholder Participation in Corporate Governance" 74; Kershaw *Company Law in Context* 180-185; French, Mayson & Ryan *Mayson, French & Ryan on Company Law* 434-435; Davies & Worthington *Gower Principles of Modern Company Law* 413 and Esser & Delport "Shareholder Protection Philosophy in terms of the Companies Act 71 of 2008" 26-28.

[154] Austin & Ramsay *Ford, Austin and Ramsay's Principles of Corporations Law* para 7.061 at 239.

[155] King IV Report at 32. See further the Code for Responsible Investing in South Africa 2011 ("CRISA"), which is a voluntary code that applies to institutional investors. It was launched on 19 July 2011. It provides guidance to institutional investors on how they should execute investment activities to promote sound corporate governance and how they should incorporate environmental, social and governance considerations into their investment activities. See further Esser & Delport "Shareholder Protection Philosophy in terms of the Companies Act 71 of 2008" 26-28 where CRISA is discussed in detail.

mitigate shareholder apathy.[156] Nonetheless, institutional investors may not be as influential as one might hope because, in an attempt to diversify their share portfolio and obtain quick financial gains, institutional shareholders generally own shares in a large number of companies and are thus not able to wield real control in any one of the companies in which they invest.[157]

It must be conceded that shareholders in modern times are no longer as powerless as they were during the time of Berle and Means. For instance, individual shareholders in the 1930s did not have an instantaneous means of communication with each other whereas today with modern technology shareholders are able to communicate with each other faster, easier and with less expense, and consequently to act together to influence boards of directors.[158] For example, under section 63(2) of the Companies Act, unless prohibited by its Memorandum of Incorporation, a company may provide for a shareholders' meeting to be conducted entirely by electronic communication or for one or more shareholders or proxies for shareholders to participate by electronic communication in all or part of a shareholders' meeting that is being held in person.[159] Under section 61(10) of the Companies Act every shareholders' meeting of a public company must be "reasonably accessible" within South Africa for electronic participation by shareholders

[156] Sirodoeva-Paxson "Judicial Removal of Directors: Denial of Directors' License to Steal or Shareholders' Freedom to Vote" 14; Mitchell, O'Donnell & Ramsay "Shareholder Value and Employee Interests: Intersections between Corporate Governance, Corporate Law and Labor Law" 452-453; Stout "The Mythical Benefits of Shareholder Control" 807.

[157] Mongalo "The Myth of Director Appointment by Shareholders and Shareholder Activism in Listed Companies" 99; Keay "Company Directors Behaving Poorly: Disciplinary Options for Shareholders" 665. Mitchell, O'Donnell & Ramsay argue that patterns of institutional activism vary depending on the size of the institutional investor's shareholding, the size of other non-institutional holdings in the company, the size of the company, the resources devoted to monitoring the performance of the directors and the nature of the institutional investor's portfolio (Mitchell, O'Donnell & Ramsay "Shareholder Value and Employee Interests: Intersections between Corporate Governance, Corporate Law and Labor Law" 456-457).

[158] Stout "The Mythical Benefits of Shareholder Control" 807.

[159] This is subject to the proviso in s 63(2) that the electronic communication employed ordinarily enables all persons participating in that meeting to communicate concurrently with each other without an intermediary and to participate reasonably effectively in the meeting. If a company provides for participation in a meeting by electronic communication the notice of that meeting must inform shareholders of the availability of that form of participation and provide any necessary information to enable shareholders or their proxies to access the means of electronic communication (s 63(3)(*a*) of the Companies Act).

in the manner contemplated in section 63(2) of the Companies Act, irrespective of whether the meeting is held in South Africa or elsewhere.[160]

The qualifications to the concept of separation of ownership and control as propounded by Berle and Means do not detract from the fact that in general, and particularly in large companies, there is a separation of ownership and control between directors and shareholders. The degree of the separation of the ownership and control between directors and shareholders varies from company to company.

4. SHAREHOLDERS' POWER TO REMOVE DIRECTORS FROM OFFICE

The Cohen Committee, in 1945, recommended that shareholders be given "greater powers to remove directors with whom they are dissatisfied".[161] This recommendation formed the underlying rationale of section 184 of the UK Companies Act of 1948.[162] The purpose of section 184 of the UK Companies Act of 1948 was to strengthen shareholder control over management by conferring power on the shareholders to remove a director from office by ordinary resolution, notwithstanding any provisions in the constitution of the company.[163]

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[160] It is not clear what the phrase "reasonably accessible" means in this context and no guidance regarding the meaning of this phrase is provided by the legislature (R Cassim "Governance and Shareholders" in FHI Cassim et al *Contemporary Company Law* 379). Despite shareholders having the option to participate in meetings electronically, they do not necessarily do this. There is still some expense for shareholders to do so, particularly since the access to the means of electronic communication is at the expense of the shareholder or proxy, unless the company determines otherwise (s 63(3)(*b*) of the Companies Act).

[161] Report of the Committee on Company Law Amendment (Cohen Report 1945) Cmnd 6659 (June 1945) para 130.

[162] See Prentice "Removal of Directors from Office" 693. Section 184(1) of the UK Companies Act of 1948 stated as follows: "A company may by ordinary resolution remove a director before the expiration of his period of office, notwithstanding anything in its articles or in any agreement between it and him: provided that this subsection shall not, in the case of a private company, authorise the removal of a director holding office for life on the eighteenth day of July, nineteen hundred and forty-five, whether or not subject to retirement under an age limit by virtue of the articles or otherwise."

[163] Hill "The Rising Tension between Shareholder and Director Power in the Common Law World" 354. In *In re El Sombrero Ltd* [1968] Ch 900 the court exercised its discretion to order an annual general meeting of the company to be held on the basis that if it did not do so, in the context and specific circumstances of this case, this would deprive the applicant, a shareholder of the company, of his statutory right under s 184(1) of the UK Companies Act of 1948 to remove the respondents as directors.

In a similar vein, in order to promote the policy of giving shareholders a greater say in the management of a company, to increase the control which shareholders could exercise over directors and to enable shareholders to assert themselves against the directors, section 69*ter* of the (South African) Companies Act 46 of 1926, in 1952, conferred on shareholders the power to remove directors from a company.[164] Section 69*ter* of the Companies Act 46 of 1926 was based on section 184 of the UK Companies Act of 1948.[165] The Companies Act 61 of 1973, in section 220, likewise conferred on shareholders the power to remove directors from a company notwithstanding the provisions of the company's memorandum and articles of association.[166]

In line with the recommendation of conferring greater powers on shareholders to remove directors with whom they are dissatisfied, the Supreme Court of Delaware in *Unocal Corp v Mesa Petroleum Co*[167] asserted that "[i]f the stockholders are displeased with the action of their elected representatives, the powers of corporate democracy are at their disposal to turn the board out." The Supreme Court of Delaware in *Aronson v Lewis*[168] likewise asserted that a stockholder is not powerless to challenge director action which results in harm to the corporation and that the machinery of corporate democracy is a potent tool to redress the conduct of a "torpid or unfaithful management."

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[164] Henochsberg *Henochsberg on the Companies Act* 151; FHI Cassim "The Division and Balance of Power" 155. Section *69ter* of the Companies Act 46 of 1926 was inserted by s 43 of the Companies Amendment Act 46 of 1952. Section 69*ter* (1) stated as follows: "A company may by ordinary resolution remove a director before the expiration of office, notwithstanding anything in its articles or in any agreement between it and him: Provided that this sub-section shall not, in the case of a private company, authorize the removal of a director holding office for life on the thirteenth day of June, 1949."

[165] *Amoils v Fuel Transport (Pty) Ltd* 1978 (4) SA 343 (W) at 346-347.

[166] Section 220(1)(*a*) of the Companies Act 61 of 1973 provided as follows: "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." See further on s 220 of the Companies Act 61 of 1973 *Stewart* v *Schwab* 1956 (4) SA 791 (T); *Swerdlow* v *Cohen and Others* 1977 (3) SA 1050 (T); *Amoils* v *Fuel Transport (Pty) Ltd* 1978 (4) SA 343 (W); *Barlows Manufacturing Co Ltd and Others v RN Barrie (Pty) Ltd and Others* 1990 (4) SA 608 (C); *James North (Zimbabwe) (Pvt) Ltd v Mattinson* 1990 (2) SA 229 (ZHC); Beuthin "A Director Firmly in the Saddle" 489; MJ Oosthuizen "Swerdlow v Cohen and Others 1977 1 SA 178 (W)" 165; J Du Plessis "Praktiese Aspekte Aangaande die Ontslag van Maatskappydirekteure" 511-516; J Du Plessis "Die Nywerheidshof, Werknemers en Direkteure" 119-122; Kunst, Delport & Vorster *Henochsberg on the Companies Act* 422(2)-424; Beuthin & Luiz *Beuthin's Basic Company Law* 209-211; Esser "Company Law and the Spoliated Director" 135 and Masinire "A Critical Analysis of the Role and Protection of Shareholders in the Removal of Directors in the South African Companies Act 71 of 2008" 1988-1990.

[167] 493 A.2d 946 (Del., 1985) at 959.

[168] 473 A.2d 805 (1984) at 811.

The power of removal of directors by shareholders furthermore enhances the ability of shareholders to control the disposition of their investment in the company.[169] Additionally, it serves to enhance the accountability of directors. If shareholders have removal rights, directors would know that if they behave in an incompetent manner or engage in self-serving opportunistic behaviour, the shareholders may well exercise their right to remove them from office.[170] Since directors exercise significant discretion over the affairs of the company it is important for them to have incentives to serve the interests of shareholders.[171] The threat of replacement by the shareholders would provide directors with such an incentive to serve the interests of the shareholders, and therefore the removal power of shareholders gives directors a strong incentive to focus on the interests of the shareholders.[172]

In light of the effects of the separation of power and control in a company, the power given to the shareholders to remove directors is a critical tool in the hands of shareholders which strikes a balance between the directors' powers of management on the one hand and the shareholders' powers of control on the other hand.[173] If the directors exercise their powers of management in the best interests of the company, the shareholders will not interfere in the running of the company. But if the shareholders are displeased with the manner in which the company is being run, then they have the right to exercise their ultimate power of control by removing the directors from office.[174] Therefore the power of removal of directors conferred on shareholders serves to balance the attenuated power of control of shareholders with the power of directors to manage the company, and constitutes a form of corporate democracy.[175] The conferral of this power is rooted in the

[169] Bailey "Shareholder Control over Management" 86.

[170] Kershaw *Company Law in Context* 220.

[171] Bebchuk "The Myth of the Shareholder Franchise" 680.

[172] Bebchuk "The Myth of the Shareholder Franchise" 680 and 682.

[173] Cartoon "The Removal of Company Directors" 17.

[174] Cartoon "The Removal of Company Directors" 18.

[175] Sirodoeva-Paxson "Judicial Removal of Directors: Denial of Directors' License to Steal or Shareholders' Freedom to Vote" 11.

separation of ownership and control (particularly in public companies), and provided that shareholders choose to exercise these powers, they are of fundamental importance in the control of a company.[176]

The Organisation for Economic Co-operation and Development (OECD) published its revised *Principles of Corporate Governance* in 2015 ("the OECD Principles of Corporate Governance").[177] The OECD Principles of Corporate Governance are an international benchmark for policy makers, investors, corporations and stakeholders worldwide.[178] They emphasise that the ability to remove directors is one of the fundamental rights of shareholders. Chapter II, titled "The rights and equitable treatment of shareholders and key ownership functions" states as follows:

> "Basic shareholder rights should include the right to: 1) secure methods of ownership registration; 2) convey or transfer shares; 3) obtain relevant and material information on the corporation on a timely and regular basis; 4) participate and vote in general shareholder meetings; 5) *elect and remove members of the board;* and 6) share in the profits of the corporation."[179] [Emphasis added]

It is evident from the above discussion that the underpinning philosophy of our corporate law regime is that the shareholders' right to remove directors from office is both elementary and necessary, and is a key provision of modern company law.[180] Section 71(1) of the Companies Act confers this right on shareholders by stating that a director

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[176] FHI Cassim "The Division and Balance of Powers" 154.

[177] OECD (2015), G20/OECD Principles of Corporate Governance. The OECD Principles of Corporate Governance were originally developed in 1999 and were updated in 2004 and again in 2015. The updated Principles were launched at the meeting of G20 Finance Ministers and Central Bank Governors in Ankara on 4-5 September 2015. They were subsequently endorsed at the G20 Leaders Summit in Antalya on 15-16 November 2015.

[178] The OECD Principles of Corporate Governance at 3. The OECD Principles of Corporate Governance have also been adopted as one of the Financial Stability Board's Key Standards for Sound Financial Systems, and form the basis for the World Bank Reports on the Observance of Standards and Codes in the area of corporate governance (see the OECD Principles of Corporate Governance at 3). The OECD Principles of Corporate Governance, which are non-binding, focus on both financial and non-financial publicly traded companies, but are also a useful tool to improve corporate governance in companies whose shares are not publicly traded and in smaller and unlisted companies (see the OECD Principles of Corporate Governance at 9).

[179] The OECD Principles of Corporate Governance at 21.

[180] Cartoon "The Removal of Company Directors" 17; FHI Cassim "The Division and Balance of Power" 154.

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 section 71(2). Section 71(2) sets out the procedure that must be followed before the shareholders may consider such a resolution. Briefly, the director concerned must be given notice of the meeting and a copy of the resolution, which notice must be at least equivalent to what which a shareholder is entitled to receive, (irrespective of whether or not the director is a shareholder of the company), and the director must be afforded a reasonable opportunity to make a presentation, in person or through a representative, to the meeting, before the resolution is put to the vote. No reasons are required for the removal of a director by the shareholders. The power given to shareholders to remove a director in section 71(1) applies despite anything to the contrary in a company's Memorandum of Incorporation or rules, or any agreement between a company and a director, or between any shareholders and a director.[181]

5. IMPACT OF THE BOARD'S POWER TO REMOVE A DIRECTOR FROM OFFICE

The conferral of the removal power on the board of directors has had an impact on the shareholders of a company as well as an impact on the board of directors itself. The extent of this impact is discussed below.

5.1 Impact on the Shareholders of the Company

Section 71(3) of the Companies Act confers the power of removal on the board of directors by providing as follows:

> "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,

[181] This is evident from the words "Despite anything to the contrary in a company's Memorandum of Incorporation or rules, or any agreement between a company and a director, or between any shareholders and a director" in s 71(1) of the Companies Act.

> 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."[182]

Even though the right to remove directors may now no longer be the sole privilege of the shareholders of a company under the Companies Act, this does not mean that the right of removal has been withdrawn from the shareholders. Section 71(1) of the Companies Act preserves the right of shareholders to remove directors from office. Accordingly, under the Companies Act, the right of removal of a director belongs to both the shareholders and the directors. This accords with the reasoning in *Auer v Dressel*,[183] where the Court of Appeals of New York proclaimed that even if the board of directors of a company is authorised to remove any director, this would not be an abdication by the shareholders of their inherent right to remove the directors, but rather, it provides an additional method of removing the directors. Were this not so, the court explained, the shareholders might find themselves without an effective remedy in a case where a majority of the directors were accused of wrongdoing and would be unwilling to remove themselves from office.[184]

There is merit in the power of removal not being the sole prerogative of the shareholders. A few examples when it may be beneficial for the board of directors to have the power of removal, are:

- When the shareholders who wish to remove an incompetent or misbehaving director from office do not have sufficient voting power to remove that director from office.[185]

- When the shareholders do not wish to remove a particular director from office despite his wrongdoing because they believe he is bringing in profits for the

[182] Section 71(3) of the Companies Act is discussed further in chapter 3.

[183] 118 N.E. 2d 590 (N.Y. 1954) at 593.

[184] *Auer v Dressel* 118 N.E. 2d 590 (N.Y. 1954) at 593.

[185] Knight "The Removal of Public Company Directors in Australia: Time for Change" 362.

company, when in fact such director is destructive and is exposing the company to potential legal action.

- When the shareholders fail to remove a director from office because they are not convinced of the legitimate reasons advanced by the board of directors to remove the director in question from office.

- When the board of directors suspects that a director is passing on confidential information to a competitor, or is engaged in an ethically questionable activity that will reflect poorly on the company, and they do not wish to disclose to the shareholders some wrongdoing by one of their members for fear that this may expose the company to a potential legal action.[186] Such matters ought to be disclosed to the shareholders but the board may be concerned that if they disclosed such information to the shareholders the shareholders would consider instituting legal action against the board of directors.[187]

Now that the right of removal is no longer the sole privilege of the shareholders of a company under the Companies Act, there is a shift in the balance of power between the directors and the shareholders. Despite the merits in conferring the power of removal on the board of directors, the conferment of this power on the board of directors is not consistent with the rationale of originally giving shareholders the right to remove directors, as discussed earlier,[188] that is, to give the shareholders more power over the directors because the separation of ownership and control has resulted in attenuated shareholder control. As the Supreme Court of Western Australia in *Allied Mining & Processing Ltd v Boldbow Pty Ltd*[189] asserted, shareholders must "retain ultimate control of the company and the appointment or removal of directors".[190] Section 220 of the

[186] McConvill "Removal of Directors of Public Companies takes Centre Stage in Australia" 210.

[187] McConvill "Removal of Directors of Public Companies takes Centre Stage in Australia" 210.

[188] See para 4 above.

[189] FLR 369 (W.A.S.C. 2002) at 379.

[190] The court in this case stated that a further reason for giving shareholders the power to remove directors is to prevent directors from becoming entrenched in their positions (paras 47 and 52).

Companies Act 61 of 1973 gave shareholders the exclusive right of removal and bolstered the concept of shareholder democracy and shareholder control,[191] but section 71 of the Companies Act no longer does this.

As discussed earlier,[192] conferring on shareholders the power to remove directors from office gives directors a strong incentive to focus on the interests of shareholders. One effect of also conferring the power of removal on the board of directors, is that directors would be inclined to focus on the interests of the board of directors as well, which may have the effect of diluting their incentive to focus only on the interests of the shareholders and to follow the line of action preferred by the shareholders.

In terms of section 66(4)(*b*) of the Companies Act the Memorandum of Incorporation of a profit company (other than a state-owned company) must provide for the election by shareholders of at least fifty per cent of the directors and fifty per cent of any alternate directors. The shareholders therefore have a right to elect at least half of the directors on the board. As a general rule, shareholders may vote for a director in their own interests and they are not under any obligation to choose the person most suitable to be a director.[193] This is because it is well established that a shareholder's right to vote is a proprietary right.[194] In many instances the directors appointed by the shareholders are the

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[191] See chapter 1, para 1 on s 220 of the Companies Act 61 of 1973.

[192] See para 4 above.

[193] *Re HR Harmer Ltd* [1959] 1 WLR 62 at 82. In *Kuwait Asia Bank EC v National Mutual Life Nominees Ltd* [1991] 1 AC 187 (PC) at 221 the Privy Council stated as follows:

> "[I]n the absence of fraud or bad faith . . . a shareholder or other person who controls the appointment of a director owes no duty to creditors of the company to take reasonable care to see that directors so appointed discharge their duties as directors with due diligence and competence."

In contrast, the power of directors to appoint directors to the board of directors is a fiduciary power and it must be exercised in good faith in the interests of the company and for the benefit of the company as a whole and not for an improper or collateral purpose (Blackman et al *Commentary on the Companies Act* 8-243).

[194] *Pender v Lushington* (1877) 46 ChD 317. As Lord Jessel MR put it (at 321), a shareholder "has a right to say, whether I vote with the majority or with the minority, you shall record my vote; that is a right of property belonging to my interest in this company, and if you will not, I shall institute legal proceedings to compel you. It seems to me that such an action could be maintained, without any technical difficulty." See further *Re HR Harmer Ltd* [1959] 1 WLR 62 at 82; *Sammel and Others v President Brand Gold Mining Co Ltd* 1969 (3) SA 629 (A) at 680; *Desai and Others v Greyridge Investments (Pty) Ltd* 1974 (1) SA 509 (A) at 519; *Kuwait Asia Bank EC v National Mutual Life Nominees Ltd* [1991] 1 AC 187 (PC) at 221; *CDH*

representatives of the shareholders. If the board of directors were to remove from office one of the shareholder representatives this would result in the shareholder control over the board of directors being attenuated, and would further shift the balance of power between the board of directors and the shareholders.

It is submitted that the removal of a shareholder representative from the board of directors by the directors would have an effect on the balance of power not only between the board of directors and the shareholders, but also amongst the shareholders themselves. For instance, if the board of directors removes from office a director who is a representative of the minority shareholders, this would shift the equilibrium between the majority and minority representatives on the board[195] and consequently between the majority and minority shareholders.

This power shift is further exacerbated by the fact that directors are empowered to fill vacancies on the board of directors.[196] If a vacancy arises on the board of directors it must be filled by a new appointment if the director had been appointed by a person named in or determined in terms of the Memorandum of Incorporation,[197] or by a new election.[198] The new election must be conducted at the next annual general meeting of the company (if applicable), or in any other case, within six months after the vacancy arose, at a shareholders' meeting called for the purpose of electing a director, or by a written polling of the shareholders who are entitled to vote in the election of that director.[199] In terms of section 68(3) of the Companies Act, unless the Memorandum of Incorporation of a profit company provides otherwise, the board of directors is empowered to appoint a person who satisfies the requirements for election as a director to fill a vacancy on the board and

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Invest NV v Petrotank South Africa (Pty) Ltd and Another [2018] 1 All SA 450 (GJ) para 44 and chapter 4, para 2.

[195] Sirodoeva-Paxson "Judicial Removal of Directors: Denial of Directors' License to Steal or Shareholders' Freedom to Vote" 48.

[196] See Sirodoeva-Paxson "Judicial Removal of Directors: Denial of Directors' License to Steal or Shareholders' Freedom to Vote" 48.

[197] Section 66(4)(*a*)(i) of the Companies Act.

[198] Section 70(3) of the Companies Act.

[199] Section 70(3)(*b*) of the Companies Act.

to serve as a director of the company on a temporary basis until the vacancy has been filled by election. During that temporary period the director so appointed to fill the vacancy has all of the powers, functions and duties and is subject to all the liabilities of any other director of the company.[200]

The board of directors of a profit company may potentially remove a minority shareholder representative on the board and fill the vacancy, albeit on a temporary basis, with a director whom they favour. As the court in *Bruch v National Guarantee Credit Corp*[201] affirmed, the "law does not look with disfavor on the policy of securing to minority stockholders a right of representation on the board of directors". Accordingly, as stated above, the power given to directors to fill vacancies on the board of director has an impact not only on the balance of power between the directors and the shareholders, but also on the balance of power between the majority and minority shareholders. In *Loughlin v Geer*[202] the Appellate Court of Illinois warned against the danger of the redistribution of powers within a company resulting from the right of removal given to the board of directors by stating that:

> "But the board of directors may not nullify the constitutional right of a stockholder to choose whomsoever he may think proper to represent him on the board of directors. If a board of directors could legally remove a member either with or without a by-law . . . a power most dangerous to the minority stockholders would be lodged with the majority stockholders which would enable them through the action of the directors chosen by them to re-constitute the entire directory of a corporation as completely as if they owned every share of stock."

5.2 Impact on the Board of Directors

It is submitted that the board's power of removal of directors also has an impact on the dynamics of the board of directors. Such power may well have the effect of limiting or hindering free and open discussion and debate in board meetings.[203] A director may hesitate to express a dissenting opinion in a board meeting because of the concern of

[200] Section 68(3) of the Companies Act.

[201] 116 Atl 738 (Ch.1922) at 741.

[202] 121 Ill. App. 534 (1905) at 538-539.

[203] FHI Cassim "The Division and Balance of Power" 162.

removal by the board of directors[204] or a dissident director may simply toe the line in order to preserve his position on the board. If directors do not engage in discussion and debate in board meetings, or fail to question decisions to be made with regard to the company due to a concern of removal, this would impact negatively on the company and on the shareholders. A concern of removal may also create an environment where directors are so intimidated by the risks of removal that they feel stifled and refrain from taking high-risk but potentially profitable decisions, or from making long-term strategic decisions that would enhance the value of the company but would not necessarily result in an immediate return of profit.[205]

Directors have a fiduciary duty to observe good faith towards the company, and in discharging that duty they must exercise an independent unfettered judgment, and take decisions according to the best interests of the company.[206] Should directors simply toe the line because of a concern of removal and fail to express controversial or dissenting opinions they could be in breach of these fiduciary duties.[207]

Knight argues that while a fear of removal is an important concern, directors are not likely to remain on a board without attempting to contribute to board deliberations, on account of their fiduciary duty to act in the best interests of the company.[208] He contends further that there exists little incentive for the directors who form a majority on a particular issue

[204] FHI Cassim "The Division and Balance of Power" 162.

[205] Olson "Professor Bebchuk's Brave New World: A Reply to 'The Myth of the Shareholder Franchise'" 782.

[206] *Shuttleworth v Cox Brothers & Co (Maidenhead) Ltd* [1927] 2 KB 9 at 23; *Re Smith & Fawcett Ltd* [1942] Ch 304 at 306; *Boulting v Association of Cinematograph, Television and Allied Technicians* [1963] 1 All ER 716 (CA) at 723; *Charterbridge Corporation Ltd v Lloyd's Bank* [1970] Ch 62; *Fisheries Development Corporation of SA Ltd v Jorgensen; Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd* 1980 (4) SA 156 (W) at 163; *Fulham Football Club Ltd v Cabra Estates Plc* [1992] B.C.C. 863; *Neptune (Vehicle Washing Equipment) Ltd v Fitzgerald (No 2)* [1995] 1 BCLC 452 (ChD); *Regentcrest plc (in liquidation) v Cohen* [2001] 2 BCLC 80 at 105; *Extrasure Travel Insurances Ltd v Scattergood* [2003] 1 BCLC 598 (ChD) at 618-619; *Liwszyc and Another v Smolarek and Others* (2005) 55 ACSR 38 at 46-47; *Da Silva and Others v CH Chemicals (Pty) Ltd* 2008 (6) SA 620 (SCA) para 18.

[207] The fiduciary duty of directors in removing board members is discussed in chapter 4, para 3.

[208] Knight "The Removal of Public Company Directors in Australia: Time for Change" 361.

to rid themselves of a minority director when that director is not in a position to obstruct the workings of the board nor to frustrate the will of the majority of the directors.[209]

Nevertheless, in those instances where the Memorandum of Incorporation of a company requires board decisions to be unanimous, the concern of removal may well result in a minority director hesitating to express a dissenting or controversial opinion. While it is conceded that not all decisions taken by the board of directors would require unanimity and that the board of directors is not likely to remove a minority director for expressing a dissenting opinion or for voting against the majority view, the concern of dismissal may nevertheless result in a minority director hesitating to express a contrary view or failing to attempt to convince the majority to change its view in circumstances where he believes that the majority view is not in the best interests of the company.

Knight opines further that disagreements in the boardroom would usually be resolved in the normal course of events by a board vote with all directors abiding by the result, and those directors who do not wish to be associated with the particular course of action agreed upon by the board, could simply resign from office.[210] It is submitted though, that in many instances, for reasons of status, prestige or monetary rewards, a director would not be willing to resign from the board of directors if he does not wish to be associated with a particular course of action agreed upon by the board of directors. While resignation is a difficult step to take for any director, it is a particularly difficult step for an executive director to take because an executive director is involved full-time in the day-to-day affairs of the company.[211] It is accordingly submitted that Knight's suggestion of resignation would not in all instances be either a practical or an attractive one.

The concern of removal from office may further result in a director failing to bring to the attention of the board of directors any suspicion or knowledge of wrong doing by fellow directors.[212] Of concern is that this power may be used by the board of directors

[209] Knight "The Removal of Public Company Directors in Australia: Time for Change" 361.

[210] Knight "The Removal of Public Company Directors in Australia: Time for Change" 361.

[211] See chapter 3, paras 6.2.3 and 6.3.1 and chapter 5, paras 2 and 2.1 for a discussion on executive and non-executive directors.

[212] R Cassim "Contesting the Removal of a Director by the Board of Directors under the Companies Act"138.

subjectively, and not objectively, and with ulterior motives. Both of these concerns are illustrated in the UK case of *Lee v Chou Wen Hsien*.[213] The appellant, Lee, had become suspicious about certain perceived wrongdoings by the chairperson and managing director of the company. His requests for access to various accounts were denied. When he requested that a board meeting be convened so that he could discuss his suspicions and concerns with the board of directors, he received a notice signed by all his co-directors requesting him to resign immediately. In terms of the company's constitution, the effect of such a notice was that the office of the director in question had to be vacated immediately. The appellant was consequently removed from the board of directors. Even though the Privy Council found that the board of directors had acted with ulterior motives in removing the appellant from the board of directors, it nevertheless held that the removal was valid.[214]

A further example of the power of removal being used subjectively is where the board of directors is required to conduct a performance assessment of a director. Such an assessment could be conducted subjectively and with ulterior motives, and the board could consequently declare that the director has failed to meet a broadly expressed or subjective performance standard,[215] which may constitute a ground for his removal from office.[216] In this vein, David Gonski, the chairman of Coco-Cola Amatil Ltd, asserted that:

> "Judgements on who is or who is not pulling their weight must be made by other board members; and I accept that some board members may not use that power objectively. That's human nature and we have to guard against that."[217]

[213] [1984] 1 WLR 1202.

[214] This case is discussed in more detail in chapter 4, para 4.1.

[215] Austin & Ramsay *Ford, Austin and Ramsay's Principles of Corporations Law* para 7.240 at 289.

[216] The applicable ground under s 71(3) of the Companies Act would be that the director in question has neglected or has been derelict in the performance of the functions of director. This is discussed further in chapter 3, para 6.3.

[217] Australian Institute of Company Directors "David Gonski – The Role of the Chairman" (1 March 2005) available at http://www.companydirectors.com.au/Director-Resource-Centre/Publications/Company-Director-magazine/2000-to-2009-back-editions/2005/March/David-Gonski-The-role-of-the-chairman-Cover-Story (accessed on 8 April 2016).

The King IV Report makes some recommendations regarding the performance evaluations of directors. Principle 9 of the King IV Report states that the governing body (being the board of directors in the case of a company)[218] should ensure that the performance evaluations of its own performance, its committees, its chair and its individual members, support continued improvement in its performance and effectiveness. The Report recommends that the governing body should assume responsibility for the evaluation of its own performance by determining how the evaluation should be approached and conducted.[219]

The King IV Report recommends further that a description of the performance evaluations undertaken during the reporting period be disclosed, including the scope of the performance evaluations and whether a formal process or informal process was followed.[220] In contrast, the King III Report did not require the performance evaluation of the board of directors to be disclosed. The requirement of disclosing the performance evaluations undertaken would necessitate that companies have in place mechanisms to deal with the performance assessment of its directors.[221] This is particularly important in light of the power conferred on directors to remove directors under the Companies Act. There must also be disclosure of the evaluation result, remedial actions taken and whether the governing body is satisfied that the evaluation process is improving its performance and effectiveness.[222] The disclosure requirement in the King IV Report is in harmony with the recommendations of the *Australian Stock Exchange Corporate Governance*

[218] The "governing body" is defined in the King IV Report as meaning the structure that has primary accountability for the governance and the performance of the organisation. Depending on the context, it includes the board of directors of a company, the board of a retirement fund, the accounting authority of a state-owned company and a municipal council (King IV Report, Glossary of Terms, at 12).

[219] King IV Report, principle 9, recommended practice 71.

[220] King IV Report, principle 9, recommended practice 75(a).

[221] McConvill "Removal of Directors of Public Companies takes Centre Stage in Australia" 203.

[222] King IV Report, principle 9, recommended practices 75(b) and 75(c).

Council Principles and Recommendations ("ASX Corporate Governance Principles")[223] and the UK *Corporate Governance Code*,[224] as discussed below.

The ASX Corporate Governance Principles contains various principles of corporate governance and recommendations which elaborate on each of the principles. Listed companies are required to comply with the ASX Corporate Governance Principles or explain why they failed to so comply. Recommendation 1.6 of the ASX Corporate Governance Principles states that a listed entity should disclose a process for periodically evaluating the performance of the board, its committees and individual directors, and that it should disclose, in relation to each reporting period, whether a performance evaluation was undertaken in the reporting period in accordance with that process. Australia's corporate regulator, ASIC,[225] has urged companies to ensure that, in designing mechanisms for assessing the performance of directors, the arrangements, criteria and processes are transparent and fully disclosed, and that the arrangements are clear and legally enforceable.[226]

The UK *Corporate Governance Code* applies to all companies with a premium listing.[227] Such companies are required to comply with its recommendations or explain why they

[223] The ASX Corporate Governance Principles were introduced in 2003. A second edition was released in 2007, and a third edition was released in 2014. The ASX Corporate Governance Principles set out recommended corporate governance practices for entities listed on the Australian Stock Exchange.

[224] The first version of the UK *Corporate Governance Code* was produced in 1992 by the Cadbury Committee. The new Corporate Governance Code applies to accounting periods beginning on or after 17 June 2016 and applies to all companies with a premium listing of equity shares regardless of whether they are incorporated in the UK or elsewhere. A premium listing is only available to equity shares issued by trading companies and closed and open-ended investment entities, and means that the company is expected to meet the UK's highest standards of regulations and corporate governance. The distinction between a standard listing and a premium listing was introduced in the UK in 2010. While the shares listed with a standard listing must comply with the minimum standards, shares listed with a premium listing must comply with more onerous standards.

[225] ASIC is described in chapter 1, note 57. Broadly, the objects and functions of ASIC include maintaining, facilitating and improving the performance of the Australian financial system and the entities within that system in the interests of commercial certainty, reducing business costs, promoting the efficiency and development of the economy and promoting the confident and informed participation of investors and consumers in the financial system (s 1 of the Australian Securities and Investment Commission Act, 2001).

[226] Australian Securities and Investments Commission Information Release IR 04-40 "Removal of Directors of Public Companies" (17 August 2004).

[227] See note 224 above where premium listings are explained.

failed to comply.[228] The Code provides in Recommendation B6 that the "board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors." Recommendation B.6.1 of the UK *Corporate Governance Code*, like the ASX Corporate Governance Principles, states that the "board should state in the annual report how performance evaluation of the board, its committees and individual directors has been conducted."

On the question whether the performance evaluations of the directors must be conducted in-house or by external persons, the King IV Report recommends that the evaluation process may either be externally facilitated or not, but must be conducted in accordance with a methodology that is approved by the directors.[229] The Report recommends that the board of directors should disclose whether the performance evaluation was externally facilitated or not.[230] It is evident that the Report has left much scope for the performance evaluations of directors to be conducted internally, and has placed this decision in the hands of the directors themselves.[231]

In stark contrast, the OECD Principles of Corporate Governance strongly recommend that, particularly in large companies, the evaluation of board members should be supported by external facilitators to increase objectivity.[232] Likewise, the ASX Corporate Governance Principles recommends that the board should consider using external facilitators to conduct its performance reviews.[233] The UK *Corporate Governance Code* also recommends, in Recommendation B.6.2, that evaluation of the board of FTSE 350

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[228] *UK Corporate Governance Code* para 1 at 4.

[229] King IV Report, principle 9, recommended practice 73. For a further discussion on the evaluation of the performance of directors see Mongalo "Director Inductions and Board Evaluations" in Loubser & Mahony *Company Secretarial Practice* 10-6.

[230] King IV Report, principle 9, recommended practice 75(a).

[231] With regard to the performance evaluation of the chairperson, the King IV Report recommends that the governing body should appoint an independent non-executive member to lead the evaluation (King IV Report, principle 9, recommended practice 72). See chapter 3, note 314 for a description of an independent non-executive director under the King IV Report.

[232] The OECD Principles of Corporate Governance at 53.

[233] Refer to the Commentary on Recommendation 1.6 of the ASX Corporate Governance Principles.

companies[234] should be externally facilitated at least every three years. It recommends further that the external facilitator should be identified in the annual report, and a statement made as to whether such person has any other connection with the company.[235] In its Guidance on Board Effectiveness, the UK's Financial Reporting Council[236] recommends that the board evaluation process "should aim to be objective and rigorous".[237] In light of the power given to directors to remove a director from the board of directors, it is submitted that, in order to enhance objectivity and to avoid performance evaluations of directors being conducted subjectively, the King IV Report should strongly recommend that directors use external independent service providers to conduct performance evaluations of board members. This decision should not be left to the board of directors of the company.

The legal status of the King IV Report, as is the case with the King III Report, is that of a set of voluntary principles and practices.[238] If there is a conflict between legislation and the King IV Report the legislation would prevail.[239] This means that the practices and

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[234] The FTSE 350 Index is a weighted stock market index based on the market price of the largest 350 companies which have their primary listing on the London Stock Exchange. It is a combination of the FTSE 100 Index of the largest 100 companies and the FTSE 250 Index of the next largest 250 companies.

[235] Recommendation B.6.2 of the UK *Corporate Governance Code*.

[236] The Guidance on Board Effectiveness (March 2011) is one of a series of guidance notes issued by the Financial Reporting Council (FRC) to assist companies in the UK to apply the principles of the UK *Corporate Governance Code*.

[237] Para 5.1 of the Financial Reporting Council Guidance on Board Effectiveness, available at https://www.frc.org.uk/getattachment/11f9659a-686e-48f0-bd83-36adab5fe930/Guidance-on-board-effectiveness-2011.pdf.

[238] King IV Report at 35. While the application regime for the King III Report was that of "apply or explain" the application regime of the King IV Report is "apply and explain". The chief difference between the application regime of the King III Report and that of the King IV Report is that the application or adoption of the principles is assumed in the King IV Report. The principles are phrased as aspirations and ideals which are basic to good governance and therefore the application of the principles is assumed. The explanation should be provided in the form of a narrative account and reference should be made to practices that demonstrate the application of the relevant principle. The explanation should address the practice which has been implemented and how the implementation of such practice gives effect to the relevant principle (King IV Report at 37).

[239] King IV Report at 35 and 76. If the King IV Report has a higher standard than any legislation, it recommends that the organisations concerned should strive to achieve the higher standard in the interest of good governance. The fact that the King IV Report advocates a higher standard of governance than that demanded by legislation does not necessarily constitute a conflict. A conflict exists when the King IV Report and the legislation cannot be reconciled and not when they are merely different (King IV Report at 76).

recommendations of the King IV Report are persuasive and not binding on boards of directors,[240] save for listed companies.[241] Thus while one may attempt to guard against board members not using their power of assessing their fellow directors subjectively, as recommended by Gonski, it would be challenging to do so effectively. It would also be challenging to guard against the performance evaluations of directors being conducted subjectively in listed companies since the King IV Report leaves it to the board of directors to decide whether the performance evaluations of the directors are to be conducted internally or by external facilitators.

It is imperative that the board of directors does not abuse its power to remove a director from office. In *Bruch v National Guarantee Credit Corp*[242] the Delaware Court of Chancery did not look favourably on granting directors a right to remove a director from office. The general manager of the company had complained to the board of directors that the director in question had been guilty of embezzlement. Without giving the director in question an opportunity to be heard, the board of directors had passed a resolution removing him from office. At the trial the director in question denied all charges or intimations of embezzlement. The court held that the various powers which a corporation may exercise are distributed among the directors, officers and shareholders, and that the power to remove a director rests with the shareholders and not the board of directors.[243] In overturning the removal of the director in question, the court stated as follows:

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[240] This does not mean that there are no legal consequences for a failure to comply with the principles and recommendations of the King IV Report. For instance, for directors of companies the adoption of good corporate governance practices will be important for a court in assessing whether the directors may successfully rely on the protection afforded to them by the business judgment rule set out in s 76(4) of the Companies Act (King IV Report at 35).

[241] See para 7.F.5 of the Listings Requirements of the Johannesburg Stock Exchange ("the JSE Listings Requirements") which requires an applicant issuer to implement the King Code through the application of the King Code disclosure and application regime. Para 7.F.6 requires applicant issuers to comply with the requirements pursuant to para 3.84 concerning corporate governance, and to disclose their compliance therewith in their pre-listing statement. Paragraph 8.63(a) of the JSE Listings Requirements requires issuers (being a company whose shares have been admitted to listing) to disclose in their annual report their implementation of the King Code through the application of the King Code disclosure and application regime. The King Code is defined in the JSE Listings Requirements (Definitions) as the King Code on Corporate Governance for South Africa, as amended or replaced from time to time.

[242] 116 Atl 738 (Ch.1922).

[243] *Bruch v National Guarantee Credit Corp* 116 Atl 738 (Ch.1922) at 741.

> "To allow directors to frame charges against one of their fellows and then to try and expel him, would open the door to possibilities of fraud which designing men might use to wrest control of corporate affairs from the stockholders, or their sympathetic representatives on the board, and transfer it to those who might seek to grasp the corporation for their own ends."[244]

It is clear that there must be effective safeguards against abuse of the power of the board of directors to remove a director from office. If effective checks and balances are present the potential for abuse of any power of the board of directors to remove one of their fellow board members from office may be controllable.

6. IMPACT OF THE COURT'S POWER TO REMOVE A DIRECTOR FROM OFFICE

The Companies Act confers the power of removal of directors on the courts in two respects. First, in terms of section 71(6) of the Companies Act, if the board of directors has determined that a director is not ineligible, disqualified, incapacitated or has not been negligent or derelict (as the case may be) any director who voted otherwise on the resolution or any holder of voting rights entitled to be exercised in the election of that director, may apply to court to review the board's determination.[245] The court may confirm the determination of the board of directors not to remove the director in question from office or it may itself remove the director from office if it is satisfied that the director is ineligible, disqualified, incapacitated or has been negligent or derelict.[246]

A second respect in which a court has the power of removal of a director under the Companies Act, is in terms of section 162(5). Under this provision a court must make an order declaring a person a delinquent director if any of the grounds set out in that section

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[244] *Bruch v National Guarantee Credit Corp* 116 Atl 738 (Ch.1922) at 741.

[245] Section 71(6)(*a)* of the Companies Act.

[246] Section 71(6)(*b*) of the Companies Act. This is discussed further in chapter 6, para 2.2. In terms of s 71(5) of the Companies Act a director who has been removed by the board of directors, or any person who appointed that director as contemplated in s 66(4)(*a*)(i) of the Companies Act, may apply to court to review the determination of the board within twenty business days. Under s 71(5) of the Companies Act a court does not itself remove a director from office but it is empowered to confirm the board's decision to remove the director from office or to overturn the board's decision not to remove a director from office. Strictly speaking, s 71(5) of the Companies Act is not a judicial power to remove a director from office since the director will have been removed from office by the board of directors. Section 71(5) is discussed further in chapter 4, para 4.1 and chapter 7, para 2.

is applicable, such as that a person served as a director while ineligible or disqualified to be a director, or grossly abused his position as a director, or acted in a manner that amounted to gross negligence, wilful misconduct or breach of trust, to name a few grounds.[247] The effect of an order of delinquency is that a person is disqualified from being a director of a company and is thus prohibited from holding that office.[248] As the court in *Kukama v Lobelo*[249] stated, in view of the effect of an order declaring a director delinquent it is not necessary to also order his removal as such due to the automatic inherent effect of the order declaring a person to be delinquent in terms of section 162(5) of the Companies Act.[250] The role of the court in declaring directors delinquent is discussed further in chapter 6.

The power granted to courts to remove directors from office usurps the traditional sole shareholder prerogative to remove directors. The concept of shareholder democracy, that is, the rights shareholders enjoy to appoint and remove directors, conflicts with the power given to courts to remove directors.[251] In removing directors from office, the courts are in effect disregarding the results of the election outcome by which the directors were elected by the shareholders. The courts are essentially revoking the shareholders' representatives from the board of directors, and deciding for shareholders what is in the best interests of the company. In so doing, the courts deprive shareholders of the opportunity to decide for themselves what is in the best interests of the company.[252] Such action intrudes on the prerogative of shareholders to elect directors. The removal of directors by the judiciary thus impacts on the internal structure of the company and alters the composition of the body elected by the shareholders to represent their interests.[253]

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[247] The provisions of s 162 of the Companies Act are discussed in chapter 6, para 3.

[248] Section 69(8)(*a*) of the Companies Act. See also *Grancy Property Limited v Gihwala* 2014 JDR 1292 (WCC) para 159.

[249] 2012 JDR 0062 (GSJ).

[250] *Kukama v Lobelo* 2012 JDR 0062 (GSJ) para 21. See also *Msimang NO v Katuliiba* 2012 JDR 2391 (GSJ) para 32.

[251] Sirodoeva-Paxson "Judicial Removal of Directors: Denial of Directors' License to Steal or Shareholders' Freedom to Vote" 12.

[252] Sirodoeva-Paxson "Judicial Removal of Directors: Denial of Directors' License to Steal or Shareholders' Freedom to Vote" 23.

[253] Sirodoeva-Paxson "Judicial Removal of Directors: Denial of Directors' License to Steal or Shareholders' Freedom to Vote" 16.

As a general principle, the courts are disinclined to interfere in the internal operations of a company involving management decisions.[254] The courts adopt the policy that they should not get involved in situations where the parties are capable of resolving their disputes internally.[255] The election, retention, dismissal or removal of officers, directors and employees are examples of such internal corporate operations, which essentially involve management decisions.[256] With regard to the removal of directors from office, the courts tend to abstain from the substantive review of the merits of decisions made by directors on the basis that shareholders have available to them an accountability mechanism, that is, the shareholder power to remove directors whose performance they may find to be unsatisfactory.[257] Shareholders may appoint a director in their own interests, even if their interests conflict with those of the company and they are under no obligation to choose the person most suitable to be a director.[258] It follows that shareholders have no duty to remove

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[254] See *Maynard v Office Appliances (SA) (Pty) Ltd* 1927 WLD 290 at 293; *Kronenberg v Sullivan County Steam Laundry Co.* 91 N.Y.S. 2d 144 (1949) para 8; *Irvin & Johnson Ltd v Gelcer & Co (Pty) Ltd* 1958 (2) SA 59 (C); *Yende v Orlando Coal Distributors (Pty) Ltd and Others* 1961 (3) SA 314 (W); *Breetveldt and Others v Van Zyl and Others* 1972 (1) SA 304 (T); *Wilkes v Springside Nursing Home, Inc.* Mass. 353 N.E.2d 657 (1976) at 662; *Makhuva v Lukoto Bus Service (Pty) Ltd and Others* 1987 (3) SA 376 (V) at 393-395; *Connolly v Bain* 484 N.W.2d 207 (Iowa App. 1992) at 211; *Demoulas v Demoulas* 1996 WL 511519 (Mass. Super. Ct. Pct 1, 1996) para 32; *Mbethe v United Manganese of Kalahari (Pty) Ltd* 2016 (5) SA 414 (GJ) para 59 and *CDH Invest NV v Petrotank South Africa (Pty) Ltd and Another* [2018] 1 All SA 450 (GJ) paras 44 and 82.

[255] See *Cluver and Another v Robertson Portland Cement and Lime Co Ltd* 1925 CPD 45 at 52 where the court asserted as follows: "nor should the Court, unless a much stronger case is made out, interfere with the domestic forum which has been established for the management of the affairs of a company." In *CDH Invest NV v Petrotank South Africa (Pty) Ltd and Another* [2018] 1 All SA 450 (GJ) the High Court held that conferring on a court the power in terms of s 61(12) of the Companies Act to direct the board of directors to call a shareholders' meeting upon an application by a shareholder, is "company law contra-intuitive" because courts generally decline to interfere in the management of company affairs (para 81). The court stated that the intention of the legislature in enacting s 61(12) of the Companies Act must have been to invoke the oversight role of the courts (para 81). It asserted that an applicant for relief under s 61(12) of the Companies Act would have to put facts before the court that would justify the interference by the court (para 82).

[256] *Wilkes v Springside Nursing Home, Inc.* Mass. 353 N.E.2d 657 (1976) at 662; *Connolly v Bain* 484 N.W.2d 207 (Iowa App. 1992) at 211; *Demoulas v Demoulas* 1996 WL 511519 (Mass. Super. Ct. Pct 1, 1996) para 32.

[257] Bebchuk "The Myth of the Shareholder Franchise" 680.

[258] *Pender v Lushington* (1877) 46 ChD 317. See further *Re HR Harmer Ltd* [1959] 1 WLR 62 at 82; *Sammel and Others v President Brand Gold Mining Co Ltd* 1969 (3) SA 629 (A) at 680; *Desai and Others v Greyridge Investments (Pty) Ltd* 1974 (1) SA 509 (A) at 519; *Kuwait Asia Bank EC v National Mutual Life Nominees Ltd* [1991] 1 AC 187 (PC) at 221 and *CDH Invest NV v Petrotank South Africa (Pty) Ltd and Another* [2018] 1 All SA 450 (GJ) para 44. In *Pender v Lushington* (1877) 46 ChD 317 Lord Jessel MR remarked that if a shareholder votes in such a way that is wholly adverse to the interests of the company as a whole, he cannot on that ground be restrained from giving his vote in whatever way he pleases (at 319).

directors who have misconducted themselves and they may endorse a dishonest director should they wish to do so. If the courts were to remove a director whom the shareholders have decided not to remove from office, this would be an infringement of the principle of non-interference in the internal company affairs of a company.

The right given to the judiciary to remove directors from office impacts not only on the shareholders, as discussed above, but also on the directors. If the board of directors removes a director from office and an application to review the board's decision is instituted under section 71(5) of the Companies Act, a court may decide that the director was improperly removed by the board of directors and may reinstate the director. If on the other hand the board of directors decides not to remove a director from office and an application to court to review the board's decision is instituted under section 71(6) of the Companies Act, a court may itself decide to remove the director from office if it is satisfied that valid grounds exist for such removal. If the court does not affirm the board's decision to remove a director or not to remove a director, it would be acting contrary to the decision made by the board of directors. This infringes on the principle of non-interference by courts in the internal affairs of the company.

In *Yende v Orlando Coal Distributors (Pty) Ltd and Others*[259] the applicant, a shareholder and former director of a company, applied to court under section 62(2) of the Companies Act 46 of 1926 for an order authorising him to call a meeting in the name of the company for the purpose of deciding on a resolution to remove the directors of the company from office. The applicant alleged that there had been numerous irregularities on the part of the directors, but the directors denied these allegations and made numerous counter-allegations against the applicant. In refusing the relief requested by the applicant, Dowling J proclaimed that:

> "In general, the policy of the Courts has been not to interfere in the internal domestic affairs of a company, where the company ought to be able to adjust its affairs itself by appropriate resolutions of a majority of the shareholders. On the papers there appears to be nothing to prevent the applicant from requistioning a general meeting of the company under the provisions of sec. 61 or 62 (1) *(c)* of the Companies' Act. If the applicant can secure the vote of the majority of the

[259] 1961 (3) SA 314 (W).

> shareholders, the second respondent and his co-directors may be removed, and fresh ones be appointed."[260]

Nevertheless, access to a court is an important safety mechanism in instances in which traditional internal governance procedures may fail to protect the company from the recurring misconduct of a director.[261] In such instances the judicial removal of a director might be the most appropriate remedy. In the context of deciding whether to grant a judicial management order, Barry J, in an oft quoted dictum in *Maynard v Office Appliances (S.A.) (Pty) Ltd*[262] stated as follows:

> ". . . if the facts show that there has been mismanagement in the conduct of the company's affairs, the Court will not interfere on the application of a shareholder or an individual director. And the reason is that the directors can redress the mismanagement, or the shareholders can in the general meeting. If a director or shareholder is in a minority as regards the domestic policy of the company, a Court will not assist him unless he can show something *illegal* on the part of the company or something *oppressive* or *fraudulent* on the part of the persons who control the company."[263] [Emphasis added]

These grounds of illegality, oppressive conduct and fraud on the part of the persons who control the company, advocated by Barry J, are some examples of instances which may justify interference by a court in the form of a removal of a director, and where judicial removal would be an appropriate remedy.[264] Other examples of instances where the judicial removal of a director would be the most appropriate or most practical remedy are:

- where the shareholders do not have a sufficient majority to remove a director;

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[260] *Yende v Orlando Coal Distributors (Pty) Ltd and Others* 1961 (3) SA 314 (W) at 316. See further *Van Zyl v Nuco Chrome Bophuthatswana (Pty) Ltd* 2013 JDR 0453 (GSJ) para 33 where the court affirmed that the general policy is that courts should be loathe or reluctant to interfere with the internal affairs of the company, especially in instances where the company ought to be able to regulate its own affairs by appropriate resolutions of a majority of shareholders.

[261] Cox & Hazen *Corporations* 171.

[262] 1927 WLD 290. The dictum of this case was followed in numerous cases, such as *Reich v Hathorn Syndicate* 1930 NPD 233; *Silverman v Doornhoek Mines* 1935 TPD 349; *In Re Mulvihal's Mineral Waterworks (Pty) Ltd* 1936 CPD 135; *Repp v Ondundu Goldfields Ltd* 1937 CPD 375 and *Irvin & Johnson Ltd v Gelcer & Co (Pty) Ltd* 1958 (2) SA 59 (C) at 65.

[263] *Maynard v Office Appliances (S.A.) (Pty) Ltd* 1927 WLD 290 at 294.

[264] See further *Kronenberg v Sullivan County Steam Laundry Co.* 91 N.Y.S. 2d 144 (1949) para 8 and *Demoulas v Demoulas* 1996 WL 511519 (Mass. Super. Ct. Pct 1, 1996) para 32.

- where the director in question owns or controls sufficient shares to block his removal from office;[265]

- where shareholders refuse to remove a director charged with serious misconduct for personal reasons or to protect their own personal interests;

- where a shareholders' meeting to consider the removal of a misbehaving director would entail significant expense and a period of delay that would be contrary to the best interests of the company;[266] and

- where the board of directors removes a director from office with ulterior motives.

To illustrate by example the point that in certain instances judicial interference in the form of removal of a director is justified, in *Markovitz v Markovitz*[267] a young and inexperienced director had harassed his colleagues, employees and customers and had abused the authority and discretion vested in him as a director to the detriment and harm of the business of the company. The shareholders who had the power to remove the director from office did not wish to do so because the shareholders who had elected him to office were his mother and brother. The majority shareholders instituted proceedings under Article IV, section 405C of the Pennsylvania Business Corporation Law of 1933 requesting the court to remove the director from office and to bar him from re-election for a period prescribed by the court. Prior to the enactment of the Business Corporation Law in Pennsylvania the power to remove a director from office before the expiration of his term could be exercised only by the shareholders.[268] The Supreme Court of Pennsylvania found that the director in question was guilty of abuse of authority.[269] The court consequently removed the director

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[265] Ferber *Corporation Law* 41; Schneeman *The Law of Corporations and Other Business Organizations* 262; *Model Business Corporation Act with Official Comments and Reporter's Annotations* 8-95. Even though these examples are provided in respect of USA law they would apply equally in the South African context. The concept of loaded voting rights is discussed in chapter 5, para 3.

[266] Ferber *Corporation Law* 41-2; Schneeman *The Law of Corporations and Other Business Organizations* 262; *Model Business Corporation Act with Official Comments and Reporter's Annotations* 8-95.

[267] 8 A.2d 46 (Pa. 1939).

[268] Section 405C of the Business Corporation Law empowered shareholders holding at least ten per cent of the shares of the company to institute proceedings requesting a court to remove a director in the case of fraudulent or dishonest acts, or gross abuse of authority or discretion.

[269] *Markovitz v Markovitz* 8 A.2d 46 (Pa. 1939) at 48.

from his directorship position and barred him from re-election as a director for a period of two years.[270]

7. MAINTAINING THE BALANCE OF POWERS WITH REGARD TO THE REMOVAL OF DIRECTORS FROM OFFICE

It is important to bear in mind the provisions of section 7 of the Companies Act, setting out its purposes. Section 5(1) of the Companies Act states that the Companies Act must be interpreted and applied in a manner that gives effect to the purposes set out in section 7. In *Nedbank Ltd v Bestvest 153 (Pty) Ltd; Essa and Another v Bestvest 153 (Pty) Ltd and Others*[271] Gamble J expressed the view that the effect of section 7 of the Companies Act is that courts are now required to adopt a "fresh approach" when assessing the affairs of corporate entities in South Africa. The court remarked that the legislature has pertinently charged the courts with the duty to interpret the Companies Act such that the founding values of the Constitution are respected and advanced, and further, so that the spirit and purpose of the Companies Act is given effect to.[272] The court stated as follows, with regard to the interpretation of the Companies Act:

> "Fundamental to the Act is the promotion and stimulation of the country's economy through, inter alia, the use of the company as a vehicle to achieve economic and social wellbeing. This must be done efficiently and in accordance with acceptable levels of corporate stewardship, all the while balancing the rights and obligations of shareholders and directors in the company, its employees and any outside parties with which a company ordinarily interacts on the course of its business."

As emphasised by the court in *Nedbank Ltd v Bestvest 153 (Pty) Ltd; Essa and Another v Bestvest 153 (Pty) Ltd and Others*[273] one of the purposes of the Companies Act is to balance the rights and obligations of shareholders and directors within companies. This purpose is contained in section 7(*i*) of the Companies Act. It is patent from the above discussion that the conferment of the power of removal of a director on the board of

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[270] *Markovitz v Markovitz* 8 A.2d 46 (Pa. 1939) at 48.

[271] 2012 (5) SA 497 (WCC) para 20.

[272] *Nedbank Ltd v Bestvest 153 (Pty) Ltd; Essa and Another v Bestvest 153 (Pty) Ltd and Others* 2012 (5) SA 497 (WCC) para 20. See further *Booysen v Jonkheer Boerewynmakery (Pty) Ltd (in business rescue) and Another* [2017] 1 All SA 862 (WCC) para 46 where the court endorsed this approach.

[273] 2012 (5) SA 497 (WCC) para 20.

directors by the Companies Act has shifted the balance of powers between the shareholders and the directors. The shift in the balance of power between the directors and shareholders is more pronounced in light of section 66(1) of the Companies Act, which confers original power on the board of directors and results in the board being subject to less shareholder control.[274] Arguably, from the director's point of view the current position under the Companies Act is a preferable "balance" because the power of the directors has been enhanced. This is not necessarily so from the point of view of the shareholders because their control over the directors has been reduced. It is important for the rights and obligations of the directors and shareholders to be balanced so that directors do not abuse their powers and do not neglect the interests of the shareholders. The balance of powers between the shareholders and directors is furthermore crucial so that the shareholders are able to act as an effective counterbalance to the powerful directors.[275]

The question arises whether it is possible to maintain the balance of powers between the directors and the shareholders. It is submitted that, in light of the redistribution of the power between the shareholders and the directors, it is not possible to maintain the power between these entities in the manner that had existed prior to the conferment of the power of removal on the board of directors. The mere conferral of the power of removal on the board of directors, even if such power were not used, impacts on the balance of powers between the directors and the shareholders, and on the dynamics between them, because the threat of the power of removal being used is persistently present.

Nevertheless, even if the balance of power between the directors and the shareholders can no longer be maintained to the same extent that had existed prior to the conferment of the power of removal on the board of directors, it is submitted that the proper balance sought by section 7(*i*) of the Companies Act could perhaps be achieved if the board of directors gives due consideration to the following factors before deciding whether to remove a fellow board member:

- The concept of corporate democracy and the inherent rights of shareholders to appoint and remove a director. Before removing a fellow director from office, the

[274] Havenga "Directors' Exploitation of Corporate Opportunities and the Companies Act 71 of 2008" 262.

[275] Hannigan *Company Law* 185.

board should consider whether the inherent rights of shareholders to remove directors should be honoured, or whether they should be disregarded, particularly where the director in question was appointed by the shareholders and not by the board of directors.

- Whether a fellow director whom the board of directors wishes to remove is a representative of the minority shareholders, and if so, the impact of such removal on the dynamics between the majority and minority shareholders.

- Whether in removing a director from office the board of directors would be breaching its fiduciary duties or acting with ulterior motives.

- Whether the board of directors is acting openly and transparently at all times and in the best interests of the company when removing a director from office.

The last two factors stated above would in any event have to be complied with by the board of directors in removing a fellow board member from office. Yet, as illustrated in the UK case of *Lee v Chou Wen Hsien*,[276] boards of directors do act with ulterior motives in removing a director from office and do not necessarily act openly and transparently and in the best interests of the company when removing a director from office. It is evident from *Lee v Chou Wen Hsien*[277] that even where directors breach their fiduciary duties when removing a director and remove a director with ulterior motives, a court may nevertheless affirm the board's decision and not reinstate the improperly removed director.

The conferral of the removal power on the judiciary also affects the relationship between the shareholders and the judiciary and the relationship between the judiciary and the board of directors because it offends the principle of non-interference in the internal affairs of the company. In an attempt to minimise the interference of the judiciary in the internal affairs of the company, it is submitted that, before the judiciary makes a decision whether to remove a director from office or whether to reinstate in office a director who

[276] [1984] 1 WLR 1202.

[277] [1984] 1 WLR 1202. This case is discussed further in chapter 4, para 4.1.

has been removed, it should carefully reflect on whether the removal would involve the court in an undue interference in internal company disputes which should preferably be left to the board of directors and/or the shareholders to resolve. Some considerations which the judiciary should bear in mind before exercising its discretion to remove a director from office or to reinstate a director in office are the following:

- the circumstances and reasons why the shareholders or the board of directors failed to remove the director in question;

- whether the removal of the director in question would be in the best interests of the company;[278]

- the adequacy of any other available remedies;[279]

- whether, in making its decision to remove a director from office, the board of directors has complied with its fiduciary duties in removing the director in question, or whether it has acted with ulterior motives;

- whether the board of directors has made an objective, and not a subjective, assessment of a fellow director with regard to whether he had neglected his functions, or had been derelict in the performance of his functions, should this be the reason the board gives for the removal of the director in question; and

- whether the board of directors has acted openly and transparently and in the best interests of the company in removing the director in question.[280]

It is submitted that if these factors were deliberated upon by courts in judicial removal proceedings, due consideration would have been given by the courts to the inherent right of shareholders to remove directors and to the principle of non-interference in the internal

[278] See further chapter 6, para 3.10.

[279] See further chapter 6, para 3.10.

[280] It should be noted that under s 162(5) of the Companies Act, in declaring a director delinquent, a court is obliged to make an order declaring a person a delinquent director if any of the grounds set out in s 162(5) are satisfied and that a court does not have any discretion in this regard. This is discussed further in chapter 6, para 3.9.

affairs of the company. There must be a balance between the courts having a convincing reason for the removal of a director and the shareholders' or board of directors' privilege to remove a director from office.

8. CONCLUSIONS AND RECOMMENDATIONS

This chapter examined the underpinning philosophy of the removal of directors from office. It explored the reason why shareholders were initially regarded as the supreme organ of a company, and how the balance of power has gradually shifted away from the shareholders in favour of the directors.[281] The division of powers between the directors and shareholders was discussed, and it was evident that in terms of section 66(1) of the Companies Act the management of a company is vested firmly in the board of directors and that directors are now subject to less shareholder control.[282] Directors now have original powers – their powers no longer have to be delegated to them by the shareholders.[283]

The separation of ownership and control, as famously documented by Berle and Means,[284] was examined and the consequences of the split between ownership and control were canvassed.[285] It was seen that the separation of ownership and control has resulted in attenuated control by the shareholders, shareholder apathy, a situation where the interests of the directors and the shareholders often diverge, and managerial autonomy without much control by the shareholders.[286] This chapter further discussed some qualifications which must be made to the concept of separation of ownership and control as documented by Berle and Means in 1932.[287]

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[281] See para 2 above.

[282] See para 2 above.

[283] See para 2 above.

[284] Berle & Means *The Modern Corporation and Private Property*.

[285] See para 3 above.

[286] See para 3 above.

[287] See para 3 above.

This chapter additionally explored the rationale of conferring the power of removal of directors on shareholders.[288] It found that this power was conferred on shareholders as a consequence of the separation of ownership and control, with the expectation that such power would make directors accountable to shareholders, and give directors a strong inducement to serve the interests of the shareholders.[289] It was argued that in light of the effects of the separation of power and control in a company, the power conferred on shareholders to remove directors strikes a balance between the attenuated power of control of shareholders with the power of directors to manage the company.[290] It was further argued that the shareholders' power of removal is a critical tool in the hands of shareholders, a form of corporate democracy, and a necessary and key provision of modern company law.[291]

While there are advantages to conferring the power of removal of a director on the board of directors and on the judiciary, as canvassed in this chapter, it was also argued that the conferral of this power of removal has had an impact on the balance of power between the shareholders and the board of directors, between the shareholders themselves and between the directors themselves.[292] It has also impacted on the relationship between the shareholders, the directors and the judiciary.[293] These arguments are summed up below:

- The balance of power between the shareholders and the directors has shifted on account of the power to remove directors no longer being the sole prerogative of shareholders.[294] The conferment of this power on the board of directors is not consistent with the original rationale of giving shareholders the right to remove directors. This original rationale was to give shareholders more control over directors because the separation of ownership of control resulted in attenuated

[288] See para 4 above.

[289] See para 4 above.

[290] See para 4 above.

[291] See para 4 above.

[292] See para 5 above.

[293] See para 6 above.

[294] See para 5.1 above.

control by shareholders.[295] Additionally, the strong inducement to the directors to focus on the interests of shareholders or to follow the line of action preferred by the shareholders may be diminished.[296]

- The balance of power between the shareholders among themselves has shifted in view of the fact that the board of directors may well remove from office a director representative of the minority shareholders.[297] This would have the effect of altering the dynamics between the majority and the minority shareholders.[298] The balance of power between the shareholders is further affected on account of the fact that under section 68(3) of the Companies Act (unless the Memorandum of Incorporation provides otherwise) the board of directors has the power to fill vacancies, and may well replace a minority director representative with a director whom they favour.[299]

- The balance of power between the directors among themselves has shifted seeing that the board of directors would now have to manage the threat of removal from the board of directors.[300] Previously this threat emanated from the shareholders only.[301] What is more, the conferral of the power of removal on the board of directors may have the effect of limiting or hindering free and open discussion and debate in board meetings, and may result in a dissident director simply toeing the line in order to preserve his position on the board of directors.[302] It may also stifle directors and result in them refraining from taking high-risk but potentially profitable decisions.[303] It may further result in directors failing to bring to the

[295] See paras 4 and 5.1 above.

[296] See para 5.1 above.

[297] See para 5.1 above.

[298] See para 5.1 above.

[299] See para 5.1 above.

[300] See para 5.2 above.

[301] See para 5.2 above.

[302] See para 5.2 above.

[303] See para 5.2 above.

attention of the other board members a suspicion or knowledge of wrong doing by fellow directors.[304] In addition, the power of removal may be used with ulterior motives by directors in order to remove a director whom they do not favour or whom they perceive to be a threat.[305]

- The relationship between the shareholders and the judiciary has changed since the judicial power to remove directors usurps the traditional sole shareholder prerogative to remove directors.[306] By removing from office a director elected by the shareholders, the judiciary in effect disregards the election outcome by which the directors were elected by the shareholders to the board, and revokes the representatives of the shareholders from the board of directors.[307] Furthermore, the removal of directors by the judiciary has the effect of the judiciary deciding for shareholders what is in the best interest of the company, and thus depriving shareholders of the opportunity to decide this for themselves.[308]

- The relationship between the directors and the judiciary has changed because if a court reinstates a director whom the board of directors has removed or, alternatively, removes from office a director whom the board decided not to remove, it contradicts the decision of the board of directors to remove or not to remove the director from office.[309] The decision of the judiciary furthermore involves an interference by the courts with the internal affairs of a company. This is contrary to the general policy of the courts not to interfere in the internal affairs of a company.[310]

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[304] See para 5.2 above.

[305] See para 5.2 above. As discussed in para 5.2 above, the fiduciary duties of directors may not necessarily address the concerns of the removal power being used with ulterior motives. It is evident from *Lee v Chou Wen Hsien* [1984] 1 WLR 1202 that even where directors breach their fiduciary duties when removing a director a court may nevertheless affirm the board's decision and not reinstate the director. This case is discussed further in chapter 4, para 4.1.

[306] See para 6 above.

[307] See para 6 above.

[308] See para 6 above.

[309] See para 6 above.

[310] See para 6 above.

It was contended in this chapter that the balance of power between the shareholders and the directors can no longer be maintained in the manner that had existed prior to the conferment of the power of removal on the board of directors and the judiciary.[311] In an effort to achieve the proper balance sought by section 7(*i*) of the Companies Act, this chapter advocated certain suggestions with regard to containing the redistribution of power between the directors and the shareholders.[312] Finally, this chapter put forward some factors to be deliberated upon by the courts in exercising its removal power so as to give due consideration by the courts to the inherent right of shareholders to remove directors and to the principle of non-interference in the internal affairs of the company.[313]

[311] See para 7 above.

[312] See para 7 above.

[313] See para 7 above.

CHAPTER 3 THE REMOVAL OF DIRECTORS BY THE BOARD OF DIRECTORS

1. INTRODUCTION

The board of directors is empowered by section 71(3) of the Companies Act to remove a director from office. Before the board of directors may validly remove a director from office, the procedures set out in section 71(4) of the Companies Act must be meticulously complied with. This chapter examines the grounds under which a director may be removed from office under section 71(3) of the Companies Act, and the procedural requirements to do so. It compares the grounds for removal of a director by the board of directors and the requisite procedures with the equivalent provisions in the Australian Corporations Act of 2001, the UK Companies Act of 2006, the MBCA, the DGCL[1] and the corporations laws of various States in the USA, with a view to assessing the extent to which sections 71(3) and (4) of the (South

[1] The MBCA and the DGCL are described in chapter 1, para 2.1.

African) Companies Act measure up to their equivalent provisions in the foreign jurisdictions considered. This chapter also discusses how the provisions of South African company law on the removal of directors by the board of directors may be strengthened and improved. The removal of directors by the Companies Tribunal under section 71(8) of the Companies Act is also discussed in this chapter.

2. THE POWER CONFERRED ON THE BOARD OF DIRECTORS TO REMOVE DIRECTORS FROM OFFICE

The power conferred on the board of directors to remove directors from office under the (South African) Companies Act is examined, followed by a discussion of this power under the Australian Corporations Act of 2001, the UK Companies Act of 2006, the MBCA, the DGCL and the relevant corporate legislation of various States in the USA.

2.1 Power of the Board of Directors to Remove Directors under the Companies Act

The Companies Act contains two main types of provisions. The first one is the unalterable provision. An unalterable provision is a provision of the Companies Act that does not expressly contemplate that its effect on any particular company may be negated, restricted, limited, qualified, extended or otherwise altered in substance or effect by a company's Memorandum of Incorporation or rules.[2] A company may not "contract out" of the unalterable provisions of the Companies Act.[3] A company's Memorandum of Incorporation may however impose a more onerous requirement on the company than that contained by an unalterable provision of the Companies Act.[4]

The second type of provision is the alterable provision, which is a provision of the Companies Act in which it is expressly contemplated that its effect on a particular company may be negated, restricted, limited, qualified, extended or otherwise altered in substance or effect by

[2] Section 1 of the Companies Act.

[3] See the *Memorandum on the Objects of the Companies Bill, 2008*, Companies Bill [B 61D-2008] para 5.

[4] See s 15(2)(*a*)(iii) of the Companies Act which provides that the Memorandum of Incorporation of a company may impose on the company a higher standard, greater restriction, longer period of time or any similarly more onerous requirement than would otherwise apply to the company in terms of an unalterable provision of the Companies Act.

that company's Memorandum of Incorporation.[5] Most of the alterable provisions of the Companies Act are "opt-out" provisions, that is, they will apply to the company unless it opts out of them by expressly stipulating so in its Memorandum of Incorporation, as opposed to the "opt-in" provisions which do not apply to a company unless it specifically so provides in its Memorandum of Incorporation.[6]

It is submitted that the power conferred by section 71(3) of the Companies Act on the board of directors to remove fellow board members is an unalterable provision as it does not expressly contemplate that its effect may be negated, restricted, limited, qualified, extended or otherwise altered in substance or effect by a company's Memorandum of Incorporation. It follows that no Memorandum of Incorporation of a company may negate, restrict, limit, qualify, extend or alter the substance or effect of the power conferred by section 71(3) of the Companies Act on the board of directors to remove fellow board members. It is evident that under the Companies Act the board's power to remove fellow board members is a mandatory statutory power that may not be contracted out of.

Both section 69*ter*(6) of the Companies Act 46 of 1926 and section 220(7) of the Companies Act 61 of 1973 provided that nothing in those sections should be taken as "derogating from any power to remove a director which may exist apart from this section". This provision made it clear that the statutory method of removing a director from office was not the only ground on which a director could be removed from office. It also had the effect of exempting a company from having to comply with the statutorily prescribed procedures to remove a director should such procedures be regulated in the constitution of the company.[7] There is no similar provision in section 71 of the Companies Act. Now that this provision has been removed from the Companies Act it would appear that a director of a company must be removed solely and

[5] Section 1 of the Companies Act. These types of provisions usually have the introductory phrase "unless prohibited by its Memorandum of Incorporation" or "except to the extent that the Memorandum of Incorporation of a company provides otherwise".

[6] MF Cassim "Formation of Companies and the Company Constitution" in FHI Cassim et al *Contemporary Company Law* 126. For a further discussion on the alterable and unalterable provisions of the Companies Act see Delport *New Entrepreneurial Law* 28-29 and Delport *Henochsberg on the Companies Act 71 of 2008* 70(1)-78(3).

[7] Cilliers & Benade *Corporate Law* 128; Van Eck & Lombard "Dismissal of Executive Directors: Comparing Principles of Company Law and Labour Law" 28; Esser "Company Law and the Spoliated Director" 144.

strictly in terms of the Companies Act and in accordance with the provisions of section 71 of the Companies Act.

However, section 71 does not (unlike some other provisions in the Companies Act), explicitly exclude any right at common law to remove a director from office.[8] It is consequently not clear whether section 71 of the Companies Act applies in substitution for any rights at common law to remove a director from office, or whether it exists concurrently with the common law rights to remove a director. It is submitted that since section 71 is a mandatory provision it impliedly repeals any common law principles relating to the removal of directors from office. In any event, if the common law were to apply to the removal of directors from office it could defeat the purpose of the statutory protection provided to directors under section 71 of the Companies Act if such common law procedures did not measure up to the statutory protection provided to directors by section 71 of the Companies Act.

In contrast to the Companies Act, the company law statutes of the foreign jurisdictions considered do not confer on the board of directors an unalterable statutory power to remove fellow board members from office. The conferral of power on the board of directors to remove fellow board members in Australia, the UK and the USA is discussed below.

2.2 Power of the Board of Directors to Remove Directors under the Australian Corporations Act of 2001

The Australian Corporations Act of 2001 makes a clear distinction between public companies and private companies with regard to the removal of directors by the board of directors.[9] Directors of public companies in Australia may not remove fellow board members. Section 203E of the Australian Corporations Act of 2001 states that a resolution, request or notice of any or all of the directors of a public company is void to the extent that it purports to remove a director from his office or requires a director to vacate his office. It is thus patently clear that

[8] For example, s 165 of the Companies Act, which relates to derivative actions, expressly states that any right at common law of a person other than a company to bring or prosecute any legal proceedings on behalf of that company is "abolished" and that the rights in s 165 "are in substitution for any such abolished right." See further on this point *Mbethe v United Manganese of Kalahari (Pty) Ltd* 2017 (6) SA 409 (SCA) para 6.

[9] A distinction is also drawn in the Australian Corporations Act of 2001 between the removal of directors by shareholders of private companies (s 203C) and by shareholders of public companies (s 203D). These provisions are discussed below and in paras 4.4, 8.2, 8.4 and 8.5 of chapter 3.

in Australia the power to remove directors of public companies is a power that may not be assumed by the board of directors. The Australian Institute of Company Directors has expressed the view that allowing a board of directors to remove a director could potentially compromise the essential independence of mind (of the directors comprising the board) that is the objective of many corporate governance principles.[10] The example given by the Australian Institute of Company Directors is that a director who conscientiously challenges a board's thinking may be fulfilling his duties under the Australian Corporations Act of 2001.[11] Section 203E of the Australian Corporations Act of 2001 embodies in public companies the concept of shareholder democracy and control,[12] that shareholders should ultimately have the power to remove directors.[13]

In 2004 the power to remove directors of public companies was fervently debated in Australia. Several public companies had implemented what has been called in Australia "pre-nuptial agreements" with incoming directors.[14] Pre-nuptial agreements in this context require a director to resign if the board resolves to pass a vote of no-confidence in him.[15] It has been controversial in Australia whether such pre-nuptial agreements are valid, and whether shareholders have an exclusive, or merely unerodable, right to remove directors of a public company from office.[16] The prevailing view is that in light of section 203E of the Australian Corporations Act of 2001 these pre-nuptial agreements are not valid and that they contravene section 203E of the

[10] Australian Institute of Company Directors "Resignations or Removal of Directors" Position Paper No. 6 (May 2007) at 2.

[11] Australian Institute of Company Directors "Resignations or Removal of Directors" Position Paper No. 6 (May 2007) at 2.

[12] See chapter 2, para 4 where the concept of shareholder democracy and control is discussed.

[13] McConvill & Holland "'Pre-nuptial Agreements' for Removing Directors in Australia – Are they a Valid Part of the Marriage between Shareholders and the Board?" 206; Austin & Ramsay *Ford, Austin and Ramsay's Principles of Corporations Law* para 7.240 at 288-289.

[14] See Austin & Ramsay *Ford, Austin and Ramsay's Principles of Corporations Law* para 7.240 at 288; McConvill "Removal of Directors of Public Companies takes Centre Stage in Australia" 194 and Knight "The Removal of Public Company Directors in Australia: Time for Change?" 352.

[15] McConvill "Removal of Directors of Public Companies takes Centre Stage in Australia" 194.

[16] See *Scottish & Colonial Ltd v Australian Power & Gas Company Ltd* [2007] NSWSC 126; *Allied Mining and Processing v Boldbow Pty Ltd* 160 FLR 369 (W.A.S.C. 2002); McConvill "Removal of Directors of Public Companies takes Centre Stage in Australia" 200-232; Knight "The Removal of Public Company Directors in Australia: Time for Change?" 356-362 and Hill "The Rising Tension between Shareholder and Director Power in the Common Law World" 353.

Australian Corporations Act of 2001.[17] In 2004 ASIC proclaimed in an Information Release titled "Removal of Directors of Public Companies" that only the shareholders of a company may remove the directors of a public company and that attempts by directors to remove another director from office are void.[18] ASIC asserted further that an agreement or any other arrangement that provides that a director of a public company may be removed from office if the other directors so decide, is ineffective.[19] In light of ASIC considering the pre-nuptial agreements to be ineffective, it appears that in Australia the removal of directors of public companies is a matter for the shareholders only, and not a matter for the board of directors.

With regard to private companies, under the Australian Corporations Act of 2001, the board of directors is empowered to remove a director from office if the constitution of the company permits this to be done.[20] This is, however, not expressly stated in the Australian Corporations

[17] See McConvill "Removal of Directors of Public Companies takes Centre Stage in Australia" 232; Hill "The Shifting Balance of Power between Shareholders and the Board" 80 available at http://ssrn.com/abstract=1086477 (accessed on 27 September 2016) and Hill "The Rising Tension between Shareholder and Director Power in the Common Law World" 353.

[18] Australian Securities and Investments Commission Information Release IR 04-40 "Removal of Directors of Public Companies" (17 August 2004).

[19] Australian Securities and Investments Commission Information Release IR 04-40 "Removal of Directors of Public Companies" (17 August 2004).

[20] See Knight "The Removal of Public Company Directors in Australia: Time for Change?" 353; Hill "The Shifting Balance of Power between Shareholders and the Board" 77 available at http://ssrn.com/abstract=1086477 (accessed on 27 September 2016) and Hill "The Rising Tension between Shareholder and Director Power in the Common Law World" 353. With regard to the removal of directors by the shareholders, the Australian Corporations Act of 2001 again draws a distinction between private and public companies. Section 203D applies to the removal of a director by the shareholders of a public company. Sections 203D(2) to (6) confer on the director in question an entitlement to defend himself by putting his case before the shareholders and by sending a written statement to all the shareholders. In terms of s 203D(1), the power to remove directors using the process referred to in s 203D would apply regardless of any provision in the company's constitution, any agreement that the company may have with the director or any agreement between any or all the shareholders and the director. In *Scottish & Colonial Ltd v Australian Power & Gas Company Ltd* [2007] NSWSC 1266 para 39 the New South Wales Supreme Court held that compliance with ss 203D(2) to (6) is mandatory. It stated that the strength of the language used in several places in s 203D indicates that the provision was intended to operate whether or not some provision in the constitution of the company intended some other procedural course which give directors less or no protection (para 39). It placed emphasis on the fact that s 203D is different from its predecessors, which had contained a provision to the effect that nothing in the provision would be taken as derogating from any power to remove a director (paras 21-23). Thus companies were, prior to the enactment of s 203D, able to remove a director either in accordance with the legislation or with any other provisions in their constitution. As is the position under the (South African) Companies Act, s 203D no longer contains such a provision. There is however some controversy regarding the mandatory nature of s 203D. For instance, in *Allied Mining & Processing Ltd v Boldbow Pty Ltd* 160 FLR 369 (W.A.S.C. 2002) at 378-379 the Supreme Court of Western Australia held that s 203D is not mandatory. In *Scottish & Colonial Ltd v Australian Power & Gas Company Ltd* [2007] NSWSC 1266 para 37 the New South Wales Supreme Court asserted that it did not agree with this view expressed in *Allied Mining & Processing Ltd v Boldbow Pty Ltd* 160 FLR 369 (W.A.S.C. 2002). See chapter 3 para 8.2 for a further discussion of *Scottish & Colonial Ltd v Australian Power & Gas Company Ltd* [2007] NSWSC 1266 and Austin & Ramsay

Act of 2001. In terms of section 203C of the Australian Corporations Act of 2001, which is a replaceable rule (meaning that it may be ousted or modified by the constitution of the company)[21] the shareholders of a private company may remove a director by an ordinary resolution passed at a general meeting. Since section 203C is a replaceable rule, for private companies it is possible to displace this rule with a provision in the constitution of the company permitting the board of directors to remove a director from office.[22] Thus, with regard to private companies in Australia, the board of directors may remove directors from office only if empowered to do so by the constitution of the company. Accordingly private companies have the flexibility to decide for themselves whether the board of directors may remove fellow board members from office.

The Australian Corporations Act of 2001 does not set out any grounds for the removal of a director of a private company by the board of directors, nor the procedures to do so. This would presumably be regulated by the constitution of a private company that empowers the board of directors to remove directors from office.[23] This implies that the requirements of removing a director from office by the board of directors will vary from private company to private company, depending on the provisions of the constitution of each company.

2.3 Power of the Board of Directors to Remove Directors under the UK Companies Act of 2006

Unlike the Australian Corporations Act of 2001, the UK Companies Act of 2006 does not distinguish between the removal of the directors of public companies and private companies. Notably, the UK Companies Act of 2006 does not make any explicit provision for the board of

Ford, Austin and Ramsay's Principles of Corporations Law para 7.230 at 284-286 for a discussion on the conflicting views regarding the mandatory nature of ss 203D(2) to (6) of the Australian Corporations Act of 2001.

[21] The concept of replaceable rules under s 135 of the Australian Corporations Act of 2001 is discussed in chapter 2, note 87.

[22] See the heading to s 203C which expressly states that it is a replaceable rule; s 135 of the Australian Corporations Act of 2001 dealing with replaceable rules; Knight "The Removal of Public Company Directors in Australia: Time for Change?" 353; Hill "The Shifting Balance of Power between Shareholders and the Board" 77 available at http://ssrn.com/abstract=1086477 (accessed on 27 September 2016) and Hill "The Rising Tension between Shareholder and Director Power in the Common Law World" 353.

[23] The Australian Corporations Act of 2001 only sets out a specific procedure that must be followed if a director of a public company is removed by the shareholders in a general meeting (see s 203D of the Australian Corporations Act of 2001).

directors to remove a director from office. It empowers only the shareholders to do so. Section 168(1) of the UK Companies Act of 2006 provides that a director of a company may be removed at any time by an ordinary resolution of shareholders, despite anything contained in any agreement between the director and the company.[24] In contrast to section 203E of the Australian Corporations Act of 2001, there is no provision in the UK Companies Act of 2006 which specifically prohibits the removal of directors by the board of directors of public companies.

Section 168(5)(b) of the UK Companies Act of 2006 (which permits shareholders to remove directors by ordinary resolution) states that section 168 is not to be taken as "derogating from any power to remove a director that may exist apart from this section." This has the implication that the articles of association of a company may provide additional grounds for the removal of directors.[25] These grounds will vary from one company's articles of association to another. The most common additional ground is that a director will be removed from office upon a request from fellow directors.[26] In this manner, if the articles of association of a company permit it, directors of both public and private companies in the UK may be removed from office

[24] Section 168 does not require that a reason be given by the shareholders to remove the director from office (see further Kershaw *Company Law in Context* 222). The predecessor to s 168, which was s 303 of the UK Companies Act of 1985, stated that a company may by ordinary resolution remove a director before the expiration of his period in office "notwithstanding anything in its articles or any agreement between it and him." Section 168(1) of the UK Companies Act of 2006 now states that a company may by ordinary resolution at a meeting remove a director before the expiration of his period of office "notwithstanding anything in any agreement between it and him". The deletion of the reference to the articles may suggest that the removal right no longer explicitly overrides a contrary intention in the articles of association. This interpretation is not however correct because the reason why the reference to the articles was deleted was because the Government was of the view that it was not necessary to state expressly that the provisions of the UK Companies Act of 2006 have effect notwithstanding anything in the company's articles since, in any case, "the articles may not override the requirements set out in the Bill" (now the UK Companies Act of 2006) (see Hansard, May 2006, Volume No. 681, Part No. 142 at column 826, per Lord Sainsbury of Turville). See further Kershaw *Company Law in Context* 223; Worthington *Sealy & Worthington's Text, Cases and Materials in Company Law* 300 and chapter 5 para 3.3.3 where this is discussed further.

[25] Worthington *Sealy & Worthington's Text, Cases and Materials in Company Law* 301; Davies & Worthington *Gower Principles of Modern Company Law* 379; Hannigan *Company Law* 174. It also has the implication that the removal of a director by the shareholders may be done without special notice and without permitting the director to make representations to the general meeting (*Browne and Another v Panga Pty Ltd and Another* (1995) 120 FLR 34; French, Mayson & Ryan *Mayson, French & Ryan on Company Law* 447; Worthington *Sealy & Worthington's Text, Cases and Materials in Company Law* 301).

[26] Bourne "The Removal of Directors" 195; Griffin *Company Law Fundamental Principles* 287; Keay "Company Directors Behaving Poorly: Disciplinary Options for Shareholders" 670; Dignam *Hicks & Goo's Cases and Materials on Company Law* 332; French, Mayson & Ryan *Mayson, French & Ryan on Company Law* 447; Worthington *Sealy & Worthington's Text, Cases and Materials in Company Law* 300; Davies & Worthington *Gower Principles of Modern Company Law* 379.

by the board of directors. This is similar to the prevailing position in Australia with regard to the removal of directors by the board of directors of private companies.

An example of the board of directors removing a fellow director from office while acting under a power conferred on it by the articles of association is found in the UK case of *Lee v Chou Wen Hsien*.[27] Article 73*(d)* of the company's articles of association stated that the office of a director shall be vacated if "he is requested in writing by all his co-directors to resign". Lee had become suspicious about certain perceived wrongdoings by the chairperson and managing director of the company. He requested that a board meeting be convened so that he could discuss his concerns with the board of directors. However, he subsequently received a notice signed by all his co-directors requesting him to resign immediately. The Privy Council held that the power given in article 73*(d)* of the articles of association of the company to directors to expel one of their number from the board was a fiduciary power, in the sense that each director concurring in the expulsion had to act in accordance with what he believed to be the best interests of the company.[28] A director could not properly concur in the expulsion of a fellow board member for ulterior reasons of his own.[29] But the court stated that it does not follow that such a notice will be void and of no effect or that the director sought to be removed will remain a director of the board, if one or more of the requesting directors had acted from an ulterior motive.[30] In other words, bad faith on the part of any one director would not vitiate the notice to vacate office and leave in office the director whose removal was sought.[31] The court reasoned that this was necessary in order to give business sense to article 73(*d*) of the articles of association of the company and to avoid uncertainty in the management of the company.[32] Thus, even though the Privy Council found that the board of directors had acted

[27] [1984] 1 WLR 1202. Section 184(1) of the UK Companies Act of 1948 applied at the time of this decision. The articles of association of companies could at that time also provide additional grounds for the removal of directors (see further chapter 2, para 4 where s 184(1) is discussed and Davies & Worthington *Gower Principles of Modern Company Law* 379).

[28] *Lee v Chou Wen Hsien* [1984] 1 WLR 1202 at 1206.

[29] *Lee v Chou Wen Hsien* [1984] 1 WLR 1202 at 1206.

[30] *Lee v Chou Wen Hsien* (1984) [1984] 1 WLR 1202 at 1206.

[31] *Lee v Chou Wen Hsien* (1984) [1984] 1 WLR 1202 at 1206-1207.

[32] *Lee v Chou Wen Hsien* [1984] 1 WLR 1202 at 1207.

with ulterior motives in removing Lee from the board of directors under article 73(*d*) of the company's articles of association, it nevertheless held that his removal from office was valid.[33]

Another example of the board of directors of a UK company removing a fellow director from office while acting under a power conferred on them by the articles of association of the company, emanates from *Bersel Manufacturing Co Ltd and Another v Berry*.[34] Article 16(H) of the articles of association of the company stated that "the permanent life directors shall have power to terminate forthwith the directorship of any of the ordinary directors by notice in writing". Berry and his wife were the two permanent life directors of the company. When Berry's wife died the question arose whether this power was still exercisable by Berry on his own or whether the power had to be exercised jointly. The House of Lords held that this power did not vest in life directors as recipients of a joint confidence,[35] and that there was no reason why the power of removal should not survive to the other when it is lost by one of two joint holders.[36] Accordingly Berry was entitled to exercise the power under article 16(H) of the company's articles of association to terminate the directorship of his daughter-in-law, who was an ordinary director.

In *Jackson v Dear*[37] article 88(e) of the articles of association of the company had conferred the power on all the directors of the company, acting together, to give notice to a director to vacate office, whereupon that directors' office would be vacated. All the directors of the company were also shareholders of the company and were also subject to the terms of a shareholders' agreement, in terms of which Jackson was to be appointed as a director of the company and over time, would continue to be re-appointed unless and until a termination event occurred. The power conferred on the directors by article 88(e) was not affected by any of the express terms of the agreement. This power was invoked by the directors of the company and a notice under article 88(e) of the articles of association of the company was served on Jackson

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[33] This case is critically discussed in chapter 4, para 4.1.

[34] [1968] 2 All ER 552 HL. The UK Companies Act of 1948 applied at the time of this decision. The articles of association of companies could at that time also provide additional grounds for the removal of directors (see further Davies & Worthington *Gower Principles of Modern Company Law* 379).

[35] *Bersel Manufacturing Co Ltd and Another v Berry* [1968] 2 All ER 552 HL at 554.

[36] *Bersel Manufacturing Co Ltd and Another v Berry* [1968] 2 All ER 552 HL at 555.

[37] 2013 WL 617163.

to vacate office. The question before the court was whether it was an implied term of the shareholders' agreement that Jackson would not be removed as a director. The Chancery Division found that such a term should be implied, but this ruling was overturned by the UK Court of Appeal. The shareholders' agreement addressed the appointment and removal of directors by the parties to the agreement but it was silent on the parties' powers under the articles of association of the company. The UK Court of Appeal held that in these circumstances the shareholders' agreement did not have any effect on the power of removal under article 88(e) of the articles of association and to imply a term that it did would be an impermissible re-writing of the parties' agreement.[38] The UK Court of Appeal commented that when exercising the power to remove a board member, the directors must exercise this power in good faith in the interests of the company and in accordance with all the directors' fiduciary duties to the company.[39]

As is the case under the Australian Corporations Act of 2001, the UK Companies Act of 2006 does not specify the grounds under which a director may be removed by the board of directors, should such a provision to this effect be included in the articles of association of the company. The procedures under which this must be done are not specified by the UK Companies Act of 2006 either. This means that the methods of removing a director from office by the board of directors will vary from company to company, depending on the provisions of the constitution of each company. In *Lee v Chou Wen Hsien*[40] and *Jackson v Dear*[41] the relevant provision in the articles of association required all the directors on the board of directors to give a written notice requesting a director to vacate his office, but it seems that there is nothing to prevent a company from stating in its articles of association that only a simple majority of directors would be required to give such a notice.

It is evident from the above examples in case law that the courts in the UK construe a provision in the constitution empowering the board of directors to remove a director from office strictly in accordance with its terms, and to treat the office of director as vacated once the event

[38] *Jackson v Dear* 2013 WL 617163 paras 28-30.

[39] *Jackson v Dear* 2013 WL 617163 para 33.

[40] [1984] 1 WLR 1202.

[41] 2013 WL 617163.

specified in the constitution occurs. While the respective courts in *Jackson v Dear*[42] and *Lee v Chou Wen Hsien*[43] had emphasised that the power to remove a board member is a fiduciary power and must be exercised by the board of directors in good faith in the interests of company, the Privy Council in *Lee v Chou Wen Hsien*[44] nevertheless held that the removal of a director in circumstances where it was reasonably evident that the board of directors had acted with ulterior motives rather than to protect the best interests of the company, was valid.[45]

2.4 Power of the Board of Directors to Remove Directors under the MBCA, the DGCL and Corporate Law Provisions of various USA States

The MBCA does not provide for the board of directors to remove a director from office. It only makes provision for the removal of directors from office by the shareholders. In terms of section 8.08(a) of the MBCA a director may be removed by the shareholders with or without cause unless the articles of incorporation[46] provide that directors may only be removed for cause. If a director was elected by a voting group of shareholders only the shareholders of that voting group may participate in the vote to remove him.[47] A voting group of shareholders is a group of shareholders who have all agreed, by written agreement, to either appoint one person to vote for them as a group or that they will all vote together as one.[48] A director may be

[42] 2013 WL 617163.

[43] [1984] 1 WLR 1202.

[44] [1984] 1 WLR 1202.

[45] The correctness of this decision is considered in chapter 4, para 4.1.

[46] In the USA a distinction is drawn between the articles of incorporation, also known as the certificate of incorporation or the charter, and the by-laws. The articles of incorporation is a document filed with the Secretary of State by the individuals organising the corporation. The State then issues a certificate of incorporation that legally entitles a corporation to operate as a business within the State. The articles of incorporation set out a minimal amount of information which concerns primarily the corporation's external relations with the State. For example, it describes the purpose of the corporation, the name and address of the corporation, and the share structure of the corporation. It also lists the names of the individuals who are acting as incorporators for the corporation, and may list the names of the individuals acting as initial directors for the corporation. The by-laws on the other hand contain the actual rules governing the management of the corporation and the internal relationships of the shareholders, directors and officers of the corporation. The by-laws are not filed with the Secretary of State because they are for the internal use of the corporation only. The certificate of incorporation usually identifies whether the directors or the shareholders or both have the competence to change the by-laws (Ferber *Corporation Law* 31-32; Cox & Hazen *Corporations* 51-60).

[47] Section 8.08(b) of the MBCA.

[48] Ferber *Corporation Law* 41.

removed by the shareholders only at a meeting called for the purpose of removing that director, and the meeting notice must state that removal of the director is a purpose of the meeting.[49]

Special requirements apply to the removal of directors elected by cumulative voting. Cumulative voting as described in section 7.28(c) of the MBCA is where the shareholders are entitled to multiply the number of votes they are entitled to cast (based on the number of shares held by the shareholders) by the number of directors for whom they are entitled to vote and cast the product for a single candidate or distribute the product among two or more candidates. By casting all of the shareholder's votes for a single candidate or a limited number of candidates a minority shareholder's voting power may be enhanced and such shareholder may be able to elect one or more directors. For example, if four vacancies have to be filled each share may be voted four times for one individual to fill one position instead of casting one vote per share for each of the four positions. A person holding one hundred shares may cast four hundred votes in favour of one candidate or may distribute the votes in favour of one or more persons for the four vacancies.[50] By focusing all their votes on one candidate a group of minority shareholders would be able to ensure that they are represented on the board. Cumulative voting thus ensures minority shareholder representation on the board of directors, and favours minority shareholders when all of the minority shareholders agree to vote all of their shares for the same director.[51] If there is no cumulative voting then there usually will be one vote per share and directors will be elected by a plurality of the votes cast by the shares entitled to vote in the election of the directors.[52] Under the MBCA shareholders do not have a right to cumulate their

[49] Section 8.08(d) of the MBCA.

[50] See Cox & Hazen *Corporations* 349.

[51] Hupp "Corporations: Officers and Directors: Relationship between Cumulative Voting and Removal Provisions" 745; Hoffman "Status of Shareholders and Directors under New York's Business Corporation Law: A Comparative View" 520; Burbury "The Role of the Board of Directors in the Closely Held Corporation: A Comparative Assessment of Recent Legislation" 65; Dalebout "Cumulative Voting for Corporation Directors: Majority Shareholders in the Role of a Fox Guarding a Hen House" 1199; Sirodoeva-Paxson "Judicial Removal of Directors: Denial of Directors' License to Steal or Shareholders' Freedom to Vote?" 121; Ferber *Corporation Law* 110-111.

[52] Section 7.28(a) of the MBCA. The straight voting method permits a shareholder to cast only the number of votes he has, as determined by the shares he holds, for each director position to be filled (Striegel "Cumulative Voting, Yesterday and Today: The July, 1986 Amendments to Ohio's General Corporation Law" 1266; Dalebout "Cumulative Voting for Corporation Directors: Majority Shareholders in the Role of a Fox Guarding a Hen House" 1201-1202).

votes for directors unless the articles of incorporation so provide.[53] In the leading case of *Bruch v National Guarantee Credit Corp*[54] the court asserted as follows:

> "The law does not look with disfavor on the policy of securing to minority stockholders a right of representation on the board of directors. This is the reason for the provision allowing cumulative voting. This policy would be endangered, if directors could pursue amotion proceedings[55] against a fellow director."

Under section 8.08(c) of the MBCA, if cumulative voting is not authorised, a director may be removed from office by the shareholders if the number of votes cast to remove him exceeds the number of votes cast not to remove the director from office, except to the extent that the articles of incorporation or by-laws require a greater number. If cumulative voting is authorised by the articles of incorporation, a director may not be removed from office if the number of votes sufficient to elect him under cumulative voting are voted against his removal. In other words, under cumulative voting, a director may be removed from office only if the votes cast in favour of retaining the director would not have been sufficient to elect the director pursuant to cumulative voting. This provision ensures that the minority shareholders with sufficient votes to guarantee the election of a director under cumulative voting will be able to protect that director from removal by the remaining shareholders.[56]

In line with the approach adopted under the MBCA, under the common law of Delaware, directors do not have the power to remove a fellow board member.[57] Like the MBCA, the DGCL does not make any provision for the board of directors to remove a director from office. Section 141(k) of the DGCL makes provision for a director or the entire board of directors to be removed, with or without cause, by the holders of a majority of the shares then entitled to

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[53] Section 7.28(b) of the MBCA.

[54] 116 Atl 738 (Ch.1922) at 741.

[55] Under the USA common law "amotion" refers to the act of removing a director from office for cause before the expiry of the term for which he was appointed (see *Matter of Koch* 257 N.Y. 318 (1931) at 321-322).

[56] See *Model Business Corporation Act with Official Comments and Reporter's Annotations* 8-80. Section 8.08(c) of the MBCA essentially acts to prevent the majority shareholders from abusing their power by removing by majority vote those directors who were elected by the minority shareholders by means of cumulative voting (Dalebout "Cumulative Voting for Corporation Directors: Majority Shareholders in the Role of a Fox Guarding a Hen House" 1221-1222).

[57] See for example the leading cases of *Bruch v National Guarantee Credit Corp* 116 Atl 738 (Ch.1922); *Dillon v Berg* 326 F Supp. 1214 (D. Del. 1971) and *Kurz v Holbrook* 989 A.2d 140 (Del. Ch. 2010).

vote at an election of directors, unless the board of directors is classified or certain directors are elected by shareholders using cumulative voting.[58]

Notably, the DGCL does not expressly prohibit directors from removing other directors. It is not clear whether the power to remove directors in Delaware may be conferred on the board of directors by the certificate of incorporation or the by-laws of the company,[59] as is provided for under the Australian Corporations Act of 2001 and the UK Companies Act of 2006. In *Bruch v National Guarantee Credit Corp*[60] the Delaware Court of Chancery left open the possibility that such authority could be inserted into the certificate of incorporation or the by-laws, on the basis that this question was not before the court. Nevertheless, the courts in Delaware do not look favourably on granting directors the power to remove a director from office and regard the right to remove a director to be a "fundamental element of stockholder authority."[61]

In *Bruch v National Guarantee Credit Corp*[62] the general manager of the company had complained to the board of directors that a particular director had been guilty of embezzlement.

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[58] Prior to 1974 Delaware law did not expressly deal with the removal of directors at all. With the enactment of s 141(k) of the DGCL in 1974 this policy against removing directors from office was modified (see further Collins "Choice of Corporate Domicile: California or Delaware?" 137). There are three exceptions to the general rule that the board of directors may be removed, with or without cause, by the majority of the shareholders. The first exception, in terms of s 141(k)(1) of the DGCL, is that where a corporation has a classified board and the certificate of incorporation does not provide otherwise, the shareholders may remove directors only for cause. A board is considered to be classified if the certificate of incorporation or the by-laws of the company divide the directors into three classes with the term of office of those of the first class to expire at the first annual meeting held after such classification becomes effective, the term of office of those of the second class to expire one year thereafter, and of the third class to expire two years thereafter (see s 141(d) of the DGCL). A classified board is thus one which has multiple classes of directors with staggered terms of service, in contrast to a board having a single class of directors with no staggered terms. Accordingly, in a classified board every director would not stand for re-election every year. If a shareholder wishes to remove a director on a board which is classified, cause for the removal must be shown. The second exception to the general rule contained in s 141(k) of the DGCL, is that where the certificate of incorporation authorises cumulative voting and less than the entire board is to be removed, a director may not be removed without cause if the votes cast against his removal would be sufficient to elect him if cumulatively voted at an election of the entire board or at an election of a class of directors which includes him (see s 141(k)(2) of the DGCL). The third exception is that where the holders of a class or series of shares are entitled by the certificate of incorporation to elect one or more directors, the power to remove without cause a director so elected inures to the holders of that class of series only and not to the holders of the outstanding shares as a whole (s 141(d)(k) of the DGCL).

[59] See Brown "Kurz v Holbrook: Shareholder voting, Omnibus Proxies and the Role of DTC: The Authority of the Board to Remove Directors" (2010) available at http://www.theracetothebottom.org/shareholder-rights/kurz-v-holbrook-shareholder-voting-omnibus-proxies-and-the-r-4.html (accessed on 29 June 2016).

[60] 116 Atl 738 (Ch.1922) at 741.

[61] *Rohe v Reliance Training Network, Inc.* CA No 17992 (Del. Ch. July 21, 2000) para 11.

[62] 116 Atl 738 (Ch.1922).

Without giving the director in question an opportunity to be heard, the board of directors passed a resolution removing him from office. At the trial, the director denied all charges or intimations of embezzlement against him. The Delaware Court of Chancery declared that the various powers which a corporation may exercise are distributed among the directors, officers and shareholders, but the power to remove a director rests with the shareholders and not the board of directors.[63] In overturning the decision to remove the director from office, the Delaware Court of Chancery proclaimed that:

> "To allow directors to frame charges against one of their fellows and then to try and expel him, would open the door to possibilities of fraud which designing men might use to wrest control of corporate affairs from the stockholders or their sympathetic representatives on the board, and transfer it to those who might seek to grasp the corporation for their own ends."[64]

In *Dillon v Berg*[65] a director (Berg) had obtained an undated resignation letter from another director (Power) as a *quid pro quo* for allowing Power's uncontested re-election to the board of directors. The undated resignation letter was worded to take effect immediately. Power subsequently had second thoughts concerning the undated resignation letter and withdrew that letter by means of a written letter sent to Berg and to the other board members. When Berg learnt of Power's wish to withdraw the undated resignation letter, he dated Power's resignation letter to a date prior to Power's letter withdrawing his resignation letter, and circulated the dated resignation letter to the board of directors. The District Court for the District of Delaware held that the agreement giving Berg the authority to remove Power at any time without cause was void and unenforceable.[66] The purported resignation of Power could consequently be given no force and effect.[67] The court found that an agreement that purported to permit the board of directors to remove a director was contrary to public policy.[68] The court ruled that to allow the

[63] *Bruch v National Guarantee Credit Corp* 116 Atl 738 (Ch.1922) at 741.

[64] *Bruch v National Guarantee Credit Corp* 116 Atl 738 (Ch.1922) at 741.

[65] 326 F Supp. 1214 (D. Del. 1971).

[66] *Dillon v Berg* 326 F Supp. 1214 (D. Del. 1971) at 1224.

[67] *Dillon v Berg* 326 F Supp. 1214 (D. Del. 1971) at 1225.

[68] *Dillon v Berg* 326 F Supp. 1214 (D. Del. 1971) at 1225.

board of directors to remove one of its members at any time without cause would violate shareholder rights, Delaware statutes and public policy.[69]

In *Kurz v Holbrook*,[70] the Delaware Court of Chancery reiterated the rule that in Delaware a director may not be removed from office by his fellow directors. In this case the court struck down a proposed by-law that attempted to reduce the size of the board on the basis of its potential for directors to remove other directors by shrinking the size of the board. The Delaware Court of Chancery noted as follows:

> "If a bylaw amendment reducing the size of a board could eliminate sitting directors, then directors suddenly would have the power to remove other directors. For 89 years, Delaware law has barred directors from removing other directors. *Bruch v. Nat'l Guar. Credit. Corp.*, 116 A. 738, 741 (Del.Ch.1922); *accord* Robert Pennington, *Pennington on Delaware Corporations* 117 (1925) ("A director being an officer chosen by the stockholders cannot be removed by his fellow directors."). In 1974, when the stockholders' power to remove directors was confirmed and addressed through the adoption of Section 141(k), two leading authorities on the DGCL wrote that "by negative implication intended by the draftsmen, directors do not have the authority to remove other directors." S. Samuel Arsht & Lewis S. Black, *The 1974 Amendments To The Delaware Corporation Law* 378 (1974). I do not believe the DGCL contemplates a bylaw amendment could overturn this rule."[71]

The approaches in the MBCA and the DGCL represent the most common approaches to the removal of directors in the USA. As the Supreme Court of Indiana pointed out in *Murray v Conseco Inc.*[72] most USA States reserve the power to remove a member of the board to the shareholders who elected the director. The Indiana Court of Appeals in *Murray v Conseco Inc*[73] found that thirty nine USA States, by its count, made no allowance for board removal of directors, with many States having simply adopted verbatim section 8.08 of the MBCA. There are differences between the laws of the different States of the USA. Approximately thirteen

[69] *Dillon v Berg* 326 F Supp. 1214 (D. Del. 1971) at 1225.

[70] *Kurz v Holbrook* 989 A.2d 140 (Del. Ch. 2010).

[71] *Kurz v Holbrook* 989 A.2d 140 (Del. Ch. 2010) para 157.

[72] 795 N.E.2d 454 (Ind.2003) at 456.

[73] 766 N.E.2d 38 (Ind. Ct. App. 2002) at 46.

USA States do empower the board of directors to remove directors from office in certain circumstances.[74]

For instance, section 706(a) of the New York Business Corporation Law[75] empowers the board of directors to remove fellow board members for cause, but only when the certificate of incorporation or a by-law adopted by the shareholders makes provision for the board of directors to remove a fellow board member. Section 706(a) of the New York Business Corporation Law states as follows:

> "Any or all of the directors may be removed for cause by vote of the shareholders. The certificate of incorporation or the specific provisions of a by-law adopted by the shareholders may provide for such removal by action of the board, except in the case of any director elected by cumulative voting, or by the holders of the shares of any class or series, or holders of bonds, voting as a class, when so entitled by the provisions of the certificate of incorporation."

Section 7-1.2-805 of the Rhode Island Business Corporation Act[76] emulates section 706(a) of the New York Business Corporation Law. Section 14A:6-6(3) of the New Jersey Business Corporation Act[77] also adopts a similar stance to that of the New York Business Corporation Law with regard to the removal of directors by board members. This section provides that the certificate of incorporation or a by-law adopted by the shareholders may provide that the board shall have the power to remove directors for cause and to suspend directors pending a final determination that cause exists for removal. Again, the board of directors may remove fellow board members only if the shareholders have empowered the directors to do so. Section 48-18-108(d) of the Tennessee Business Corporation Act likewise provides that directors may be removed for cause by a vote of the entire board of directors if so provided by the charter (which is the equivalent of the certificate of incorporation).

[74] These are Ohio, California, Alaska, Pennsylvania, Massachusetts, Missouri, Minnesota, North Dakota, New Jersey, New York, Rhode Island, Tennessee and Indiana.

[75] The New York Business Corporation Law is the primary corporation statute in the State of New York.

[76] This provision is codified in Title 7 (Corporations, Associations and Partnerships), Chapter 7-1.2 (Rhode Island Business Corporation Act) of the Rhode Island General Laws.

[77] This provision is codified in Title 14A (Corporations, General) of the New Jersey Revised Statutes.

While New York, Rhode Island, New Jersey and Tennessee permit the board of directors to remove directors from office if empowered to do so by the articles of incorporation or the by-laws, the Minnesota Business Corporation Act,[78] under section 302A.223(2), and the North Dakota Business Corporation Act,[79] under section 10-19.1-41, empower the board of directors to remove fellow board members unless this power is modified by the articles of incorporation, the by-laws or a shareholder control agreement. In other words, the board's power to remove directors from office is subject to modification by the articles of incorporation, the by-laws or a shareholder control agreement.[80] Section 23-1-33-8(a) of the Indiana Business Corporation Law[81] also empowers the board of directors to remove directors unless the articles of incorporation provide otherwise. Likewise, section 1726(b) of the Pennsylvania Business Corporation Law[82] permits the board of directors to remove directors from office under certain specified grounds, unless provided otherwise in a by-law adopted by the shareholders. These grounds are (i) the director has been judicially declared of unsound mind; or (ii) has been convicted of an offence punishable by imprisonment for a term of more than one year; or (iii) for any other proper cause which the by-laws may specify; or (iv) if, within sixty days or such other time as the by-laws may specify after notice of his selection, he does not accept the office either in writing or by attending a meeting of the board of directors and fulfill such other requirements of qualification as the by-laws may specify.

2.5 Evaluation of Section 71(3) of the Companies Act

Section 71(3) of the (South African) Companies Act is unique compared to the equivalent provisions in the foreign jurisdictions reviewed in that the board's power to remove fellow board members is an unalterable provision. Most USA States, including the State of Delaware, have not conferred on the board of directors the power to remove fellow board members. Of

[78] The Minnesota Business Corporation Act is codified in chapter 302A (Business Corporations) of the Minnesota Statutes.

[79] The North Dakota Business Corporation Act is codified in chapter 10-19.1, Title 10 (Corporations) of the North Dakota Century Code.

[80] See further Archerd & Scallen "A Comparison of Minnesota and Delaware Business Corporation Statutes" 164.

[81] Section 23-1-33-8 is codified in Title 23 (Business and Other Associations) of the Indiana Code, Article 1 (Indiana Business Corporation Law), Chapter 33 (Board of Directors Generally).

[82] This provision is codified in Title 15 (Corporations and Unincorporated Associations), Chapter 17 (Officers, Directors and Shareholders) of the Pennsylvania Consolidated Statutes.

those USA States which have conferred on the board of directors the power to remove fellow board members, the majority have made such power alterable and not mandatory,[83] in that the board of directors may remove fellow board members *only* if the articles of incorporation or the by-laws make provision for this to be done, or, alternatively, the board of directors may remove fellow board members *unless* the articles of incorporation or the by-laws provide otherwise. The UK Companies Act of 2006 and the Australian Corporations Act of 2001 have adopted similar positions with regard to the removal of directors by the board of directors in that the board of directors may remove directors only if empowered to do so by the constitution of the company. It is submitted that there is merit in permitting the board of directors to remove fellow board members,[84] and, provided the board of directors acts openly and there are acceptable safeguards against abuse of the power to remove fellow board members, this power ought to remain in the (South African) Companies Act. The question, however, arises whether this power should be a mandatory power or whether section 71(3) of the Companies Act ought

[83] The States of Massachusetts and Missouri are exceptions because they have made the power of removal by the board of directors a mandatory power and not an alterable power in that a corporation is not authorised to limit or eliminate this power in its articles of incorporation or by-laws. The provisions of these statutes differ from s 71(3) of the (South African) Companies Act in substantial respects. In terms of s 8.08(d) of the Massachusetts Business Corporation Act Chapter 156D (which Chapter is codified in Part I (Administration of the Government) Title 22 (Corporations) of the Massachusetts General Laws) directors may be removed for cause by vote of the greater of (i) a majority of the directors then in office or (ii) the number of directors required by the articles of organization or by-laws to take action under s 8.24 of the Massachusetts Business Corporation Act Chapter 156D (dealing with quorum and voting). This provision differs from s 71(3) in that if a director is elected by a voting group of shareholders only the directors elected by that voting group may participate in the vote to remove him. In contrast, s 71(3) of the Companies Act does not have this safeguard and under s 71(3) of the Companies Act all the directors may participate in the vote to remove a fellow board member, regardless of who appointed that director to the board of directors. Section 351.317 of the Missouri General Business Corporation Law (which Chapter 351 (General and Business Corporations) is codified in Title 23 (Corporations Associations and Partnerships) of the Missouri Revised Statutes) states that a director of the corporation may be removed for cause by the action of a majority of the entire board of directors if at the time of removal the director has failed to meet the qualifications stated in the articles of incorporation or by-laws for election as a director or is in breach of any agreement between such director and the corporation relating to such director's services as a director or employee of the corporation. This provision also does not authorise corporations to limit or eliminate this power in their articles of incorporation or by-laws. It differs from s 71(3) of the Companies Act in that a majority of the entire board of directors is required to vote on the removal of the director and not merely a majority of the directors forming a quorum. This is discussed further in para 8.1 below.

[84] See chapter 2, para 5.1 where this is discussed.

to, in line with the foreign jurisdictions considered, make the conferral of power on the board of directors to remove fellow board members an alterable power. This is discussed below.

3. DIRECTORS TO WHOM THE BOARD'S POWER OF REMOVAL OF DIRECTORS APPLIES

The question arises whether the power conferred on the board of directors by section 71(3) of the Companies Act to remove fellow board members enables the board to remove any director from office, or whether the board of directors may remove from office only those directors whom it has appointed to office. Section 71(3) of the Companies Act does not make any distinction regarding whether directors may remove only directors appointed by them or whether they may also remove directors appointed by the shareholders. The provision boldly states that the board "may remove a director" from office. It must follow that under section 71(3) of the Companies Act removal rights do not follow appointment rights and that the board of directors is empowered to remove from office any director, regardless of who had appointed that director to the board of directors. In contrast, it is debatable whether shareholders may remove from office directors who were appointed by the directors or by a person named in, or determined in terms of, the Memorandum of Incorporation pursuant to section 66(4)(*a*)(i) of the Companies Act, or whether they may remove only those directors who were appointed by them in an election of directors. [85]

[85] Section 71(1) of the Companies Act states that 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". The implication of these words is that only the shareholders or persons entitled to vote in an election of a particular director are entitled to vote on a shareholders' resolution to remove that director from office. On a strict literal interpretation of these words, if a director were appointed to the board of director by other directors or by a person named in the Memorandum of Incorporation, the shareholders would not have the power to remove that director from office by an ordinary resolution (see FHI Cassim "The Division and Balance of Power" 160 and R Cassim "Governance and the Board of Directors" in FHI Cassim et al *Contemporary Company Law* 442). An alternative interpretation of these words is that they do not restrict the power of shareholders to remove directors who are appointed by the board of directors or by a person named in the Memorandum of Incorporation because these words are intended to be interpreted in a general sense only, so as to refer to persons who would be entitled to exercise voting rights if that director were to be elected, in a general election of that director (R Cassim "Governance and the Board of Directors" in FHI Cassim et al *Contemporary Company Law* 442). It is arguable that if the legislature had intended to restrict the power of shareholders to remove only those directors whom they have elected it would have stated in s 71(1) of the Companies Act "persons entitled to exercise voting rights in *the* election of that director" (emphasis added), or the legislature would have made it much clearer that directors appointed by the board of directors or other persons named in the Memorandum of Incorporation may not be removed by the shareholders (R Cassim "Governance and the Board of Directors" in FHI Cassim et al *Contemporary Company Law* 442). For instance, s 8.08(b) of the MBCA 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 that director." A voting group of shareholders is a group of shareholders who have all agreed, by written agreement, to either appoint one person to vote for them as a group or that they will all vote together as one (Ferber

Notably, section 66(4)(*a*)(i) states that a company's Memorandum of Incorporation may provide for the "direct appointment and removal" of one or more directors by any person who is named in, or determined in terms of, the Memorandum of Incorporation. Accordingly, the Memorandum of Incorporation may provide for the removal of a director by a specific person named therein. Nevertheless, since section 71(3) of the Companies Act does not make any distinction regarding the director whom the board of directors may remove from office, it appears that the board of directors is empowered to remove from office the director so appointed by the person named in the Memorandum of Incorporation.

In sharp contrast, those USA States which permit directors to remove fellow board members, distinguish between directors who were appointed by the board of directors and those who were appointed by the shareholders. Thus, under section 706(a) of the New York Business Corporation Law the board of directors may not be empowered by the certificate of incorporation or a by-law to remove a director elected by cumulative voting. Furthermore, where the certificate of incorporation empowers a director to be elected by the holders of the shares of a class or series,[86] or holders of bonds voting as a class, the board of directors may not be empowered by the certificate of incorporation or a by-law adopted by the shareholders to remove fellow board members. These two exceptions are designed to protect minority shareholders and director representatives of a specific class of shares. Section 7-1.2-805(a) of the Rhode Island Business Corporation Act also protects minority shareholders by not

Corporation Law 41). Here the legislature has made it patently clear that if a director is elected by a specific voting group of shareholders who agreed to vote together as one, then only those shareholders, and no other shareholders, may remove that director from office. (The MBCA does not empower the board of directors to remove fellow board members.) Such clarity is lacking in s 71(1) of the Companies Act, if it is indeed the intention of the legislature to restrict the removal of directors by shareholders to those directors who were appointed by shareholders in an election of directors. If shareholders were not empowered to remove from office a director appointed by the board of directors of whom they disapproved, this would be a gross violation of the right of shareholders to remove directors (FHI Cassim "The Division and Balance of Power" 161). It is furthermore arguable that the words "despite anything to the contrary in a company's Memorandum of Incorporation or rules, or any agreement between a company and a director, or between any shareholder and a director" in s 71(1) of the Companies Act indicate that shareholders may remove a director by ordinary resolution despite any provision in the Memorandum of Incorporation of a company, such as a provision that only a person named in the Memorandum of Incorporation may remove a director (R Cassim "Governance and the Board of Directors" in FHI Cassim et al *Contemporary Company Law* 443). For these reasons it is submitted that the strict literal interpretation of the words "persons entitled to exercise voting rights in an election of that director" should not be adopted. See Ncube "You're Fired! The Removal of Directors under the Companies Act 71 of 2008" 38-39 who expresses the view that the shareholders' power to remove directors is restricted to elected directors and Masinire "A Critical Analysis of the Role and Protection of Shareholders in the Removal of Directors in the South African Companies Act 71 of 2008" 1990-1991 for a discussion of the view expressed by Ncube. The matter must be clarified by the legislature or by the courts.

[86] Directors appointed by a class or series of shares are referred to as class directors.

permitting the board of directors to remove directors who were appointed by cumulative voting or by the holders of the shares of any class or series or holders of bonds voting as a class.

Further examples of the USA States that protect minority shareholder representatives on the board from removal by the board of directors, are Minnesota and North Dakota. These States permit directors to remove from office only those directors who were appointed by the board, but not those elected by shareholders. In terms of section 302A.223(2) of the Minnesota Business Corporation Act and section 10-19.1-41 of the North Dakota Business Corporation Act directors may remove other directors, with or without cause, if the director was appointed by the board to fill a vacancy, the shareholders have not elected directors in the interval between the time of appointment to fill a vacancy and the time of removal, and a majority of the directors approve the removal. Under this provision a director appointed by the shareholders would not be subject to removal by the board. The rationale behind this provision is that if a director were appointed by the board of directors then his authority as a director flows directly from the other directors and those other directors have the power to terminate that authority. The same rationale was relied on by the Court of Chancery of Delaware in *Bruch v National Guarantee Credit Corp*[87] where the court proclaimed that the power to remove a director must be exercised by the power that elected the director.[88]

The Indiana Business Corporation Law also protects directors from removal by the board of directors if they were appointed by a particular group of shareholders. Section 23-1-33-8(a) of the Indiana Business Corporation Law states that directors may be removed in any manner provided in the articles of incorporation. The provision states further that shareholders or directors may remove one or more directors with or without cause unless the articles of incorporation provide otherwise. The limitation on the power of the board to remove a fellow director is contained in section 23-1-33-8(b) of the Indiana Business Corporation Law 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 the director.[89] Section 23-1-33-8(b) of

[87] 116 Atl 738 (Ch.1922) at 741.

[88] In terms of s 141(k) of the DGCL if shareholders of a particular class are empowered by the certificate of incorporation to elect a director, only the shareholders of that class may vote on the resolution to remove that director.

[89] A voting group of shareholders is a group of shareholders who have all agreed, by written agreement, to either appoint one person to vote for them as a group or that they will all vote together as one (Ferber *Corporation Law* 41).

the Indiana Business Corporation Law would be applicable only where a director is elected by a separate voting group of shareholders but has no application to a director elected by all of the shareholders.[90] Section 23-1-33-8(b) is designed to preserve representation on the board by a voting group and protects the rights of minority shareholders to representation on the board of directors.[91]

In *Murray v Conseco Inc*,[92] Murray, a director of Conseco Inc., had been removed by the board of directors. The company had one class of common stock and a series of preferred shares that had voting rights. Conseco Inc. had no shareholders that were elected by a separate voting group. Murray nevertheless reasoned that the shareholders as a body are a voting group who elected him as a director, and by reason of section 23-1-33-8(b) of the Indiana Business Corporation Law only the shareholders, and not the board of directors, were authorised to remove him from office. The Supreme Court of Indiana held that the words "elected by a voting group" in section 23-1-33-8(b) refer to groups that elect separate directors, and do not apply to directors elected by a voting group consisting of all voting shares voting generally.[93] In other words, the court held that all the shareholders as such do not constitute a voting group, and that the board was accordingly empowered to remove Murray from office.

In many USA States cumulative voting is permissible if so stated in the articles of incorporation or the by-laws and in a few USA States cumulative voting is mandatory. Many of the USA States which allow the board of directors to remove directors from office have provisions in their respective statutes designed to protect directors who were elected by cumulative voting.[94] The (South African) Companies Act on the other hand does not make express provision for cumulative voting. Section 68(2)(*b)* of the Companies Act states that in any election of directors, in each vote to fill a vacancy each voting right entitled to be exercised may be exercised once. It should be noted, however, that section 68(2)(*b*) of the Companies Act is an

[90] *Murray v Conseco Inc.* 795 N.E.2d 454 (Ind.2003) at 459.

[91] *Murray v Conseco Inc.* 795 N.E.2d 454 (Ind.2003) at 458-459 and 460.

[92] 795 N.E.2d 454 (Ind.2003).

[93] *Murray v Conseco Inc.* 795 N.E.2d 454 (Ind.2003) at 459.

[94] For instance, as discussed, New York and Rhode Island do not permit the board of directors to remove fellow board members where the directors were elected with cumulative voting.

alterable provision and that the Memorandum of Incorporation of a profit company may alter section 68(2)(*b*) of the Companies Act. In other words, the Memorandum of Incorporation of a profit company may provide that in an election of directors in each vote to fill a vacancy each voting right entitled to be exercised may be exercised more than once. In this way, a company's Memorandum of Incorporation may amend the default position and expressly make provision for cumulative voting. But the Companies Act has not imposed any legal safeguards to ensure that directors may not remove from office the director representatives of minority shareholders.

As discussed earlier, several USA States that permit the board of directors to remove directors have made the directors' power to remove directors an alterable power, either by providing that the board of directors may remove fellow board members only if empowered to do so by articles of incorporation or the by-laws, or by providing that the power of removal applies unless altered by the articles of incorporation or the by-laws. Under both the Australian Corporations Act of 2001 and the UK Companies Act of 2006 directors may remove fellow board members only if empowered to do so by the constitution of the company. Section 71(3) of the (South African) Companies Act is unique in that the statutory power of the directors to remove directors is mandatory and the section does not distinguish between the directors appointed by the directors or by the shareholders, nor does it make any provision to protect the shareholder representatives, or the minority shareholder representatives, on the board of directors from removal by the board of directors. As discussed in chapter 2, the fact that a director is empowered to remove from office a director appointed by the shareholders, including a minority shareholder representative on the board, shifts the balance of power between the shareholders and the board of directors, and may impact on the dynamics between the majority and minority shareholders.[95]

It is submitted that under the (South African) Companies Act the board of directors should be empowered to remove any director from office, including those directors appointed by the shareholders or a third party in terms of section 66(4)(*a*)(i) of the Companies Act. An advantage of permitting the board of directors to remove any director from office is that if a shareholder-appointed director or a director appointed by a third party neglects his duty or is derelict in the performance of his functions or if any other valid ground for removal referred to in section

[95] See chapter 2, para 5.1 where this is discussed.

71(3) of the Companies Act exists, the board would be empowered to remove the director in question from office, instead of having to rely on the shareholders or a third party, who may be reluctant to remove their representative from office, to do so.

However, in order to balance the rights between the directors and shareholders, as required by section 7(*i*) of the Companies Act,[96] it is submitted that the power to remove directors in section 71(3) of the Companies Act should be an alterable power and not an unalterable power. More specifically, the provision should be an "opt-out" provision, in that the board's power to remove a director should apply unless the company opts out of it by expressly so stipulating in its Memorandum of Incorporation. In other words, the wording of section 71(3) of the Companies Act should be preceded by the words "Except to the extent that the company's Memorandum of Incorporation provides otherwise." The company would then be empowered to determine whether it wishes to retain the default provision under the Companies Act empowering the board of directors to remove fellow board members or whether to alter this default provision to suit its particular needs by negating, restricting, limiting, qualifying, or extending the board's power to remove fellow board members. A company would also be empowered to insert in its Memorandum of Incorporation provisions protecting the minority shareholder representatives on the board of directors, should this be deemed necessary based on the company's specific needs and requirements.

For example, if the Memorandum of Incorporation under section 68(2)(*b*) of the Companies Act were to give shareholders more than one vote in electing directors so as to protect the minority shareholder representatives, then the Memorandum of Incorporation could also specifically restrict the power of the board of directors to remove directors elected by such shareholders. Another example would be if the Memorandum of Incorporation were to appoint a voting group to appoint a director, or a particular person to appoint a director under section 66(4)(*a*)(i) of the Companies Act, under the "opt-out" provision a limitation to the board's power of removal may be provided in that the Memorandum of Incorporation may provide that only the voting group or the person who appointed that director may remove him from office.

If section 71(3) of the Companies Act were to be an alterable provision in the Companies Act it would bring the provision in line with the equivalent provisions in the foreign jurisdictions

[96] Section 7(*i*) of the Companies Act is discussed in chapter 2, para 7.

considered which do not make the board's power to remove fellow board members compulsory, and which incorporate some protection for minority shareholder representatives on the board of directors. An alterable power of removal conferred on the board of directors, as opposed to a compulsory power of removal would also go some way in satisfying the requirement of section 7(*i*) of the Companies Act of balancing the rights and obligations of shareholders and directors within companies.

4. COMPANIES TO WHICH THE BOARD'S POWER OF REMOVAL OF DIRECTORS APPLIES

Section 71(3) of the Companies Act applies to companies with "more than two directors", that is, it applies to companies with three or more directors. The types of companies to which section 71(3) applies are discussed below.

4.1 Private Companies and Personal Liability Companies

The board of directors of a private company and a personal liability company must comprise at least one director.[97] Under section 66(3) of the Companies Act a company's Memorandum of Incorporation may specify a higher minimum number of directors. Section 71(3) of the Companies Act would not apply to private companies or personal liability companies if such companies do not have at least three directors on their board of directors. In this event, the provisions of section 71(8) of the Companies Act would apply to that company, in terms of which the removal of a director must be determined by the Companies Tribunal.

It follows that a private company and a personal liability company would be able to control whether the board of directors of that company would be empowered to remove directors from office by controlling whether they appoint three or more directors to the board of directors. If the company wishes to exclude the provisions of section 71(3) of the Companies Act, it could do so by appointing only one or two directors to its board of directors. If it wishes for the provisions of section 71(3) to be applicable to the company, it could in that case ensure that at least three directors are appointed to the board of directors. It is important for private companies and personal liability companies to be aware of the consequences regarding the applicability

[97] Section 66(2)(*a*) of the Companies Act.

of section 71(3) of the Companies Act when deciding on the number of directors to appoint to the board of directors.

4.2 Non-profit Companies

The board of directors of a non-profit company must comprise at least three directors.[98] It follows that section 71(3) of the Companies Act applies to the removal of directors of non-profit companies.

Even though section 71(3) of the Companies Act refers to the term "shareholders" and not "members", it follows from section 10(4) of the Companies Act that the provisions of section 71(3) apply to the voting members of a non-profit company. Section 10(4) of the Companies Act states that in respect of a non-profit company that has voting members, a reference in the Companies Act to "a shareholder" is to be regarded as a reference to the voting members of a non-profit company. Where a non-profit company does not have members or does not have voting members, the provisions of section 71(3) must be read to refer to directors only.

4.3 State-owned Companies

The Companies Act does not specify the minimum number of directors that must comprise the board of directors of a state-owned company. However section 9(1) of the Companies Act states that any provision of the Companies Act which applies to a public company applies also to a state-owned company, except to the extent that the Minister has granted an exemption in terms of section 9(3) of the Companies Act. Section 66(2)(*b*) of the Companies Act provides that the board of directors of a public company must comprise at least three directors. From this one may deduce that the board of directors of a state-owned company must comprise at least three directors (save to the extent that the Minister has granted an exemption to this provision). It follows that the provisions of section 71(3) of the Companies Act apply to the removal of directors of state-owned companies.

[98] Section 66(2)(*b*) of the Companies Act. The minimum number of directors provided for in s 66(2) are in addition to the minimum number of directors that a company must have to satisfy any requirement in terms of the Companies Act or the Memorandum of Incorporation of the company to appoint an audit committee or a social and ethics committee.

It is important to be aware that state-owned companies are often governed by their own specific legislation as well as by the Companies Act. For example, the South African Airways SOC Limited is governed by the South African Airways Act 5 of 2007, the South African Post Office SOC Limited is governed by the South African Post Office SOC Ltd Act 22 of 2011, the Armaments Corporation of South Africa SOC Limited ("Armscor") is governed by the Armaments Corporation of South Africa Limited Act 51 of 2003 ("the Armscor Act") and the South African Broadcasting Corporation SOC Limited ("SABC") is governed by the Broadcasting Act 4 of 1999 ("the Broadcasting Act").[99] Conflicts over the removal of directors under the governing legislation of these state-owned companies and the removal of directors under the Companies Act can, and do, arise.

Section 5(4) of the Companies Act states that if there is an inconsistency between a provision of the Companies Act and a provision of any other national legislation, the provisions of both Acts apply concurrently, to the extent that it is possible to apply and comply with one of the inconsistent provisions without contravening the second. To the extent that this is not possible, the Companies Act lists certain Acts which will supersede the Companies Act.[100] In all other instances of conflict, the provisions of the Companies Act will prevail.[101]

An example where the court managed to read the provisions of the Companies Act concurrently with a specific statute which applies to state-owned companies, is found in *Minister of Defence*

[99] Section 1 of the Companies Act defines a "state-owned company" as an enterprise that is registered in terms of the Companies Act as a company and either (i) is listed as a public entity in Schedule 2 or 3 of the Public Finance Management Act 1 of 1999; or (ii) is owned by a municipality, as contemplated in the Local Government: Municipal Systems Act 32 of 2000, and is otherwise similar to an enterprise referred to in (i) above. The above-mentioned entities are listed in Schedule 2 (Major Public Entities) of the Public Finance Management Act 1 of 1999.

[100] See s 5(4)(*b*)(i) of the Companies Act. These Acts are the Auditing Profession Act 26 of 2005, the Labour Relations Act 66 of 1995, the Promotion of Access to Information Act 2 of 2000, the Promotion of Administrative Justice Act 3 of 2000, the Public Finance Management Act 1 of 1999, the Securities Services Act 36 of 2000, which has since been repealed and replaced by the Financial Markets Act 19 of 2012, the Banks Act 94 of 1990, the Local Government: Municipal Finance Management Act 56 of 2003 and s 8 of the National Payment System Act 78 of 1998.

[101] Section 5(4)(*b*)(ii) of the Companies Act. Two exceptions apply in this regard. The first is that if there is a conflict between a provision of Chapter 8 of the Companies Act (Regulatory Agencies and Administration of the Companies Act) and a provision of the Public Service Act, 1994 (Proclamation 103 of 1994) the provisions of the latter Act will prevail. The other exception is that if there is a conflict between any provision of Part B of Chapter 5 (Authority of the Takeover Regulation Panel, Part C of Chapter 5 (Regulation of affected transactions and offers) or the Takeover Regulations and any provision of another public regulation, the conflicting provisions apply concurrently to the extent that it is possible to apply and comply with one of the inconsistent provisions without contravening the second. To the extent that this is not possible, the provisions of the other public regulation will prevail (see ss 5(4)(*b*)(ii), 5(5) and 118(4) of the Companies Act).

and Military Veterans v Motau and Others.[102] The Armscor Act governs the affairs of Armscor, which is a state-owned entity.[103] The State is the sole shareholder of Armscor and exercises ownership control of Armscor through the Minister of Defence and Military Veterans.[104] Armscor's affairs are managed by its board of directors, consisting of nine non-executive members and two executive members.[105]

The facts of this case are that the Minister of Defence and Military Veterans terminated the membership of two members of the board of directors of Armscor, in terms of section 8(*c*) of the Armscor Act. Section 8(*c*) of this statute provides that a member of the board must vacate office if his services are terminated by the Minister of Defence and Military Veterans on good cause shown. The membership of these two board members was terminated after they failed to attend various board meetings arranged by the Minister. The two directors who had been removed from office applied to the North Gauteng High Court, Pretoria, to set aside the Minister's decision on the ground that it was unlawful, unconstitutional and invalid, and had not complied with the Promotion of Administrative Justice Act 3 of 2008. The court *a quo* found that the Minister's dismissal power constituted administrative action, and that she had failed to comply with the Promotion of Administrative Justice Act 3 of 2008.[106] The court consequently granted judgment in favour of the two directors who had been removed from office. On appeal by the Minister to the Constitutional Court, the question before the court was whether the dismissal power of the Minister of Defence and Military Veterans comprised administrative action or whether it was executive action. If it comprised executive action, the further question before the court was whether the Minister was required to comply with the procedures for the removal of directors laid down in sections 71(1) and (2) of the Companies Act.

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[102] 2014 (5) SA 69 (CC).

[103] Armscor was incorporated primarily to provide South Africa's armed services with military material, equipment, facilities and services. It is the armament's and technology procurement agency of the Department of Defence (see *Minister of Defence and Military Veterans v Motau and Others* 2014 (5) SA 69 (CC) para 3).

[104] Section 2(2) of the Armscor Act.

[105] Section 6(1) of the Armscor Act.

[106] See *Motau and Another v Minister of Defence and Military Veterans and Another*, unreported case no 51258/13, North Gauteng High Court, Pretoria, 18 September 2013.

The Constitutional Court confirmed that the Minister of Defence and Military Veterans is, for the purposes of section 71(1) and (2) of the Companies Act, the shareholder of Armscor.[107] On the question whether the dismissal decision constituted administrative action or executive action, the majority judgment disagreed with the court *a quo* that the decision comprised administrative action. It held that the Minister's power to dismiss directors was more executive, rather than administrative, in nature. This was because it was an adjunct of the power to formulate defence policy, it was a high-level power and not a low level bureaucratic power involving the application of policy, and the Minister was afforded a broad discretion in exercising the power, which indicated that it constituted performance of an executive function rather than the implementation of national legislation.[108] On this basis the majority of the Constitutional Court found that the Minister's power was not subject to review under the Promotion of Administrative Justice Act 3 of 2008.

On the question whether there were any procedural constraints on the exercise of the Minister's power in terms of section 8(*c*) of the Armscor Act, the Constitutional Court held that this provision must be read concurrently with sections 71(1) and (2) of the Companies Act. The court found that these two provisions are "perfectly compatible"[109] in that the Armscor Act provides the substantive criterion while the Companies Act provides the process by which board members of Armscor may be dismissed. In other words, section 71(2) of the Companies Act is the prescribed procedure by which the Minister of Defence must exercise her power in terms of section 8(*c*) of the Armscor Act.[110] The Constitutional Court accordingly held that the failure of the Minister of Defence and Military Veterans to comply with the procedural requirements of sections 71(1) and (2) of the Companies Act in terminating the membership of the board members had rendered her actions unlawful.[111]

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[107] *Minister of Defence and Military Veterans v Motau and Others* 2014 (5) SA 69 (CC) para 75.

[108] *Minister of Defence and Military Veterans v Motau and Others* 2014 (5) SA 69 (CC) paras 47, 49 and 51. The minority judgment of the Constitutional Court held that the Minister's decision in dismissing the three board members was administrative action, and not an exercise of executive power. For this reason the minority held that it was not necessary to determine whether s 71 of the Companies Act applied to this matter (para 128). An analysis whether the Minister's dismissal power constitutes administrative action or executive action is beyond the scope of this study, but see Konstant "Administrative Action and Procedural Fairness – *Minister of Defence and Military Veterans v Motau*" 492-498 for a discussion of this point.

[109] *Minister of Defence and Military Veterans v Motau and Others* 2014 (5) SA 69 (CC) para 76.

[110] *Minister of Defence and Military Veterans v Motau and Others* 2014 (5) SA 69 (CC) para 76.

[111] *Minister of Defence and Military Veterans v Motau and Others* 2014 (5) SA 69 (CC) paras 77 and 80. The Constitutional Court did not, however, set aside the Minister's decision and reinstate the two directors even though

In *Minister of Defence and Military Veterans v Motau and Others*[112] the Constitutional Court read the Armscor Act and the Companies Act concurrently. It is not, however, always possible to read the Companies Act concurrently with a specific statute which regulates the affairs of a state-owned company. For example, in early 2015 three SABC board members were removed after the board of directors of the SABC had passed a vote of no confidence in them. The Minister of Communications subsequently endorsed these removals which had taken place under the Companies Act, and not the Broadcasting Act, which governs the affairs of the SABC.[113] The question arose whether the removal of the three board members in terms of the Companies Act was valid, or whether the removal should have taken place under the provisions and the terms of the Broadcasting Act. The confusion in this matter arose because the Broadcasting Act explicitly regulates the procedural removal of board members of the SABC.

Under section 15(1)(*a*) of the Broadcasting Act the "appointing body" may remove a "member" from office after due inquiry and upon due recommendation by the board of directors if such member is found guilty of misconduct or inability to perform his duties efficiently. The "appointing body" is the body charged with the appointment of members of the board in terms of section 13 of the Broadcasting Act.[114] A "member" is defined in section 1 of the Broadcasting Act to mean executive and non-executive members of the board. The appointing body in terms of section 1 read with section 13 of the Broadcasting Act is the President acting on the advice of the National Assembly. The board of directors of the SABC is thus not

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it found that the Minister had failed to comply with the procedural requirements of the Companies Act. The court found that in the exceptional circumstances of the case it would not be just and equitable to set aside the Minister's decision and to reinstate the two directors. The court found that the Minister had substantively good and compelling reasons for terminating the membership of the two directors, and she had demonstrated good cause for the removal of the two directors (para 89). The court ruled that it was sufficient to declare that the Minister's conduct was unlawful and to draw her attention to the proper procedure to be followed in dismissing directors of Armscor (para 86). This decision is discussed further in para 8.6 below. See also Wandrag "Governance of State-owned Companies" in Loubser & Mahony *Company Secretarial Practice* 29-9-29-10.

[112] 2014 (5) SA 69 (CC).

[113] See Merten "SABC mess now in Parliament's care. Don't hold your breath" (14 July 2016) available at http://www.dailymaverick.co.za/article/2016-07-14-sabc-mess-now-in-parliaments-care.-dont-hold-your-breath./#.WAYSvfl95hE (accessed on 27 September 2016). The three board members who had been removed from the SABC board had been opposed to the controversial permanent appointment of Hlaudi Motsoeneng as the chief operations officer of the SABC in July 2014, after the findings of the Public Protector that he had purged staff, irregularly boosted his salary and had made misrepresentations about having a matric certificate.

[114] Section 1 of the Broadcasting Act.

empowered to remove a director on its own, although it may make such a recommendation to the President, who has a discretion whether or not to remove the board member from office. Under section 15(1)(*b*) of the Broadcasting Act the appointing body must remove a board member after due inquiry by the National Assembly and the adoption of a resolution recommending the removal of the director in terms of section 15A of the Broadcasting Act. Under section 15A(1)(*a*) the National Assembly may, after due inquiry and by the adoption of a resolution, recommend the removal of a board member on account of misconduct, inability to perform the duties of his office efficiently, absence from three consecutive board meetings without the permission of the board (except on good cause shown), failure to disclose a conflict of interest in terms of section 17, or on the basis of a disqualification as contemplated in section 16. In essence, a board member *may* be removed by the President under section 15(1)(*a*) (on the recommendation by the board of directors), but *must* be removed by the President (on the recommendation of a committee of the National Assembly) under section 15(1)(*b*) read with section 15A(1)(*a*).

A legal opinion was sought from Parliament's Constitutional and Legal Services division to advise the Portfolio Committee on the legality of the decision of the SABC Board. The legal opinion found that the Minister of Communications and the board of directors of the SABC had erred in law in applying the Companies Act instead of the Broadcasting Act to the removal of the directors.[115] The legal opinion stated that the Broadcasting Act supersedes the Companies Act, and that any removal of an SABC board member that is not effected in line with the provisions of the Broadcasting Act is invalid and unlawful.[116] The Minister of Communications, on the other hand, contended that the Companies Act took precedence over the Broadcasting Act when it came to governance matters concerning the SABC.[117] The Portfolio Committee on Communications initially accepted the legal opinion that the removal of the three board members was unlawful. At a later stage however the Portfolio Committee

[115] Mjenxane "Legal Opinion on Powers to Remove Board Members of the SABC" (24 March 2015) (reference number 31/15) available at http://pmg-assets.s3-website-eu-west-1.amazonaws.com/150526legal.pdf (accessed on 27 September 2016).

[116] Mjenxane "Legal Opinion on Powers to Remove Board Members of the SABC" (24 March 2015) (reference number 31/15) available at http://pmg-assets.s3-website-eu-west-1.amazonaws.com/150526legal.pdf (accessed on 27 September 2016).

[117] African News Agency "Muthambi rejects Parly's legal opinion on SABC board" (23 June 2015) available at http://www.enca.com/south-africa/muthambi-rejects-parlys-legal-opinion-sabc-board (accessed on 27 September 2016).

changed its mind and accepted that the removal of the board members under the Companies Act had been valid.[118] In light of the fact that the three board members who had been removed had not lodged a formal dispute and complaint, the Portfolio Committee accepted the Minister's argument and stated that it was satisfied that due process had been followed in removing the three directors under the provisions of the Companies Act, and the matter was officially closed.[119]

As mentioned above, section 5(4) of the Companies Act states that if there is an inconsistency between a provision of the Companies Act and a provision of any other national legislation, the provisions of both Acts apply concurrently, to the extent that it is possible to apply and comply with one of the inconsistent provisions without contravening the second. To the extent that this is not possible, the Companies Act lists certain Acts the provisions of which override those of the Companies Act.[120] In all other instances of conflict, the Companies Act would prevail.[121] Since the provisions of the Broadcasting Act and the Companies Act on the removal of directors cannot be read concurrently, it is necessary to ascertain which legislation prevails. The Broadcasting Act is not listed in section 5(4)(*b*)(i) of the Companies Act as one of the Acts that takes precedence over the Companies Act. On this basis, the provisions on the removal of directors in the Companies Act would prevail over the removal provisions in the Broadcasting Act.

The confusion in this matter was ruled on by the Gauteng Local Division, Johannesburg in *SOS Support Public Broadcasting Coalition and Others v South African Broadcasting Corporation SOC Limited and Others; SOS Support Public Broadcasting Coalition and Others v South African Broadcasting Corporation SOC Limited and Others*.[122] The applicants sought a declaratory order that members of the SABC board could not be removed from office save in

[118] Davis "SABC: ANC U-turn on Legal Opinion Undermines Rule of Law" (23 June 2015) available at https://www.da.org.za/2015/06/sabc-anc-u-turn-on-legal-opinion-undermines-rule-of-law/ (accessed on 27 September 2016).

[119] Alan "Committee closes legal opinion on SABC board members" (24 June 2015) available at https://mycapetown.co.za/committee-closes-legal-opinion-on-sabc-board-members/ (accessed on 27 September 2016).

[120] See note 100 above.

[121] Section 5(4)(*b*)(ii) of the Companies Act.

[122] (81056/14) [2017] ZAGPJHC 289 (17 October 2017).

compliance with sections 15(1), (2) and 15A of the Broadcasting Act, and an order setting aside the Minister's removal of the directors from their positions as non-executive directors of the SABC. The High Court ruled that the removal provisions contained in section 71 of the Companies Act do not apply to the SABC board.[123] It found that the removal processes prescribed under the Companies Act undermine the independence of the SABC board in a manner that is inconsistent with the Constitution.[124] The court stated as follows:

> "The Broadcasting Act is not listed under section 5(4)(b)(i) of the Companies Act, according, [sic] none of the provisions of the Broadcasting Act, is made applicable in the event of inconsistency with the Companies Act. This bridges [sic] section 7(2) and 16 of the Constitution and the relevant provisions of the Companies Act are invalid to this extent."[125]

The court held that the requirement of an independent SABC is implied in the duty of the State under section 7(2) of the Constitution to protect and promote the rights in the Bill of Rights, including the right to freedom of expression and a free press, contained in section 16 of the Constitution.[126] With regard to the infringement of section 16 of the Constitution, it was asserted by the court that this provision enshrines the right of the public, being the audience of the SABC, to be able to access information and ideas.[127] The freedom to receive or impart

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[123] *SOS Support Public Broadcasting Coalition and Others v South African Broadcasting Corporation SOC Limited and Others; SOS Support Public Broadcasting Coalition and Others v South African Broadcasting Corporation SOC Limited and Others* (81056/14) [2017] ZAGPJHC 289 (17 October 2017) para 141.

[124] *SOS Support Public Broadcasting Coalition and Others v South African Broadcasting Corporation SOC Limited and Others; SOS Support Public Broadcasting Coalition and Others v South African Broadcasting Corporation SOC Limited and Others* (81056/14) [2017] ZAGPJHC 289 (17 October 2017) para 141.

[125] *SOS Support Public Broadcasting Coalition and Others v South African Broadcasting Corporation SOC Limited and Others; SOS Support Public Broadcasting Coalition and Others v South African Broadcasting Corporation SOC Limited and Others* (81056/14) [2017] ZAGPJHC 289 (17 October 2017) para 145.

[126] *SOS Support Public Broadcasting Coalition and Others v South African Broadcasting Corporation SOC Limited and Others; SOS Support Public Broadcasting Coalition and Others v South African Broadcasting Corporation SOC Limited and Others* (81056/14) [2017] ZAGPJHC 289 (17 October 2017) para 52. Section 7(2) of the Constitution requires the State to respect, protect, promote and fulfil the rights in the Bill of Rights. Section 16 of the Constitution states that the right to freedom of expression includes the freedom of the press and other media; the freedom to receive or impart information or ideas; the freedom of artistic creativity, and academic freedom and freedom of scientific research. The court held further that s 39(2) of the Constitution requires it to interpret the Broadcasting Act in a manner that promotes the spirit, purpose and objects of the Bill of Rights, and to give effect to s 192 of the Constitution (para 137). Section 192 of the Constitution provides that national legislation must establish an independent authority to regulate broadcasting in the public interest, and to ensure fairness and a diversity of views broadly representing South African society.

[127] *SOS Support Public Broadcasting Coalition and Others v South African Broadcasting Corporation SOC Limited and Others; SOS Support Public Broadcasting Coalition and Others v South African Broadcasting Corporation SOC Limited and Others* (81056/14) [2017] ZAGPJHC 289 (17 October 2017) para 31.

information or ideas relates to the right of the SABC to communicate without interference and to the right of the public to have access to the broadcast media.[128] On the basis that the SABC is the medium that should allow the free flow of ideas that is necessary for our democracy to function, the court held that the State must ensure that it has the necessary structural and operational independence.[129] The court observed that the SABC board does not report to the Minister of Communications but to the National Assembly.[130] The board is consequently meant to be strictly independent and is not required to work with other government agencies.[131] For these reasons, the court found that the removal procedures under the Companies Act deny members of the SABC board security of tenure and thus undermine the independence of the SABC board in a manner that is inconsistent with the Constitution.[132]

The court consequently declared that the members of the SABC board could not be removed from office save in compliance with sections 15(1), 15(2) and 15A of the Broadcasting Act.[133] It also set aside the removal of the two non-executive directors on the ground that the removals had been unlawfully effected under section 71 of the Companies Act, and not in accordance with the procedures set out in section 15 of the Broadcasting Act.[134]

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[128] *SOS Support Public Broadcasting Coalition and Others v South African Broadcasting Corporation SOC Limited and Others; SOS Support Public Broadcasting Coalition and Others v South African Broadcasting Corporation SOC Limited and Others* (81056/14) [2017] ZAGPJHC 289 (17 October 2017) para 31.

[129] *SOS Support Public Broadcasting Coalition and Others v South African Broadcasting Corporation SOC Limited and Others; SOS Support Public Broadcasting Coalition and Others v South African Broadcasting Corporation SOC Limited and Others* (81056/14) [2017] ZAGPJHC 289 (17 October 2017) para 52.

[130] *SOS Support Public Broadcasting Coalition and Others v South African Broadcasting Corporation SOC Limited and Others; SOS Support Public Broadcasting Coalition and Others v South African Broadcasting Corporation SOC Limited and Others* (81056/14) [2017] ZAGPJHC 289 (17 October 2017) para 48.

[131] *SOS Support Public Broadcasting Coalition and Others v South African Broadcasting Corporation SOC Limited and Others; SOS Support Public Broadcasting Coalition and Others v South African Broadcasting Corporation SOC Limited and Others* (81056/14) [2017] ZAGPJHC 289 (17 October 2017) para 48.

[132] *SOS Support Public Broadcasting Coalition and Others v South African Broadcasting Corporation SOC Limited and Others; SOS Support Public Broadcasting Coalition and Others v South African Broadcasting Corporation SOC Limited and Others* (81056/14) [2017] ZAGPJHC 289 (17 October 2017) para 141.

[133] *SOS Support Public Broadcasting Coalition and Others v South African Broadcasting Corporation SOC Limited and Others; SOS Support Public Broadcasting Coalition and Others v South African Broadcasting Corporation SOC Limited and Others* (81056/14) [2017] ZAGPJHC 289 (17 October 2017) para 146.

[134] *SOS Support Public Broadcasting Coalition and Others v South African Broadcasting Corporation SOC Limited and Others; SOS Support Public Broadcasting Coalition and Others v South African Broadcasting Corporation SOC Limited and Others* (81056/14) [2017] ZAGPJHC 289 (17 October 2017) para 146. The court did not however reinstate the two non-executive directors to their previous positions on the board, but it did not provide any reason for this decision.

While the court came to the conclusion that the Broadcasting Act prevails over the Companies Act on the basis of the applicability of the Constitution, it could have, in the alternative, reached this conclusion on the application of the common law principle of interpretation *lex specialis derogat legi generali*. This common law principle of interpretation states that when two laws govern the same factual situation a law governing a specific subject matter (*lex specialis*) supersedes a law which governs general matters only (*lex generalis*).[135] Another way of stating this principle of interpretation which the court did not refer to is that general rules do not derogate from special ones.[136] The rationale of this principle of interpretation is that when the legislature has given attention to a specific subject and has made special provisions for it, a subsequent general enactment is not intended to interfere with those special provisions unless it manifests that intention clearly.[137] In *Kent NO v South African Railways and Another*[138] the then Appellate Division formulated this rule of statutory construction by stating that statutes

> "must be read together and the later one must not be so construed as to repeal the provisions of an earlier one, or to take away rights conferred by an earlier one unless the later Statute expressly alters the provisions of the earlier one in that respect or such alteration is a necessary inference from the terms of the later Statute. The inference must be a necessary one and not merely a possible one."

In *Khumalo v Director-General of Co-operation and Development and Others*[139] and *Sasol Synthetic Fuels (Pty) Ltd and Others v Lambert and Others*[140] the Supreme Court of Appeal approved the above formulation of this rule of statutory construction.[141] The presumption falls

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[135] See *R v Gwantshu* 1931 EDL 29 at 31; *Kent NO v South African Railways and Another* 1946 AD 398 at 429-30; *Gentiruco AG v Firestone SA (Pty) Ltd* 1972 (1) SA 589 (A) at 603; *S v Shangase and Others* 1972 (2) SA 410 (N) at 430; *S v Hattingh* 1978 (2) SA 826 (A) at 829; *Consolidated Employers Medical Aid Society and Others v Leveton* 1999 (2) SA 32 (SCA) at 40-41 and De Ville *Constitutional and Statutory Interpretation* 79.

[136] De Ville *Constitutional and Statutory Interpretation* 79.

[137] *Khumalo v Director-General of Co-operation and Development and Others* 1991 (1) SA 158 (A) at 164 and Kellaway *Principles of Legal Interpretation of Statutes, Contracts and Wills* 369.

[138] 1946 AD 398 at 405.

[139] 1991 (1) SA 158 (A) at 164-165.

[140] 2002 (2) SA 21 (SCA) para 15.

[141] This principle of interpreting statutes is also recognised in English law. In the UK case of *Corporation of Blackpool v Starr Estate Company Limited* [1922] 1 AC 27 at 34 Viscount Haldane formulated this principle of interpretation as follows:

away if there are clear indications that the Legislature intended to repeal the earlier enactment.[142]

On the basis of the principle of interpretation of *lex specialis derogat legi generali*, it is arguable that the provisions on the removal of directors contained in the Broadcasting Act, being a specific legislation dealing with the governance of the SABC, must prevail over the removal provisions in the Companies Act, being a general legislation dealing with state-owned entities. This argument is reinforced by the fact that there are no clear, express or specific indications that the legislature intended to repeal the provisions of the Broadcasting Act when the Companies Act was promulgated.

Further statutory provisions which cause confusion regarding the issue whether the Companies Act or the Broadcasting Act prevails are sections 8A(5) and 8A(6) of the Broadcasting Act. Section 8A(5) states that the Companies Act applies to the SABC, save to the extent stipulated in the Broadcasting Act. Section 8A(6) of the Broadcasting Act lists those provisions of the Companies Act 61 of 1973 which do not apply to the SABC. The provisions of section 8A(6) of the Broadcasting Act have not been amended to reflect the equivalent provisions of the Companies Act (71 of 2008). Section 220 of the Companies Act 61 of 1973, the predecessor to section 71 of the Companies Act (71 of 2008), is not listed in section 8A(6) of the Broadcasting Act as one of the provisions that do not apply to the SABC. On a literal interpretation, the implication is that the legislature did not intend to exclude the removal provisions under section 220 of the Companies Act 61 of 1973 from applying to the removal of directors of the SABC board. The High Court in *SOS Support Public Broadcasting Coalition and Others v South African Broadcasting Corporation SOC Limited and Others; SOS Support Public Broadcasting Coalition and Others v South African Broadcasting Corporation SOC Limited and Others*[143] did not address the further legislative conflict caused by sections 8A(5) and 8A(6) of the Broadcasting Act.

> ". . . (W)e are bound . . . to apply a rule of construction which has been repeatedly laid down and is firmly established. It is that wherever Parliament in an earlier statute has directed its attention to an individual case and has made provision for it unambiguously, there arises a presumption that if in a subsequent statute the Legislature lays down a general principle, that general principle is not to be taken as meant to rip up what the Legislature had before provided for individually, unless an intention to do so is specifically declared."

[142] *Khumalo v Director-General of Co-operation and Development and Others* 1991 (1) SA 158 (A) at 5.

[143] (81056/14) [2017] ZAGPJHC 289 (17 October 2017).

While the court found that sections 15 and 15A of the Broadcasting Act prevailed over section 71 of the Companies Act the court did not regrettably clarify how the conflict in law between the Companies Act and the Broadcasting Act is to be practically resolved. The fact remains that the Companies Act has failed to list, in section 5(4)(*b*)(i), the Broadcasting Act as one of the statutes that would prevail in the event of a conflict with the Companies Act. It is submitted that section 5(4)(*b*)(i) of the Companies Act should be amended, by amending legislation, to include a reference to the Broadcasting Act as one of the statutes that would prevail in the event of a conflict with the Companies Act. Alternatively, it is submitted that the Minister of Trade and Industry should be requested, under sections 9(2)(*a*) and 9(3) of the Companies Act, to exempt the SABC from the provisions of section 71 of the Companies Act.[144] Since sections 15 and 15A of the Broadcasting Act would regulate the removal of directors of the SABC at least as well as the provisions of the Companies Act, it is submitted that the granting of an exemption excluding the SABC from the provisions of section 71 of the Companies Act, would practically resolve the legislative conflict between sections 15 and 15A of the Broadcasting Act, and section 71 of the Companies Act. It is further submitted that section 8A(6) of the Broadcasting Act should specifically include a reference to section 71 of the Companies Act. In this way the legislative conflict between the Companies Act and the Broadcasting Act would be resolved, and the two statutes would be in harmony.

It is evident from the above discussion that even though section 71 of the Companies Act is said to apply to the removal of directors of state-owned companies, there is considerable confusion on this issue in circumstances where state-owned companies are governed by specific legislation regulating the removal of their directors. Challenges arise from the fact that state-owned companies are governed by both the Companies Act and by their own specific legislation. It may first have to be determined whether the dismissal power constitutes administrative action or executive action, and whether the Companies Act or the Promotion of

[144] Under s 9(2) of the Companies Act the member of the Cabinet responsible for state-owned companies may request the Minister of Trade and Industry to grant a total, partial or conditional exemption from one or more provisions of the Companies Act, applicable to all state-owned companies, any class of state-owned companies or to one or more particular state-owned company. In terms of s 9(3) of the Companies Act the Minister may, by notice in the *Government Gazette* after receiving the advice of the Companies and Intellectual Property Commission ("CIPC"), grant an exemption contemplated in s 9(2) only to the extent that the relevant alternative regulatory scheme ensures the achievement of the purposes of the Companies Act at least as well as the provisions of the Companies Act, and subject to any limits or conditions necessary to ensure the achievement of the purposes of the Companies Act.

Administrative Justice Act 3 of 2008 must be applied.[145] Furthermore, the substantive criteria for the removal of directors of the state-owned company may be contained in one statute governing the state-owned company, while the procedural criteria may be contained in another statute. A careful analysis must be made in each case in order to ascertain whether the provisions of the specific statute governing the state-owned company and section 71 of the Companies Act may be applied concurrently (as was the case in *Minister of Defence and Military Veterans v Motau and Others*)[146] and if not (as was the case in *SOS Support Public Broadcasting Coalition and Others v South African Broadcasting Corporation SOC Limited and Others; SOS Support Public Broadcasting Coalition and Others v South African Broadcasting Corporation SOC Limited and Others*),[147] which statute would prevail.

4.4 Public Companies

Since the board of directors of public companies must comprise at least three directors,[148] section 71(3) of the Companies Act will always apply to the removal of directors of public companies. In striking contrast, the opposite position prevails in Australia where the board of directors of public companies have no power to remove directors from office.[149]

It is submitted that there are advantages to the approach under Australian law of confining the power to remove directors from office to the board of directors of private companies, and not

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[145] A further example of confusion arising whether the decision to remove a director of a state-owned entity from office was an executive decision or an administrative decision, arose in *Steenkamp and Another v Central Energy Fund SOC Ltd and Others* 2018 (1) SA 311 (WCC). The applicants had been removed as board members of Petroleum Oil and Gas Corporation SOC Ltd ("PetroSA") by its holding company, the Central Energy Fund SOC Ltd ("CEF"). The removal took place in terms of s 71(1) of the Companies Act since it was a removal of directors by the sole shareholder (CEF) of the company (PetroSA). Both the CEF and PetroSA are state-owned companies. One of the questions before the court was whether the removal, by one state-owned entity, of directors serving on the board of another state-owned entity was an administrative decision and was subject to the Promotion of Administrative Justice Act 3 of 2008 (para 39). The court stated that the fact that the decision was taken by the CEF board which is directly answerable to the executive does not render the power to be of an executive nature (para 52). It held further that the fact that the removal of the directors was exercised through ss 71(1) and (2) of the Companies Act did not render the decision immune to administrative review (para 53). The court accordingly concluded that the decision to remove the directors from office constituted administrative action and that it was subject to the Promotion of Administrative Justice Act 3 of 2008 (para 59). Based on the facts, the court found that, in light of the substantial difficulties in which PetroSA found itself and the strained relationship between the PetroSA board and the CEF board, the decision of the CEF to remove the applicants from office had not been predetermined, *mala fide*, unlawful or irrational, as had been contended by the applicants (paras 60-78).

[146] 2014 (5) SA 69 (CC).

[147] (81056/14) [2017] ZAGPJHC 289 (17 October 2017).

[148] Section 66(2)(*b*) of the Companies Act.

[149] Section 203E of the Australian Corporations Act of 2001. See para 2.2 above where s 203E of the Australian Corporations Act is discussed.

extending this power to the board of directors of public companies. For instance, it eliminates the threat of removal by the board of directors of public companies, and facilitates directors being able to openly discuss matters with their fellow board members and freely express dissenting views without a concern of dismissal. This is of primary importance in public companies in light of the generally large number of shareholders who invest in them. As was discussed in chapter 2, the concern of removal from office may create an environment in which the directors are intimidated by the risks of dismissal and would consequently refrain from taking high-risk but potentially profitable decisions, or from making long-term strategic decisions that would enhance the value of the company but would not necessarily result in an immediate return of profit.[150] This encourages a "short-termism" approach which is not in the interests of the company. The taking of high-risk but potentially profitable decisions, is especially important in public companies in view of the large number of shareholders who invest in such companies. As was also discussed in chapter 2, a viable shareholder power to remove directors is necessary to provide directors with a strong incentive to focus on the interests of the shareholders.[151] When the board is given the power to remove, directors may be inclined to also focus on the interests of the board of directors, which may have the effect of diminishing their incentive to focus on the interests of the shareholders. Confining the power to remove directors of public companies to the shareholders and not extending it to the board of directors may therefore have the advantage of strengthening the directors' incentive to focus on the interests of shareholders in public companies.

On the other hand, there are also advantages in conferring the right to remove fellow board members on the board of directors of public companies. For instance, if the shareholders wish to remove an incompetent or misbehaving director from office and are not able to garner sufficient support to do so, the board of directors may still be able to remove that director from office.[152] Another advantage of conferring on the board of directors the right to remove directors of public companies would be where the shareholders are not convinced of the legitimate reasons advanced by the board of directors to remove a director from office, or they do not wish to remove a particular director from office despite his wrongdoing because they

[150] See chapter 2, para 5 and Olson "Professor Bebchuk's Brave New World: A Reply to 'The Myth of the Shareholder Franchise'" 782.

[151] See chapter 2, para 4 and Bebchuk "The Myth of the Shareholder Franchise" 682.

[152] See chapter 2, para 5.1.

believe he is bringing in profits for the company, when in fact that director would be exposing the company to a potential legal action.[153]

It may be particularly time consuming and costly in a public company to convene a shareholders' meeting to remove a director due to the large number of shareholders who would need to attend the meeting in order to satisfy the quorum requirements. While the company could delay the removal of a director until the next annual general meeting in an effort to save on the costs of convening a shareholders' meeting, the delay may be impractical and may cause damage in instances when a director's actions are detrimental to the company.[154] During the notice period which must be given to convene a shareholders' meeting of a public company, and which, under section 62(1)(*a*) of the Companies Act is at least fifteen business days[155] there is a risk that the public company and its board of directors may suffer reputational risk. This is exactly what occurred in Australia as a result of a dispute between members of the board of directors of the National Australia Bank Limited ("NAB"). A public boardroom brawl occurred following revelations of a foreign exchange trading scandal at NAB. The bank appointed PricewaterhouseCoopers to prepare an independent report on the scandal, but one of the bank's non-executive directors, Catherine Walter, challenged the legitimacy of the report on the ground that PricewaterhouseCoopers had a conflict of interest as a result of its business relationship with NAB. Ms Walter made public attacks against some of the directors on the board of directors of NAB. In response, the NAB chairman announced that the board of directors would remove Ms Walter from the audit committee (of which she was the chairman during the foreign currency scandal) and she was also asked to resign as a director. The board of NAB issued a statement explaining that Ms Walter had lost the trust and respect of her fellow directors due to her not co-operating with the investigations of PricewaterhouseCoopers, and due to her unfounded attacks on the integrity of the PricewaterhouseCoopers report. These attacks had also indirectly attacked the integrity of the NAB directors. Upon her refusal to resign, the bank took steps to convene a shareholders' meeting to remove her from office. During the two month notice period of the shareholders' meeting (as required by section 203D(2) of the Australian Corporations Act of 2001) Ms Walter and her fellow non-executive

[153] See chapter 2, para 5.1.

[154] McConvill "Removal of Directors of Public Companies takes Centre Stage in Australia" 197.

[155] A company's Memorandum of Incorporation may provide for a longer or shorter minimum notice period than required by s 62(1) of the Companies Act.

directors had a public slanging match which had damaged the reputation of the bank and of the board of directors. Eventually Ms Walter agreed to resign from the board of directors in return for an undisclosed cash payment, but due to the damage caused by the boardroom battle a number of other directors, including the chairman, stepped down.[156] The reputation of a public company, particularly a listed company, is particularly important in light of the need for the company to attract investments.

Company law in the UK and the USA does not distinguish between public companies and private companies with regard to the removal of directors from office by the board of directors. Despite the advantages of confining the right to remove directors to private companies, it has been shown that there are also advantages in conferring the removal power on the board of directors of public companies. For this reason it is submitted that directors of public companies should not be prevented from removing fellow board members, provided that they act openly and transparently and that there are sufficient safeguards against the abuse of the removal power. If, as suggested,[157] the power conferred on directors to remove directors from office were an alterable provision and not a mandatory provision, then a public company would have the option of deciding whether it wishes to empower its board of directors to remove directors from office. It is submitted that the company itself should be allowed to weigh up the advantages and disadvantages of empowering its particular board of directors with the removal power and to determine whether or not to limit this power.

5. *LOCUS STANDI* TO INITIATE A BOARD MEETING TO REMOVE A DIRECTOR FROM OFFICE

Both a shareholder and a director have *locus standi* under section 71(3) of the Companies Act to allege that any of the grounds listed in that section are applicable to a director. A voting member of a non-profit company would also have such *locus standi* under section 71(3) of the Companies Act.[158] If a shareholder or a director (or a voting member of a non-profit company)

[156] See McConvill "Removal of Directors of Public Companies takes Centre Stage in Australia" at 195-198 and Hill "The Rising Tension between Shareholder and Director Power in the Common Law World" 352 for further details of the NAB board conflict.

[157] See para 3 above.

[158] Section 10(4) of the Companies Act states that in respect of a non-profit company that has voting members, a reference in the Companies Act to "a shareholder" is to be regarded as a reference to the voting members of a non-profit company.

makes an allegation under section 71(3) of the Companies Act, the board of directors is obliged to consider the allegation and must determine the matter of the removal of the impugned director by resolution. This is made clear by the words "must determine the matter by resolution" in section 71(3) of the Companies Act.

Section 71(3) of the Companies Act permits a single shareholder or director to initiate the process for a board meeting to be convened to consider the removal of a director from office. The legislature did not place a threshold on the shareholding which a shareholder must hold in the company before the provisions of section 71(3) of the Companies Act would be triggered. This means that a minority shareholder, holding as little as one per cent of the shareholding in the company, and regardless of his influence in the company, would be entitled to make an allegation under section 71(3) of the Companies Act and require the board of directors to convene a meeting to determine the matter of the removal of a director by resolution. There is no protection in section 71(3) of the Companies Act against vexatious, frivolous or groundless allegations made by a shareholder. While the board of directors has a discretion whether or not to remove an impugned director from office, as made clear by the words "may remove a director" in section 71(3),[159] the fact that the board would be compelled to consider the matter by resolution, even if the allegations are without merit, places the impugned director in a position where he must defend the allegations made against him.

It is notable that under section 61(3) of the Companies Act the board of directors is compelled to call a shareholders' meeting if demands for such a meeting are delivered to the company and in aggregate the demands are made and signed by the holders of at least ten per cent of the voting rights entitled to be exercised in relation to the matter proposed to be considered at the meeting.[160] Under section 61(5) of the Companies Act a company or any shareholder of the company may apply to a court for an order setting aside the demand made in terms of section 61(3) on the grounds that the demand is frivolous, calls for a meeting for no other purpose than to reconsider a matter that has already been decided by the shareholders, or is otherwise vexatious. In contrast, the legislature did not impose any threshold for a shareholder to be able to make an allegation against a director under section 71(3), thereby triggering the convention

[159] The discretion of the board of directors to remove a director is discussed further in para 7 below.

[160] The ten per cent threshold may be lowered in a company's Memorandum of Incorporation (s 61(4) of the Companies Act).

of a board meeting to consider the removal of the director. It is anomalous that the legislature did not provide for any precautions under section 71(3) of the Companies Act, to guard against such abuse by shareholders, yet provided safeguards to guard against shareholders abusing the mechanism of demanding a meeting under section 61(3) of the Companies Act. Convening a board meeting whenever an allegation is made by a single shareholder against a director would also incur costs for the company.

On the other hand, the power given to a single shareholder to compel the board of directors to convene a meeting to consider the allegations made against a director does have the advantage of affording substantial protection to minority shareholders who are unable to remove a director of a company by means of an ordinary resolution due to a lack of support from the majority shareholders.[161] If a ten per cent threshold were to be imposed in section 71(3) of the Companies Act it would be difficult for a single shareholder to garner the support of ten per cent of the voting rights in the company due to the general apathetic nature of shareholders.[162]

A director would not necessarily be removed from office based on the allegations made against him by a single shareholder because, under section 71(4) of the Companies Act, the impugned director is given an opportunity to defend himself at the board meeting before the resolution to remove him is voted upon. Moreover, at least a majority of the board members must vote in favour of the removal of the impugned director in order for the proposed resolution to be passed.

As discussed in chapter 2,[163] the conferral of power to remove directors has had the effect of shifting the balance of power between the board of directors and the shareholders. Permitting a single shareholder to trigger a board meeting to consider the allegations against a director restores some power to the shareholders, and furthermore affords some protection to a minority shareholder. It also encourages the board to ensure that the interests of the shareholders are not neglected because a single shareholder is empowered to initiate a board meeting to consider the removal of a director. While costs would be incurred in convening such a board meeting,

[161] Ncube "You're Fired! The Removal of Directors under the Companies Act 71 of 2008" 43.

[162] Refer to chapter 2, para 3 where shareholder passivity is discussed.

[163] Refer to chapter 2, para 5.1.

these costs may be contained, such as holding meetings electronically, as permitted by section 73(3) of the Companies Act.[164] It is accordingly submitted that, despite the disadvantages, there are considerable merits in conferring the power on a single shareholder to request a board meeting to consider the removal of a director. The disadvantages of this power can be contained or managed.

Section 71(3) of the Companies Act does not specify whether the allegation by a shareholder or a director against another director must be made in writing. It follows that the allegation under section 71(3) may be made verbally.[165] The allegation could consequently be made at a shareholders' meeting, an annual general meeting or at a board meeting.[166]

6. THE GROUNDS FOR REMOVAL OF A DIRECTOR BY THE BOARD OF DIRECTORS

Section 71(3) of the Companies Act states as follows:

> "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."

The board of directors may remove a director from office only if one of the grounds mentioned in section 71(3) of the Companies Act is applicable to a director. These grounds are discussed below.

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[164] In terms of s 73(3) of the Companies Act, except to the extent that the Companies Act or the company's Memorandum of Incorporation provides otherwise, board meetings may be conducted by electronic communication and one or more directors may participate in a meeting by electronic communication, so long as the electronic communication facility employed ordinarily enables all participants to communicate concurrently with each other without an intermediary and to participate effectively in the meeting.

[165] R Cassim "Governance and the Board of Directors" in FHI Cassim et al *Contemporary Company Law* 444.

[166] R Cassim "Governance and the Board of Directors" in FHI Cassim et al *Contemporary Company Law* 444.

6.1 Ineligible or Disqualified

The first ground on which a director may be removed from office, is if a shareholder or a director alleges that the director has become ineligible or disqualified in terms of section 69 of the Companies Act, other than on the grounds contemplated in section 69(8)(*a*). A person who is ineligible or disqualified to serve or act as a director must not act as a director of a company, nor be appointed or elected as a director of a company, nor consent to being appointed or elected as a director.[167] This ground of removal therefore envisages a situation where a director was eligible and qualified to be a director at the time that he was appointed or elected as a director of the company, but that he has now become ineligible or disqualified to be a director.

In terms of section 69(4) of the Companies Act 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) of the Companies Act.[168] In light of section 69(4) of the Companies Act, the question arises why formal removal proceedings would be necessary under section 71(3) of the Companies Act.[169] It is submitted that if a director were to become ineligible or disqualified to be a director and his ineligibility or disqualification were not in dispute, and he were to voluntarily cease to act as a director, formal removal proceedings under section 71(3) of the Companies Act would not be necessary. However in those instances where a director disputes that he has become ineligible or disqualified to be a director, formal removal proceedings are necessary so that the director is given an opportunity to make a presentation to the board of directors regarding his ineligibility or disqualification to be a director. The board of directors may then vote on whether to remove the director from office based on the allegations of the director's ineligibility or disqualification to be a director.

Some aspects of this ground of removal of a director by the board of directors are discussed below.

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[167] Section 69(2) of the Companies Act.

[168] Section 70(2) of the Companies Act provides that where the board of directors has removed a director a vacancy on the board would not arise until the later of the expiry of the time for filing an application for review of the decision or the granting of an order by the court on such an application. The director would however be suspended from office during that time.

[169] This question is raised by Ncube (see Ncube "You're Fired! The Removal of Directors under the Companies Act 71 of 2008" 41-42). See further Delport *Henochsberg on the Companies Act 71 of 2008* 274(1).

6.1.1 Obligation Placed on a Company to Ascertain Ineligibility and Disqualification of a Director

Section 69(3) of the Companies Act places an obligation on a company not to "knowingly" permit an ineligible or disqualified person to serve or act as a director. The directors or the company will be liable if an ineligible or disqualified person were permitted to serve or act as a director and either the company suffers any loss, damages or costs, or a third party suffers any loss or damage.[170]

The term "knowingly" is defined in section 1 of the Companies Act as follows:

> "'knowing', 'knowingly' or 'knows', when used with respect to a person, and in relation to a particular matter, means that the person either –
> (a) had actual knowledge of the matter; or
> (b) was in a position in which the person reasonably ought to have –
> (i) had actual knowledge;
> (ii) investigated the matter to an extent that would have provided the person with actual knowledge; or
> (iii) taken other measures which, if taken, would reasonably be expected to have provided the person with actual knowledge of the matter".

If a company has actual knowledge that a person is ineligible or disqualified to be a director it would breach section 69(3) of the Companies Act if it permitted such a person to serve or act as a director of the company. It is submitted that one instance when a company would be deemed to have actual knowledge that a person is disqualified to serve or act as a director of that company, would be if the CIPC[171] notified the company of an order or conviction under section 69(11B) of the Companies Act. Under section 69(11A) of the Companies Act the Registrar of the Court must, upon the issue of a sequestration order, the issue of an order for the removal of a person from any office of trust on the grounds of misconduct involving

[170] Sections 77(2)(*b*) and 218(2) of the Companies Act.

[171] The CIPC is described in note 144 above. The CIPC is established in terms of s 185 of the Companies Act as a juristic person to function as an organ of state within the public administration, but as an institution outside the public service (s 185(1)). It has jurisdiction throughout South Africa (s 185(2)(*a*)). It is independent and is subject only to the Constitution and the law and any policy statement, directive or request issued to it by the Minister in terms of the Companies Act (s 185(2)(*b*)). It must be impartial and it must perform its functions without fear, favour, or prejudice (s 185(2)(*c*)). The CIPC must exercise the functions assigned to it in the most cost-efficient and effective manner and in accordance with the values and principles mentioned in s 195 of the Constitution, which sets out the basic values and principles governing public administration.

dishonesty,[172] or a conviction for an offence referred to in section 69(8)(*b*)(iv) of the Companies Act,[173] send a copy of the relevant order or particulars of the conviction to the CIPC. The CIPC must in turn in terms of section 69(11B) of the Companies Act notify each company which has as a director to whom the order of convictions relates, of the order of conviction. If a company were sent such a notice by the CIPC it would arguably be deemed to have actual knowledge of the disqualification of the person to serve or act as a director.

Another instance when a company would be deemed to have actual knowledge of the ineligibility or disqualification of a person to serve or act as a director, would be where the Memorandum of Incorporation of the company, in terms of section 69(6) of the Companies Act, sets out additional grounds of ineligibility or disqualification of directors or minimum qualifications to be met by directors of the company.[174] If a company were to permit a person to serve or act as a director of the company without verifying whether any additional grounds of ineligibility or disqualification or minimum qualifications as set out in its Memorandum of Incorporation were satisfied, it would infringe section 69(3) of the Companies Act.

Under the definition of "knowingly", knowledge will be imputed to a company where the company reasonably ought to have investigated the matter to an extent that would have provided it with actual knowledge. This would be a situation where a company had a suspicion and should have investigated the matter to an extent that would have provided it with actual knowledge.[175] In terms of section 69(13) of the Companies Act the CIPC is required to establish and maintain a public register of persons who are disqualified from serving as a director (or who are subject to an order of probation) in terms of an order of a court pursuant to the Companies Act or any other law.[176] If a company has a suspicion that a director may be

[172] This ground of disqualification is covered in s 69(8)(*b*)(iii) of the Companies Act.

[173] These grounds relate to a conviction, in South Africa or elsewhere, and imprisonment without the option of a fine, or a fine more than the prescribed amount, for theft, fraud, perjury or various other offences.

[174] Section 69(6) of the Companies Act permits the Memorandum of Incorporation of a company to impose additional grounds of ineligibility or disqualification of directors, as well as minimum qualifications to be met by directors of that company.

[175] Delport *Henochsberg on the Companies Act 71 of 2008* 30.

[176] In addition to the court orders received from the Registrar of the Court under s 69(11A) of the Companies Act, the CIPC may, for purposes of maintaining the register of persons disqualified from serving as directors, obtain relevant information from the official records of the clerk of the magistrates' court, the Master of the High Court, the South African police services, any regulatory authority or any institution that regulates any profession in South Africa (see regulation 39(3) of the Companies Regulations, 2011 published under GN R351 in *GG* 34239 of 26

disqualified to be a director of a company, the company ought to investigate the matter by consulting the CIPC's public register of disqualified persons. If the company fails to do so, knowledge of the disqualification of the director may well be imputed to the company.

6.1.2 Grounds of Ineligibility as Director

The Companies Act lists three grounds of ineligibility to be a director. If any of these grounds are applicable, a director may be removed from office by the board of directors under section 71(3) of the Companies Act. These grounds of ineligibility to be a director are discussed below.

6.1.2.1 Juristic Person

The first ground under which a person would be ineligible to be a director of a company is if the person is a juristic person.[177] For purposes of the Companies Act a "juristic person" includes a foreign company and a trust, irrespective of whether or not it was established within or outside South Africa.[178] This means that under the Companies Act a director must be a natural person.

In contrast, under section 87(1) of the Companies Act a juristic person or a partnership may be appointed to hold the office of company secretary. This appointment is subject to two provisos: (i) every employee of that juristic person or partner and employee of that partnership (as the case may be) satisfies the requirements contemplated in section 84(5) of the Companies Act;[179] and (ii) at least one employee of that juristic person, or one partner or employee of that partnership (as the case may be) satisfies the requirements contemplated in section 86 of the Companies Act.[180] There is no equivalent provision in the Companies Act with regard to the appointment of directors.

April 2011, hereafter referred to as the "Companies Regulations, 2011"). An example of an institution that regulates a profession in South Africa would be the Law Society, which regulates the legal profession.

[177] Section 69(7)(*a*) of the Companies Act.

[178] See the definition of "juristic person" in s 1 of the Companies Act.

[179] In terms of s 84(5) of the Companies Act a person who is disqualified in terms of s 69(8) of the Companies Act to serve as a director of any particular company may not be appointed or continue to serve that company as a company secretary.

[180] In terms of s 86(2) of the Companies Act every company secretary must have the requisite knowledge of or experience in relevant laws and must be a permanent resident of South Africa and must remain so while serving in that capacity.

It is notable that in the UK, a juristic person may be a director, and that only one director of a company is required to be a natural person. Section 155(1) of the UK Companies Act of 2006 states that companies are required to have at least one director who is a natural person. Subject to this requirement being satisfied, any legal person, including one that is a company or a firm, may be a director but a company cannot be the sole director of another company.[181] The requirement that the director must be a natural person is met if the director is a corporation sole[182] or a person appointed on the basis of some other appointment that they hold.[183]

However, the Small Business, Enterprise and Employment Act of 2015, is expected to repeal section 155 of the UK Companies Act of 2006 (from a date to be determined),[184] and to insert a new section 156A to the UK Companies Act of 2006 which will require all company directors to be natural persons, subject to certain specified exceptions.[185] The Secretary of State for Business Enterprise and Regulatory Reform (formerly the Secretary of State for Trade and Industry) is empowered to provide by regulation for cases in which a person who is not a natural person may be appointed a director of the company.[186] These regulations have not yet been

[181] Explanatory Notes to the Companies Act of 2006 para 282, available at http://www.legislation.gov.uk/ukpga/2006/46/notes (accessed on 23 May 2016).

[182] A corporation sole is a legal entity consisting of a single (or sole) incorporated office, occupied by a single (or sole) natural person. Most corporations sole are church-related (for example, the Archbishop of Canterbury). Some political offices are also corporations sole. For instance, in the UK many of the Secretaries of State are corporations sole.

[183] See further s 155(2) of the UK Companies Act of 2006 and the Explanatory Notes to the Companies Act of 2006 para 282, available at http://www.legislation.gov.uk/ukpga/2006/46/notes (accessed on 23 May 2016).

[184] The Small Business, Enterprise and Employment Act of 2015 received Royal Assent on 26 March 2015, but its provisions are coming into force in stages. Although its title seems to imply that it will affect small businesses only, this Act implements substantial changes to company law which will impact all companies. This Act amends the UK Companies Act of 2006, the UK Company Directors Disqualification Act 1986 and the Insolvency Act of 1986.

[185] See s 87 of the Small Business, Enterprise and Employment Act of 2015 and the proposed new s 156B of the UK Companies Act of 2006.

[186] See s 87(4) of the Small Business, Enterprise and Employment Act of 2015, and the proposed new s 156B of the UK Companies Act of 2006. A corporate director that does not fall within any of the exceptions to be set out in regulations under s 156B of the UK Companies Act of 2006, will cease to be a director twelve months after the date on which s 156A of the UK Companies Act of 2006 comes into force (s 156C of the UK Companies Act of 2006).

promulgated. Thus, companies in the UK will be permitted to appoint corporate directors in certain specified instances only.[187]

Generally, a corporate director would appoint a number of natural persons to its board of directors, and if any documents have to be executed by the underlying company (as it is referred to in the UK), one of those individual directors of the corporate director would sign the documents.[188] There are advantages to appointing a corporate director. For instance, it is not necessary to appoint alternate directors for a company, as is the case when natural persons are appointed as directors.[189] Another advantage of appointing a corporate director is that a change in the membership of the company does not constitute a casual vacancy in the office of company director. Indeed, with regard to the appointment of a juristic person or partnership as a company secretary, section 87(2) of the Companies Act expressly states that a change in the membership of the juristic person or partnership that holds office as company secretary does not constitute a casual vacancy in the office of company secretary if the juristic person or partnership continues to satisfy the requirements of section 87(1) of the Companies Act.

On the other hand, there are also disadvantages to appointing a corporate director to the board of directors. One disadvantage is that the appointment of corporate directors may make it difficult to determine who controls a company.[190] The investigation and prosecution of corporate frauds could also be hindered when corporate directors are appointed.[191] Furthermore, it could be difficult to apply meaningful sanctions to corporate directors.[192]

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[187] This is a strong shift away from the common law regime in the UK which permitted companies to appoint a company as their sole director, as established in *In re Bulawayo Market and Offices Co Ltd* [1907] 2 Ch 458 at 463-464.

[188] AO HALL Advocates "Corporate Company Directors" (3 August 2011) available at http://www.lexology.com/library/detail.aspx?g=5d0f4352-83a6-45cb-9054-39c329e35a15 (accessed on 20 May 2016).

[189] See s 66(4)(*a*)(iii) of the Companies Act on alternate directors.

[190] Hannigan *Company Law* 156.

[191] Hannigan *Company Law* 157.

[192] *Holland v The Commissioners for Her Majesty's Revenue and Customs and Another* [2010] UKSC 51 para 101; Hannigan *Company Law* 157.

The case of *Holland v The Commissioners for Her Majesty's Revenue and Customs and Another*[193] provides a useful illustration of some disadvantages of appointing corporate directors. In this case a company's sole director was a corporate director. All of the individual director's acts were done as a director of the corporate director and could be attributed in law solely to the activities of the corporate director. The question before the Supreme Court of England and Wales was whether the individual director of the corporate director was a *de facto* director of the underlying company, and accordingly liable for a breach of fiduciary duties as a *de facto* director of that underlying company in circumstances where all of his acts could be attributed in law solely to the activities of the corporate director.[194] The majority of the Supreme Court found that the individual director in these circumstances was not the *de facto* director of the corporate director. The Supreme Court reasoned that to impose fiduciary duties on the individual in relation to the underlying company in such circumstances would be an unjustifiable extension of the scope of a *de facto* director.[195] The court opined that this was a matter that was best left to the legislature rather than the court.[196] The court found that the individual director in this case was doing no more than discharging his duties as a director of the corporate director of the underlying company and that everything he had done was done under that umbrella.[197] The individual director thus escaped personal liability. The dissenting minority judgment, on the other hand, pointed out that to attribute everything the individual did to his capacity as a director of the corporate director was "the most arid formalism"[198] and

[193] [2010] UKSC 51.

[194] *Holland v The Commissioners for Her Majesty's Revenue and Customs and Another* [2010] UKSC 51 para 53. A *de facto* director is a person who claims to act and purports to act as a director without having been appointed as a director either validly or at all, or whose appointment had come to an end but who continued to act as a director. There is no single test to determine whether a person is a *de facto* director and all relevant factors must be taken into account in determining whether a person is a *de facto* director. A *de facto* director is subject to the fiduciary duties of a director and may not escape his duties simply because he was not formally or validly appointed as a director (see *Re Hydrodam (Corby) Ltd* [1994] BCC 161 at 162-163; *Secretary of State for Trade and Industry v Tjolle* [1998] BCC 282 at 290; *Re Kaytech International plc; Portier v Secretary of State for Trade and Industry* [1999] BCC 390 at 402; *Shepherds Investment Ltd v Walters* [2007] 2 BCLC 20; *Holland v The Commissioners for Her Majesty's Revenue and Customs and Another* [2010] UKSC 51 paras 39 and 54).

[195] *Holland v The Commissioners for Her Majesty's Revenue and Customs and Another* [2010] UKSC 51 para 53.

[196] *Holland v The Commissioners for Her Majesty's Revenue and Customs and Another* [2010] UKSC 51 para 54.

[197] *Holland v The Commissioners for Her Majesty's Revenue and Customs and Another* [2010] UKSC 51 para 40.

[198] *Holland v The Commissioners for Her Majesty's Revenue and Customs and Another* [2010] UKSC 51 para 115.

that it makes it easier for risk-averse individuals to use artificial corporate structures to insulate themselves against liability.[199]

Section 201B(1) of the Australian Corporations Act of 2001 does not permit corporate directors to be appointed and states that only an individual may be appointed as a director of the company. Likewise, section 8.03(a) of the MBCA requires the board of directors to consist of one or more individuals. In a similar vein, section 141(*b*) of the DGCL states that every member of the board of directors of a corporation must be a natural person. The trend, accordingly, seems to be moving away from permitting corporate directors to be appointed to the board of directors and instead requiring directors to be natural persons.

Importantly, section 7(*b*)(iii) of the Companies Act confirms that one of the purposes of the Companies Act is to promote the development of the South African economy by encouraging transparency and high standards of corporate governance as appropriate, given the significant role of enterprises within the social and economic life of the nation. It is submitted that permitting corporate directors to be appointed would detract from this purpose of encouraging transparency because it would make it difficult to determine who controls a company and may, as the minority judgment in *Holland v The Commissioners for Her Majesty's Revenue and Customs and Another*[200] warned, make it easier for individuals to use artificial corporate structures to insulate themselves against liability. It would be useful to see what exceptions are promulgated in the UK in due course with regard to the instances when corporate directors may be appointed, but it is nonetheless submitted that the Companies Act adopts the commendable approach of permitting only natural persons to be appointed as directors of the company.

6.1.2.2 Unemancipated Minor or Persons Under a Similar Legal Disability

6.1.2.2.1 Minor

Under section 69(7)(*b*) of the Companies Act a person is ineligible to be a director of a company if he is an unemancipated minor or is under a similar legal disability. In terms of

[199] *Holland v The Commissioners for Her Majesty's Revenue and Customs and Another* [2010] UKSC 51 para 101.

[200] [2010] UKSC 51 para 101.

section 17 of the Children's Act 38 of 2005 every child, whether male or female, becomes a major upon reaching the age of eighteen years.[201] This means that a person is not eligible to be a director of a company under the Companies Act unless that person has reached the age of eighteen years, or alternatively has been emancipated.

In contrast, under the UK Companies Act of 2006, the minimum age at which a person may be appointed a director of a company, is sixteen years.[202] Appointments made in breach of this rule are void.[203] This prohibition does not prevent the appointment of a person younger than sixteen years of age provided that it is not to take effect until that person is sixteen years old.[204] The rationale behind introducing a minimum age requirement of sixteen in the UK is due to evidence that the appointment of young directors was being used to exploit their immunity from prosecution, and the reluctance of public authorities to prosecute young persons.[205] The Secretary of State in the UK may make provision by regulation for cases in which a person who is younger than sixteen years may be appointed a director of a company.[206]

The (South African) Companies Act has not adopted the liberal approach adopted in the UK regarding the minimum age of a director. Despite this, the (South African) Companies Act is in line with section 201B(1) of the Australian Corporations Act of 2001 which states that an individual must be at least eighteen years old to be appointed as a director of a company. Various USA States also require a director to be at least eighteen years old. For example section 701 of the New York Business Corporation Law and section 14A:6-1 of the New Jersey

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[201] Prior to this date, the age of majority in South African law, under the now repealed Age of Majority Act 57 of 1972, was twenty one years. Section 17 of the Children's Act 38 of 2005 came into operation on 1 July 2007. The age of majority was changed in 2007 in order to bring it in line with the definition of a "child" in the Constitution. Section 28(3) of the Constitution states that a "child" means a person under the age of eighteen years.

[202] Section 157(1) of the UK Companies Act of 2006. The age of majority in the UK is eighteen years (s 105(1) of the Children Act 1989). The age of majority does vary in certain circumstances in that it typically ranges from between sixteen years of age (in which school no longer becomes compulsory) to eighteen years of age (for voting rights and the consumption of alcohol). For a discussion on the age of majority in the UK see Feikert "Children's Rights: United Kingdom (England and Wales)" *Law Library of Congress* (August 2007) 167-180 available at https://www.loc.gov/law/help/child-rights/uk.php (accessed on 23 May 2016).

[203] Section 157(4) of the UK Companies Act of 2006.

[204] Section 157(2) of the UK Companies Act of 2006.

[205] Davies & Worthington *Gower Principles of Modern Company Law* 368.

[206] Sections 158(1) and 158(2) of the UK Companies Act of 2006.

Business Corporation Act require a director to be at least eighteen years old. Section 10A-2-8.02 of the Alabama Business and Nonprofit Entities Code requires a director to be at least nineteen years old.[207]

If a shareholder or director alleges, in terms of section 71(3) of the Companies Act, that a director of the company is ineligible to be a director on the ground that he is an unemancipated minor, the board of directors would have to determine the matter by resolution. Should the board find that the director in question is indeed an unemancipated minor, the director must be removed from office on the basis that he is not eligible to be a director. The question arises whether an underage person who purported to act as a director would be liable for breach of any of the fiduciary duties of a director, and whether his past acts would remain valid. The Companies Act does not address these matters.

In striking contrast, section 157(5) of the UK Companies Act of 2006 clearly states that nothing in section 157 affects any liability of a person under any provision of the UK Companies Act of 2006 if he purports to act as a director or acts as a shadow director, despite the fact that such person could not be validly appointed as a director. In other words, even though in the UK a person under the age of sixteen years may not be validly appointed as a director, he will not be protected from criminal prosecution or civil liability were he to act as a *de facto* director or a shadow director.[208]

It is submitted that a similar approach ought to be adopted with regard to underage directors under the (South African) Companies Act. This approach is further bolstered by the definition of the term "director" in section 1 of the Companies Act, which states that a director means "a member of the board of a company, as contemplated in section 66, or an alternate director of a company and includes any person occupying the position of a director or alternate director, by whatever name designated". The words "occupying the position of a director" and "by

[207] This provision is codified in Title 10A (Alabama Business and Nonprofit Entities Code), Chapter 2 (Business Corporations) of the Code of Alabama.

[208] See the Explanatory Notes to the Companies Act of 2006 para 284, available at http://www.legislation.gov.uk/ukpga/2006/46/notes (accessed on 23 May 2016). A shadow director is defined in s 251(1) of the UK Companies Act of 2006 as "a person in accordance with whose directions or instructions the directors of the company are accustomed to act". The difference between a *de facto* director and a shadow director is that a *de facto* director assumes to act as a director, and claims and purports to be a director, although never actually or validly appointed as such, while a shadow director does not claim or purport to act as a director but in fact claims not to be a director (see *Re Hydrodam (Corby) Ltd* [1994] BCC 161 at 163).

whatever name designated" make it clear that the definition of a "director" is wide enough to include a *de facto* director[209] and a shadow director.[210] Accordingly, if an underage director were to act as a director, he would be "occupying the position of a director", regardless of the name by which he is designated. In his capacity as a *de facto* director or a shadow director, he ought not to escape liability for his actions.[211]

In terms of section 161 of the UK Companies Act of 2006, the acts of a person acting as a director are valid notwithstanding that it is afterwards discovered that there was a defect in his appointment or that he was disqualified from holding office. The Companies Act 61 of 1973 contained a similar provision which was not retained in the current Companies Act. Section 214 of the Companies Act 61 of 1973 provided that the "acts of a director shall be valid notwithstanding any defect that may afterwards be discovered in his appointment or qualification." It is submitted that it would be too disruptive to the running of a company's business and its affairs if the past acts of an underage director were not regarded as valid. It is submitted that a provision similar to section 214 of the previous Companies Act 61 of 1973 and section 161 of the UK Companies Act of 2006 should be inserted in the Companies Act.

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[209] R Cassim "Governance and the Board of Directors" in FHI Cassim et al *Contemporary Company Law* 409; Delport *New Entrepreneurial Law* 124.

[210] FHI Cassim "The Duties and the Liability of Directors" in FHI Cassim et al *Contemporary Company Law* 510.

[211] Under s 66(7)(*b*) of the Companies Act a person becomes entitled to serve as a director of a company when that person has delivered to the company a written consent to serve as its director. This would obviously not apply to *de facto* and shadow directors (R Cassim "Governance and the Board of Directors" in FHI Cassim et al *Contemporary Company Law* 425.) Generally a minor can incur contractual liability only if he is assisted by his guardian when the contract is entered into (*Edelstein v Edelstein* 1952 (3) SA 1 (A); RA Jordaan & Davel *Law of Persons Source Book* 143; Du Bois et al *Wille's Principles of South African Law* 178; Schäfer *Child Law in South Africa: Domestic and International Perspectives* 200; Heaton *The South African Law of Persons* 89). With regard to incurring delictual liability, under the common law minors below the age of seven years are not delictually liable, while it is rebuttably presumed that minors between the ages of seven years and puberty (being fourteen years for boys and twelve years for girls) are not accountable for their delicts (*Weber v Santam Versekeringsmaatskappy Bpk* 1983 (1) SA 381 (A) at 399; RA Jordaan & Davel *Law of Persons Source Book* 215). Boys between fourteen and eighteen years of age and girls between twelve and eighteen years of age are rebuttably presumed to be delictually accountable. Criminal liability of a minor is governed by the Child Justice Act 75 of 2008. The minimum age for criminal accountability, in terms of this Act, is ten years (ss 7(1) and 7(3)). A child between the age of ten and fourteen years is rebuttably presumed to lack criminal capacity (ss 7(2) and 7(3)). Such a child would have criminal capacity only if the State proves beyond a reasonable doubt that when the crime was committed the minor had the capacity to appreciate the difference between right and wrong and to act in accordance with such appreciation (s 11(1)). A minor over the age of fourteen years is criminally accountable in the same way as an adult. On the contractual, delictual and criminal accountability of minors see further RA Jordaan & Davel *Law of Persons Source Book* 215; Du Bois et al *Wille's Principles of South African Law* 174-188; Snyman *Criminal Law* 178-181; Schäfer *Child Law in South Africa: Domestic and International Perspectives* 199-205; Heaton *The South African Law of Persons* 89-103 and 111-112 and Burchell *Principles of Criminal Law* 259-262.

6.1.2.2.2 Unemancipated

The Companies Act states that an "unemancipated minor" would be ineligible to be a director. The use of the word "unemancipated" implies that if the minor were emancipated, he would be eligible to be a director. Thus it is possible under the Companies Act to appoint as a director a person under the age of eighteen years, provided such person has been emancipated. Since an unemanicipated minor is ineligible to be appointed a director of a company and may be removed from office by the board of directors under section 71(3) of the Companies Act, it is important to understand what is meant by the term "unemancipated minor".

A minor is emancipated when he has received the express or tacit consent of his parent or guardian to participate in commercial dealings as an economically independent person.[212] Either of the minor's parents may provide the requisite consent for the minor to act economically independently, as long as they have guardianship of the minor.[213] Roman-Dutch law recognised two forms of emancipation, namely express emancipation and tacit emancipation. Express emancipation required a declaration by the minor's guardian before a court to the effect that the minor had been emancipated from parental responsibilities and rights.[214] By the eighteenth century express emancipation had been replaced by the institution of *venia aetatis.*[215] This doctrine was subsequently rendered obsolete by the Age of Majority Act 57 of 1972, which has now been repealed. Regarding whether tacit emancipation still forms part of our law, in *Grand Prix Motors WP (Pty) Ltd v Swart*[216] the court left this question open, but in *Watson v Koen h/a BMO*[217] the court assumed, without deciding the issue, that tacit

[212] *Dickens v Daley* 1956 (2) SA 11 (N) at 13; *Grand Prix Motors WP (Pty) Ltd v Swart* 1976 (3) SA 221 (C) at 224; *Ex parte Botes* 1978 (2) SA 400 (O) at 402; RA Jordaan & Davel *Law of Persons Source Book* 185; Heaton *The South African Law of Persons* 114.

[213] Sections 19 and 20 of the Children's Act 38 of 2005.

[214] Schäfer "Young Persons" in Clark *Family Law Service* para E24.

[215] *Venia aetatis* was a common-law institution whereby the head of state could grant majority status to a person older than eighteen years (see RA Jordaan & Davel *Law of Persons Source Book* 216-224; Du Bois et al *Wille's Principles of South African Law* 190; Boezaart *Law of Persons* 92; Schäfer *Child Law in South Africa: Domestic and International Perspectives* 20-21 and Heaton *The South African Law of Persons* 113). *Venia aetatis* was granted in the former Province of the Free State only. It was governed by statute (Chapter 89 of the OFS Wetboek 1901) (Law Book of the Orange River Colony 1901) and granted by the State President by proclamation in the *Government Gazette* after the High Court had considered the desirability of granting it.

[216] 1976 (3) SA 221 (C).

[217] 1994 (2) SA 489 (O).

emancipation does remain part of South African law. It is generally accepted that tacit emancipation persists in South African law.[218]

The Children's Act 38 of 2005 does not contain provisions dealing with emancipation of minors. Whether a minor has been emancipated or not is a question of fact to be decided from the circumstances of each case.[219] Tacit emancipation may be effected only by the express or implied consent of the minor's guardian.[220] Relevant facts may be that the minor lives on his own and manages his own business, the relationship between the minor and his guardian, the nature of the minor's occupation, and the length of time for which the occupation has been pursued independently of parental control.[221] It is not essential for the minor to live apart from his parents, but stronger evidence would be required to prove tacit emancipation where the minor lives with his parents.[222]

The effect of tacit emancipation on the minor's capacity to act has not been authoritatively decided. There is authority for the view that tacit emancipation gives the minor capacity to act in respect of all contracts, save that he cannot alienate or encumber his immovable property and he cannot enter into a marriage without his guardian's consent.[223] On the other hand there is authority to the effect that the minor is only tacitly emancipated in respect of contracts in connection with his particular business.[224] The effect of tacit emancipation is a matter of degree, and is determined by the guardian's intention, as evidenced by the circumstances of each case.[225] The general weight of opinion is that tacit emancipation, in modern times, does

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[218] See Van Heerden et al *Boberg's Law of Persons and the Family* 473 and Schäfer "Young Persons" in Clark *Family Law Service* para E24.

[219] *Dama v Bera* 1910 TPD 928; Heaton *The South African Law of Persons* 114.

[220] *Watson v Koen h/a BMO* 1994 (2) SA 489 (O); *Sesing v Minister of Police and Another* 1978 (4) SA 742 (W).

[221] Van Heerden et al *Boberg's Law of Persons and the Family* 478-479; RA Jordaan & Davel *Law of Persons Source Book* 185-186; Du Bois et al *Wille's Principles of South African Law* 191; Heaton *The South African Law of Persons* 114-115.

[222] *Dama v Bera* 1910 TPD 928; Heaton *The South African Law of Persons* 114-115.

[223] *Dickens v Daley* 1956 (2) SA 11 (N); *Watson v Koen h/a BMA* 1994 (2) SA 489 (O).

[224] *Ambaker v African Meat Co* 1927 CPD 326; *Ahmed v Coovadia* 1944 TPD 364; *Sesing v Minister of Police and Another* 1978 (4) SA 742 (W).

[225] Van Heerden et al *Boberg's Law of Persons and the Family* 487; Du Bois et al *Wille's Principles of South African Law* 192.

not result in a minor attaining majority status because an emancipated minor is still not competent to enter into a marriage without consent or to alienate or encumber immovable property.[226]

The onus of proving that a minor is emancipated rests on the person who alleges this, and it must be proved, on a balance of probabilities, that the minor's guardian emancipated him, and not that the minor considered himself to be emancipated.[227] It is not settled whether a guardian who has emancipated a minor may legally revoke the emancipation, but the preferred view is that since emancipation depends on parental consent, it should be revocable.[228]

In *Ex parte Velkes*[229] a minor of twenty years old, who wished to be appointed a director of a company, applied, with the support of his guardian, for an order declaring that he had become emancipated, either tacitly or by express consent, from the parental power of his guardian. Section 68*bis*(1)(a) of the then Companies Act 46 of 1926 disqualified a minor from being appointed a company director. The court, per Corbett AJ, did not grant the application for emancipation because it found that there was no existing and concrete dispute between persons and that it had no jurisdiction under section 19(1)(c) of the Supreme Court Act 59 of 1959 to make such a declaration of right.[230] In passing, the court cast doubt on whether the order sought

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[226] *Sesing v Minister of Police and Another* 1978 (4) SA 742 (W) at 746; Van Heerden et al *Boberg's Law of Persons and the Family* 474; Du Bois et al *Wille's Principles of South African Law* 192; Boezaart *Law of Persons* 80.

[227] *Grand Prix Motors WP (Pty) Ltd v Swart* 1976 (3) SA 221 (C) at 222; *Watson v Koen h/a BMO* 1994 (2) SA 489 (O) at 492-493; Du Bois et al *Wille's Principles of South African Law* 191.

[228] *Dickson v Daley* 1929 OPD 19; *Ahmed v Coovadia* 1944 TPD 364 at 366; *Ex parte Van den Hever* 1969 (3) SA 96 (E) at 99; Van Heerden et al *Boberg's Law of Persons and the Family* 474; Du Bois et al *Wille's Principles of South African Law* 192-193; Boezaart *Law of Persons* 80; Heaton *The South African Law of Persons* 115.

[229] 1963 (3) SA 584 (C).

[230] Section 19(1)(*c*) of the Supreme Court Act 59 of 1959 empowered a court "in its discretion, and at the instance of any interested person, to enquire into and determine any existing, future or contingent right or obligation, notwithstanding that such person cannot claim any relief consequential upon the determination." This provision was interpreted to mean that in the exercise of the jurisdiction conferred upon it a court will not deal with or pronounce on abstract or academic points of law (*Ex parte Velkes* 1963 (3) SA 584 (C) at 587). The court asserted that there must be an existing and concrete dispute between persons before it will act under s 19(1)(*c*) of the Supreme Court Act 59 of 1959 (at 587). In this case there was no such dispute since the court was merely being asked to declare that the applicant had become emancipated, and, in the papers before the court there was no indication that any party had disputed that the applicant had become emancipated. The court accordingly held that if it were to grant the order asked for it would be making a pronouncement upon an academic point which was unrelated to any concrete dispute between persons (at 587). The court accordingly declined to make an order on the application (at 588).

would remove the minor's disqualification to be a company director.[231] It is accordingly an open question under the common law whether tacit emancipation would remove a minor's disqualification to be appointed a director.

It is submitted that it must be taken into account that under section 69(7)(*b*) of the Companies Act an "unemancipated" minor is disqualified to be a company director. Notably, at the time that *Ex parte Velkes*[232] was decided the Companies Act 46 of 1926 was applicable, and section *68bis*(1)(*a*)*bis* of that Act disqualified a "minor or any other person under legal disability" from being appointed a director of a company. No mention was made of an "unemancipated minor" in the section. Likewise, the Companies Act 61 of 1973 disqualified a "minor" from being a director (in section 218(1)(*b*)) and did not refer to an "unemancipated" minor. For the first time in our statutory company law, an "unemancipated minor" has been disqualified from being appointed a director of a company. It is submitted that the express inclusion of the word "unemancipated" in section 69(7)(*b*) of the Companies Act implies that an emancipated minor may qualify to be a director.

Nevertheless, as discussed earlier, there are different degrees of tacit emancipation, and the prevailing view is that tacit emancipation does not, in modern times, result in a minor attaining majority status.[233] The degree of legal independence which a minor has acquired by tacit emancipation will depend on the circumstances of each case, and whether the minor has been given complete freedom of action with regard to his mode of living and earning his livelihood, or whether the minor's capacity to act has been restricted to matters connected with his business.[234] It is therefore submitted that, if a minor has been emancipated, whether or not he will qualify to be a director of a company, would depend on the extent of his emancipation. It would accordingly have to be ascertained on a case by case basis whether the emancipated minor in question would be eligible to be a director of a company.

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[231] *Ex parte Velkes* 1963 (3) SA 584 (C) at 586.

[232] 1963 (3) SA 584 (C).

[233] See *Sesing v Minister of Police and Another* 1978 (4) SA 742 (W) at 746; Van Heerden et al *Boberg's Law of Persons and the Family* 474 and Boezaart *Law of Persons* 80.

[234] *Dama v Bera* 1910 TPD 928; *Sesing v Minister of Police* 1978 (4) SA 742 (W); Heaton *The South African Law of Persons* 115.

Should a company appoint an emancipated minor to its board of directors, it must take note of the fact that emancipation may be revocable, as discussed above.[235] Accordingly, if a director or a shareholder becomes aware of the revocation of the emancipation of the minor, such director or shareholder must bring the loss of the director's emancipated status to the attention of the company under section 71(3) of the Companies Act. Failure to do so would violate section 69(3) of the Companies Act, which prohibits a company from knowingly permitting an ineligible person to serve or act as a director.[236]

While emancipation may not necessarily confer majority status on a minor, marriage by a minor, with the consent of his parents, guardian or in certain circumstances, a commissioner of child welfare, a judge of the High Court of South Africa or the Minister of Home Affairs, would result in the minor attaining majority status.[237] It is thus possible for a company to appoint to its board of directors a person below the age of eighteen years who is not emancipated but who is legally married. Even if such marriage is subsequently dissolved by death or divorce before either or both parties reach the age of eighteen years, the status of majority acquired by each party to the marriage would endure. This is made clear by section 24(2) of the Marriage Act 25 of 1961, which states that a minor does not include a person who is under the age of twenty one years who had previously contracted a valid marriage that has been dissolved by death or divorce.[238]

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[235] *Dickson v Daley* 1929 OPD 19; *Ahmed v Coovadia* 1944 TPD 364 at 366; *Ex parte Van den Hever* 1969 (3) SA 96 (E) at 99; Van Heerden et al *Boberg's Law of Persons and the Family* 474; Du Bois et al *Wille's Principles of South African Law* 192-193; Boezaart *Law of Persons* 80; Heaton *The South African Law of Persons* 115.

[236] See para 6.1.1 above where the meaning of "knowingly" as defined in s 1 of the Companies Act is discussed.

[237] See ss 24, 24A, 25 and 26 of the Marriage Act 25 of 1961; *Santam Versekeringsmaatskappy Bpk v Roux* 1978 (2) SA 856 (A) at 864; RA Jordaan & Davel *Law of Persons Source Book* 225; Du Bois et al *Wille's Principles of South African Law* 189; Boezaart *Law of Persons* 91; Schäfer *Child Law in South Africa: Domestic and International Perspectives* 18 and Heaton *The South African Law of Persons* 113.

[238] See further Schäfer *Child Law in South Africa: Domestic and International Perspectives* 18-19. It should however be noted that a void marriage would not confer majority status on the minor spouses (Du Bois et al *Wille's Principles of South African Law* 189). Examples of when a marriage would be void would be where the marriage was concluded by someone who was not appointed as a marriage officer, or a marriage within the prohibited degrees of a relationship. In the case of a voidable marriage there is a valid marriage from the date of the marriage. A voidable marriage is one that comes into existence but may be set aside by a court as a result of non-compliance with a requirement. Examples of a voidable marriage are a marriage by a minor without the consent of his parents, or a marriage by reason of fraud or duress (Joubert "Law of Marriage" in Clark *Family Law Service* para A50). A voidable marriage would confer majority status on the spouses (Schäfer "Young Persons" in Clark *Family Law Service* para E22). Significantly, the annulment of a voidable marriage restores the minority status of the minor, unless the age of eighteen has been reached (*Berning v Berning* 1942 1 PH B26 (W)). Accordingly, a company that has appointed to its board of directors a person younger than eighteen years old who is married, must pay heed to whether, after such appointment, the marriage dissolves, either by death or divorce (in which event the minor will still be eligible to be a director) or by annulment (in which case the minor would

6.1.2.2.3 Persons Under a Similar Legal Disability

Section 69(7)(*b*) of the Companies Act states that an unemancipated minor or a person under a "similar legal disability" is ineligible to be a director. The meaning of the phrase "legal disability" was expounded in *Standard Bank of South Africa Limited v Jwara*[239] where the court stated:

> "Persons are under legal disability when, by law, their capacity or ability to relate, as legal subjects, to the legal system, is curtailed. Examples are minors and insolvents that are not permitted ('*regsonbevoeg*') to perform certain juristic acts. In our law, '*legal disability*' relates to situations where there is an impediment in law (impendimentum iuris) without narrowing or limiting it to specific circumstances."

Section 218(1)(*a*) of the Companies Act 61 of 1973 prohibited a minor "or any other person under legal disability" from being appointed or acting as a director of a company. In contrast, section 69(7)(*b*) of the Companies Act prohibits an unemancipated minor or a person "under *a similar* legal disability" (emphasis added) from being a director. Consequently, the legal disability which makes a person ineligible to be a director, must now be similar to the legal disability which is experienced by a minor.

The relevant capacities in our law are legal capacity, capacity to act and capacity to litigate.[240] Legal capacity is the judicial capacity that vests an individual with legal subjectivity and enables him to hold offices as a legal subject.[241] Every person has legal capacity but in certain

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immediately cease to be eligible to be a director). Of course, if the marriage were void to begin with, then majority status would not have been conferred on the minor at all, and such minor would not be eligible to be appointed a director of a company. It is of interest that a union solemnised in terms of the Civil Union Act 17 of 2006 would not result in a minor acquiring majority status because persons under the age of eighteen are, by definition, not legally permitted to form such a union. The term "civil union" is defined in s 1 of the Civil Union Act 17 of 2006 as meaning the "voluntary union of two persons who are both eighteen years of age or older, which is solemnised and registered by way of either a marriage or a civil partnership, in accordance with the procedures prescribed in this Act, to the exclusion, while it lasts, of all others". Section 13 of the Civil Union Act 17 of 2006 states that the legal consequences of a marriage contemplated in the Marriage Act 25 of 1961 apply, with such changes as may be required by the context, to a civil union. It may be that s 13 of the Civil Union Act 17 of 2006 has extended the scope of the provisions that permit the marriage of a minor under the Marriage Act 25 of 1961 with the appropriate permission, but this is not clear (Schäfer "Young Persons" in Clark *Family Law Service* para E2).

[239] 2012 JDR 0204 (GSJ) para 5.

[240] See *Standard Bank of South Africa Limited v Jwara* 2012 JDR 0204 (GSJ) para 6; Van Heerden et al *Boberg's Law of Persons and the Family* 746 and Boezaart *Law of Persons* 7.

[241] Boezaart *Law of Persons* 7.

instances legal capacity is limited. A minor's legal capacity is limited in that a minor under the age of puberty cannot marry,[242] and a person under the age of sixteen is not competent to make a will.[243] An example of a person with a "similar legal disability" as a minor in this respect is an unrehabilitated insolvent, who cannot be elected or appointed a trustee of an estate under sequestration.[244] Capacity to act is the judicial capacity to enter into legal transactions.[245] A minor has limited capacity to act and must be assisted or represented by his natural or legal guardian to enter into legal transactions. An example of a person with a "similar legal disability" as a minor in this regard would be a mentally ill person. A curator *bonis* may be appointed to represent the mentally ill person and to enter into juristic acts on his behalf. Capacity to litigate is the judicial capacity that enables a person to appear in court as a party to a law suit.[246] A minor has limited capacity to litigate because while he may sue or be sued, the assistance of a parent or guardian is required.[247] An example of a person with a "similar legal disability" to a minor in this regard would be a person with a mental disability or a person who has been declared by a court to be incapable of managing his affairs. A curator *ad litem* may be appointed to assist such persons to litigate.

To sum up, an unemancipated minor (being below the age of eighteen years) is ineligible to be a company director. Whether a minor has been emancipated or not is a question to be decided from the circumstances of each case. A married minor (provided the marriage is not void) would not be ineligible to be a director. Any person with a legal disability which is similar to the legal disability which is experienced by a minor (such as an unrehabilitated insolvent and a person with a mental disability) is also ineligible to be a company director.

6.1.2.3 Failure to Satisfy any Qualification set out in the Memorandum of Incorporation

In terms of section 69(6) of the Companies Act, the Memorandum of Incorporation of a company may set out minimum qualifications for directors of the company, as well as

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[242] See s 26(1) of the Marriage Act 25 of 1961 and ss 12(2) and 18(3)(*c*)(i) of the Children's Act 38 of 2005.

[243] Section 4 of the Wills Act 7 of 1953.

[244] See ss 55(a) and 58(a) of the Insolvency Act 24 of 1936.

[245] Boezaart *Law of Persons* 7.

[246] *Standard Bank of South Africa Limited v Jwara* 2012 JDR 0204 (GSJ) para 6.

[247] Van Heerden et al *Boberg's Law of Persons and the Family* 748.

additional grounds of ineligibility and disqualification of directors. Under section 69(7)(*c*) of the Companies Act a person is ineligible to be a director of a company if the person does not satisfy any qualification set out in the company's Memorandum of Incorporation. Consequently, if a director fails to satisfy any of the additional qualification grounds set out in the Memorandum of Incorporation, the board of directors of the company may remove him from office under section 71(3) of the Companies Act.

An example of a minimum qualification would be that a director must hold shares in the company in order to be eligible to be a director of the company. Additional eligibility requirements could be those based on experience, expertise, professional qualifications or length of service. The additional qualifications in the Memorandum of Incorporation should in principle endeavour to enhance the ability of the board of directors to perform its role effectively.[248] They should not be used for improper purposes, nor should they be unreasonable or unlawful. For example, a qualification that a director must be affiliated to a particular political party would be unreasonable, or a qualification that a director must be of a certain race, would be discriminatory and unlawful.

The Companies Act does not impose any requirement to the effect that any additional grounds of eligibility or disqualification or minimum qualifications to be a director must be reasonable and lawful. In contrast, section 8.02(a) of the MBCA, which specifies that the articles of incorporation or by-laws may prescribe qualifications for directors, states that these qualifications must be reasonable as applied to the corporation, and must be lawful. It is submitted that if an additional ground of ineligibility or disqualification or minimum qualification provided for in a Memorandum of Incorporation were unreasonable or unlawful, it could well be challenged. It is further submitted that, in order to avoid any ambiguity regarding the type of permissible qualifications that may be inserted in the Memorandum of Incorporation of a company, section 69(6) of the Companies Act should be amended to specify, as in section 8.02(a) of the MBCA, that any additional minimum qualification requirements or additional grounds of ineligibility or disqualification specified in the Memorandum of Incorporation of a company, must be both reasonable and lawful.

[248] See *Model Business Corporation Act with Official Comments and Reporter's Annotations* 8-28.

The question arises how a director is affected by the introduction of a new ground of ineligibility or disqualification or minimum qualification in the Memorandum of Incorporation of the company during his term of office.[249] The Companies Act does not address this matter. It would appear that a director may well immediately cease to be eligible to be a director if a new ground of ineligibility or disqualification or a new minimum qualification, which would make him ineligible to be a director or disqualify him from office, were to be introduced during the term of his appointment. The Companies Act does not contain any provision guarding against the introduction of qualification requirements being used for improper purposes, such as to remove directors.

Section 8.02(e) of the MBCA guards against the misuse of the introduction of new qualification requirements, by stating that a qualification for a director prescribed before a director has been elected or appointed may apply only at the time an individual becomes a director or may apply during a director's term, but a qualification prescribed after a director has been elected or appointed shall not apply to that director before the end of his term. It is submitted that section 69(6) of the Companies Act should adopt similar provisions as those contained in section 8.02(e) of the MBCA. This would prevent the new ground of ineligibility or disqualification being introduced and abused as a means to remove a director under section 71(3) of the Companies Act.

6.1.3 Grounds of Disqualification as Director

Section 69(8) of the Companies Act sets out the grounds of disqualification to be a director of a company. If a shareholder or director alleges that a director has become disqualified to be a director of the company, that director may be removed from office by the board of directors under section 71(3)(*a*)(i) of the Companies Act. The difference between disqualification and ineligibility is that a disqualification is not absolute. A court has a discretion to permit a disqualified person to accept an appointment as a director, but an ineligible person is absolutely

[249] The Memorandum of Incorporation of a company may be amended at any time by a special resolution of the shareholders if such special resolution is proposed by the board of directors or by shareholders entitled to exercise at least ten per cent of the voting rights that may be exercised on such a resolution, or in accordance with any other requirements imposed by a company's Memorandum of Incorporation (s 16 of the Companies Act).

prohibited from being a director.[250] The following persons are disqualified by section 69(8) of the Companies Act from being a director of a company:

(i) a person prohibited by a court from becoming a director;
(ii) a person declared to be delinquent by a court in terms of section 162 of the Companies Act or section 47 of the Close Corporations Act 69 of 1984;
(iii) an unrehabilitated insolvent;
(iv) a person prohibited in terms of any public regulation to be a director of a company;
(v) a person removed from an office of trust, on the grounds of misconduct involving dishonesty; and
(vi) a person convicted, in South Africa or elsewhere, and imprisoned without the option of a fine, or fined more than the prescribed amount,[251] for theft, fraud, forgery, perjury or an offence –

- involving fraud, misrepresentation or dishonesty;
- in connection with the promotion, formation or management of a company, or in connection with any act contemplated in subsection (2) or (5); or
- under the Companies Act, the Insolvency Act 24 of 1936, the Close Corporations Act 69 of 1984, the Competition Act 89 of 1998; the Financial Intelligence Centre Act 38 of 2001, the Financial Markets Act 19 of 2012,[252] or Chapter 2 of the Prevention and Combating of Corrupt Activities Act 12 of 2004.[253]

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[250] See s 69(11) of the Companies Act which makes provision for a court to exempt a person from the application of any provision of s 69(8)(*b)*, which section sets out the grounds upon which a director will be disqualified to be a director of a company.

[251] The prescribed amount, in terms of regulation 39(4) of the Companies Regulations, 2011 is an amount of one thousand Rand.

[252] Section 69(8)(*b*)(iv)(*cc*)of the Companies Act refers to the Securities Services Act 36 of 2004, but this Act has been repealed and replaced by the Financial Markets Act 19 of 2012.

[253] Section 69(8)(*b*)(iv)(*cc*) refers to the "Prevention and Combating of Corruption Activities Act, 2004". This is an error, and should be a reference to the "Prevention and Combating of Corrupt Activities Act, 2004". A disqualification in terms of grounds (v) and (vi) listed in para 6.1.3 above ends at the later of five years after the date of removal from office or the completion of the sentence imposed for the relevant office, as the case may be, or at the end of one or more extensions, as determined by a court from time to time, on application by the CIPC. At any time before the expiry of a person's disqualification in terms of grounds (v) and (vi) listed in para 6.1.3 above, the CIPC may apply to a court for an extension of the period of disqualification. The court may extend the disqualification for no more than five years at a time, if the court is satisfied that an extension is necessary to protect the public, having regard to the conduct of the disqualified person up to the time of the application (see ss 69(9) and 69(10) of the Companies Act).

An "insolvent" is a debtor whose estate is under sequestration.[254] An unrehabilitated insolvent may apply to court to be rehabilitated, in terms of section 124 of the Insolvency Act 24 of 1936. Alternatively, an insolvent who has not been rehabilitated by a court within a period of ten years from the date of sequestration of his estate, will be deemed to be rehabilitated after the expiry of ten years, unless a court, upon an application by an interested person, orders otherwise prior to the expiry of the ten year period.[255] One of the effects of the rehabilitation of an insolvent is that it relieves the insolvent of every disability resulting from the sequestration.[256] A court may however impose conditions to the rehabilitation of an insolvent.[257] It is consequently important for directors and shareholders to take note of any conditions that a court imposes in this context, and of whether such conditions affect the capacity of the rehabilitated insolvent to be appointed a director of a company.

The term "dishonesty" is referred to twice in section 69(8)(*b*) of the Companies Act. A person who has been removed from an office of trust on the grounds of misconduct involving dishonesty is disqualified from being a director,[258] as is a person convicted of an offence involving dishonesty.[259] In *Ex parte Bennett*[260] the court found that dishonesty in its ordinary meaning denotes a disposition to deceive, defraud or steal.[261] The court stated further that an "offence involving dishonesty" is one of which dishonesty is an element or ingredient - in the case of a common law offence in terms of its definition, and in the case of a statutory offence in terms of the statute which created it.[262] An example of an offence involving dishonesty

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[254] Section 1 of the Insolvency Act 24 of 1936. A "sequestration order" is defined in s 1 of the Insolvency Act 24 of 1936 as meaning any order of court whereby an estate is sequestrated and includes a provisional order, when it has not been set aside.

[255] Section 127A(1) of the Insolvency Act 24 of 1936.

[256] Section 129(1) of the Insolvency Act 24 of 1936.

[257] See s 129(1) of the Insolvency Act 24 of 1936.

[258] Section 69(8)(*b*)(iii).

[259] Section 69(8)(*b*)(iv)(*aa*).

[260] 1978 (2) SA 380 (W) at 383-384.

[261] See also *Nucsa v Da Ponte* 1994 (3) SA 251 (BG) at 256.

[262] *Ex parte Bennett* 1978 (2) SA 380 (W) at 384. See further *Nucsa v Da Ponte* 1994 (3) SA 251 (BG) at 259.

emanates from *Nucsa v Da Ponte*[263] where the court held that illicit diamond dealing was an offence involving dishonesty, and that a person convicted of illicit diamond dealing was disqualified from acting as a director of a company.[264]

Section 69(8)(*b*)(iv)(*bb*) of the Companies Act states that a person is disqualified to be a director of a company if the person has been convicted in South Africa or elsewhere of an offence in connection with the promotion, formation or management of a company, or in connection with any act contemplated in sections 69(2) or 69(5) of the Companies Act. Section 69(5) of the Companies Act provides that a person who has been placed under probation by a court in terms of section 162 of the Companies Act or section 47 of the Close Corporations Act 69 of 1984 must not serve as a director except to the extent permitted by the order of probation. Section 69(2) of the Companies Act provides that a person who is ineligible or disqualified as set out in section 69 must not be appointed or elected as a director of a company, consent to being appointed or elected as a director, or act as a director of a company. A reference to section 69(2) in section 69(8)(*b*)(iv)(*bb*) seems peculiar because when the two sections are read together, as required by section 69(8)(*b*)(iv)(*bb*), they provide that a person is disqualified to be a director of a company if he has been convicted of an offence in connection with being appointed or elected as a director of a company, or consenting to be appointed or elected as a director of a company, or acting as a director of a company, while ineligible or disqualified to be a director. This seems circular. It is not clear why the legislature would list as a ground of disqualification a person who is convicted of an offence of acting as a director whilst disqualified, or being appointed or elected as a director or consenting to being appointed or elected as a director whilst disqualified, because the person is already disqualified from being a director. Clarity on the reason why the legislature referred to section 69(2) of the Companies Act in section 69(8)(*b*)(iv)(*bb*) is required.

With regard to an offence in connection with the management of a company, referred to in section 69(8)(*b*)(iv)(*bb*) of the Companies Act, the Companies Act does not define the phrase

[263] 1994 (3) SA 251 (BG).

[264] Another example of an offence involving dishonesty, as illustrated by *Marpro Trawling (Pty) Ltd v Cencelli* 1992 (1) SA 407 (C), is that of bilking, which is where a person leaves a hotel without paying his account. This was an offence under s 32 of the now repealed Hotels Act 70 of 1965. The court in this case held that a person convicted of bilking had committed an offence involving dishonesty and was disqualified, in terms of s 47(1)(*b*)(iii) of the Close Corporations Act 69 of 1984, from taking part in the management of the business of a close corporation.

"management of a company". In *Ex parte Bennett*[265] Le Grange J asserted that an "offence connected with the management of a company" is one committed by a manager of a company, in the course of his management of the company, and which relates to his managing of the company. The "management of a company" is said to mean the "collective control, regulation, conduct or direction of the affairs of the business",[266] and refers to the participation in the management of the whole of the affairs of the corporation.[267] Section 15(4) of the UK Company Directors Disqualification Act 1986 sets out a much wider definition of the meaning of being involved in the "management of a company". The section states that a person is involved in the management of a company (for the purposes of section 15 of that Act) if he is concerned, whether directly or indirectly, or takes part, in the management of the company.[268] "Taking part in" and "being concerned in" are broad terms and include activities involving some responsibility and participation in the decision-making processes of a company, as opposed to

[265] 1978 (2) SA 380 (W) at 389-390.

[266] *Ex parte Jacobson* 1944 OPD 112 at 117; *Ex parte Bennett* 1978 (2) SA 380 (W) at 387.

[267] *Marpro Trawling (Pty) Ltd v Cencelli* 1992 (1) SA 407 (C) at 414. A "manager" was defined in s 1 of the Companies Act 61 of 1973 as meaning any person who is a principal executive officer of the company, by whatever name he may be designated and whether or not he is a director. In light of this wide definition, it is arguable that if a manager were to manage only a part of the company's affairs, such as a division, and not the whole of the affairs of the company, he would nevertheless be participating in the management of the company if he exercises the functions of a principal executive officer in relation to such division (Delport *Henochsberg on the Companies Act 71 of 2008* 266(2)).

[268] Under s 15(1) of the UK Company Directors Disqualification Act 1986 a person is personally responsible for all the relevant debts of a company if at any time in contravention of a disqualification order or of s 11 of this Act he is involved in the management of the company or, as a person who is involved in the management of the company he acts or is willing to act on instructions given without the leave of the court by a person whom he knows at that time to be the subject of a disqualification order or to be an undischarged bankrupt. Section 11 of the UK Company Directors Disqualification Act 1986 makes it an offence for a person who is an undischarged bankrupt to act as a director of a company, or directly or indirectly to take part in or be concerned in the promotion, formation or management of a company, except with the leave of the court. The UK Company Directors Disqualification Act 1986 consolidates various enactments relating to the disqualification of person from being directors of company and from being otherwise concerned with a company's affairs. The Act replaced provisions which were previously found in ss 295-299 of the UK Companies Act of 1985 and ss 12 and 13 of the Insolvency Act of 1985. The Act empowers a court to make a disqualification order against a director in various instances. These instances include committing an indictable offence in connection with the formation or management of a company; persistent failure to comply with the disclosure obligations of the company legislation; the commission of fraudulent or wrongful trading; insolvency, and conduct that makes the director unfit to be concerned in the management of the company. A disqualification order means that for a specified period, a person may not be a director of a company, act as a receiver of a company's property or in any way, whether directly or indirectly, be concerned or take part in the promotion, formation or management of a company unless he has the leave of the court, and he may not act as an insolvency practitioner either (see s 1 of the UK Company Directors Disqualification Act 1986). As part of the Small Business, Enterprise and Employment Act of 2015 the provisions relating to the UK Company Directors Disqualification Act 1986 were introduced in 2015. These provisions introduce new grounds for the disqualification of directors, make the disqualification regime more efficient and update the matters that courts must take into account when considering whether to disqualify a director. The UK Company Directors Disqualification Act 1986 is discussed further in chapter 6, para 3.4.11.

routine administrative duties which may be associated with management.[269] In *Cullen v Corporate Affairs Commission*[270] the Supreme Court of New South Wales held that decision-making power need not be at the highest level before a person will be considered to be involved in the management of the company.

In terms of section 69(6)(*a*) of the Companies Act the Memorandum of Incorporation may impose additional grounds of disqualification of directors. As discussed above with regard to the additional grounds of ineligibility which may be imposed in the Memorandum of Incorporation,[271] such additional grounds of disqualification should be both reasonable and lawful. As is the position under section 8.02(e) of the MBCA, in order to guard against the misuse of the timing of the disqualification requirements, it is submitted that if an additional ground of disqualification is introduced during a director's term of office, such disqualification requirement should not apply to that director before the end of his term.

Under section 71(3)(*a*)(i) of the Companies Act, a shareholder or director may allege that a director of the company has become disqualified in terms of section 69 "other than on the grounds contemplated in section 69(8)(*a*)" of the Companies Act. Section 69(8)(*a*) of the Companies Act has been specifically excluded as a ground of removal that may be raised by a shareholder or a director under section 71(3) of the Companies Act. Section 69(8)(*a*) disqualifies a person from being a director of a company if a court has prohibited that person to be a director or declared the person to be delinquent, either in terms of section 162 of the Companies Act or in terms of section 47 of the Close Corporations Act 69 of 1984. In *Kukama v Lobelo*[272] the court stated that if a person has been declared delinquent by a court, it is not necessary to also order his removal as a director of a company because of the "automatic inherent effect" of the order declaring a person to be delinquent.[273] It is likely for this reason that section 69(8)(*a*) of the Companies Act has been specifically excluded as a ground of removal that may be raised by a shareholder or director under section 71(3)(*a*)(i) of the

[269] French, Mayson & Ryan *Mayson, French & Ryan on Company Law* 710.

[270] (1989) 7 ACLC 121 at 126.

[271] See para 6.1.2.3 above with regard to the additional grounds of ineligibility in the Memorandum of Incorporation.

[272] 2012 JDR 0062 (GSJ) para 21.

[273] See also *Msimang NO v Katuliiba* 2012 JDR 2391 (GSJ) para 32 where this was affirmed.

Companies Act. In terms of section 69(11) of the Companies Act a court may exempt a person from any of the grounds of disqualification set out in section 69(8)(*b*) of the Companies Act, but it may not exempt a person from being disqualified from being a director of a company if a court has prohibited that person to be a director or if a court has declared that person to be delinquent.[274]

6.2 Incapacitated

Under section 71(3)(*a*)(ii) of the Companies Act a director may be removed from office by the board of directors if he is incapacitated. Before a director may be removed from office on this ground, the following requirements must be satisfied:

- the director must be incapacitated;
- the incapacity must be to the extent that the director is unable to perform the functions of a director; and
- the director must be unlikely to regain that capacity within a reasonable time.

These requirements are discussed below.

6.2.1 The Director must be Incapacitated

The Companies Act does not define or provide any guidance on the meaning of the term "incapacitated" in the context of section 71(3)(*a*)(ii). The *Oxford Dictionary of English* defines

[274] The Australian Corporations Act of 2001 also automatically disqualifies a person from being a director of a company in certain instances. A person is automatically disqualified from managing corporations if the person is an undischarged bankrupt (s 206B(3)) or is convicted of certain offences set out in s 206B(1). These offences are that a person is convicted of an offence that concerns the making or participation in the making of decisions that affect the whole or a substantial part of the corporation's business, or concerns an act that has the capacity to significantly affect the corporation's financial standing, or an offence that involves dishonesty that is punishable by imprisonment for at least three months, or an offence that is a contravention of the Australian Corporations Act of 2001 and is punishable by imprisonment for longer than twelve months. Automatic disqualification will also occur if a person is convicted of an offence against the law of a foreign country that is punishable by imprisonment for longer than twelve months. Directors may also be disqualified by a court order (this is discussed further in chapter 6, para 3). A court may disqualify a person from managing corporations for breach of a civil penalty provision under s 1317E (see s 206C), or because of involvement in two or more failed corporations in the previous seven years (see s 206D), or for repeated contraventions of the Australian Corporations Act of 2001 (see s 206E). Civil penalty provisions include certain duties of company directors, contraventions in relation to company financial reports, and contraventions of certain requirements regarding share capital transactions. ASIC is also empowered to disqualify a person from managing a corporation where the person has been involved in several failed companies (see s 206F). These grounds of disqualification apply equally to directors of public companies and private companies. The disqualification of directors under the Australian Corporations Act of 2001 is discussed further in chapter 6, paras 3.4.4 and 3.9.

the term "incapacity" as the "physical or mental inability to do something or to manage one's affairs",[275] while "incapacitate" is defined as "prevent from functioning in a normal way."[276]

Further guidance on the meaning of the term "incapacity" may be gleaned from the LRA.[277] Section 188 of the LRA recognises that incapacity may be a valid reason for dismissal provided that the employer is able to show that the dismissal was for a fair reason and that a fair pre-dismissal procedure was followed. In order to determine whether or not the reason for the dismissal was fair or whether or not the dismissal was effected in accordance with a fair procedure, one must take into account any relevant code of good practice issued in terms of the LRA.[278] The Code of Good Practice: Dismissal in Schedule 8 of the LRA (hereafter referred to as "the LRA Code of Good Practice") distinguishes between three types of incapacity, namely, poor work performance, ill health and injury.[279] In the context of employment law, incapacity means that, unrelated to any intentional or negligent conduct or performance, the employee is not able to meet the standard of performance required by the employer.[280] It involves a form of behaviour, conduct or inability which is not intentional or negligent, and accordingly, a dismissal based on incapacity is known as a "no-fault" dismissal.[281]

It is submitted that the reference to "incapacitated" in section 71(3)(*a*)(ii) of the Companies Act would not, as is the case under the LRA, include poor work performance, because the section states that the director must be "unlikely to regain that capacity" within a reasonable

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[275] *Oxford Dictionary of English* 874.

[276] *Oxford Dictionary of English* 874.

[277] The LRA is described in chapter 1, para 2.3.
[278] Section 188(2) of the LRA.

[279] Items 9 and 10 of the LRA Code of Good Practice.

[280] Basson et al *Essential Labour Law* 135. See further Grogan *Workplace Law* 309-316 (a new edition of this work has been published but it was not available to me at the time of writing this thesis); Du Toit et al *Labour Relations Law: A Comprehensive Guide*; Van Niekerk et al *Law@work* 293-294 and Bendix *Labour Relations: A Southern African Perspective* 311-312 on the meaning of incapacity in the context of employment law. Incapacity must be distinguished from misconduct, which involves situations in which the employee is able to comply with the standard of performance required by the employer but either deliberately or through neglect and carelessness, fails to do so. The employee is therefore "at fault" (B Jordaan & Stander *Effective Workplace Solutions: Employment Law from a Business Perspective* 142).

[281] Basson et al *Essential Labour Law* 135; McGregor et al *Labour Law Rules!* 176; Bendix *Labour Relations: A Southern African Perspective* 311; B Jordaan & Stander *Effective Workplace Solutions: Employment Law from a Business Perspective* 73.

time. This would not be applicable to incapacity based on poor work performance. Incapacity in section 71(3)(*a*)(ii) of the Companies Act would, it is submitted, as is the case under the LRA, comprise ill health and injury, and in accordance with the definition of the term "incapacity" in the *Oxford Dictionary of English*, as discussed above, it would comprise a physical or a mental inability to perform the functions of a director, but not poor work performance.

6.2.2 The Incapacity must be to the Extent that the Director is Unable to Perform the Functions of a Director

This requirement envisages that the board of directors must consider the extent of the incapacity of the director, and whether such incapacity prevents the director from performing the functions of a director. If the incapacity does not prevent the director from performing the functions of a director, he may not be validly removed from office under section 71(3)(*a*)(ii) of the Companies Act. Section 66(1) of the Companies Act states that the business and affairs of a company must be managed by or under the direction of the board, which has the authority to exercise all of the powers and perform any of the functions of the company (save to the extent that the Companies Act or the company's Memorandum of Incorporation provides otherwise).[282] Accordingly, the functions of a director, broadly, are to manage the business and affairs of a company.

Notably, section 71(3)(*a*)(ii) of the Companies Act states that the incapacity must prevent a director from performing "the functions of a director". The provision envisages that the functions of the director must be objectively ascertained. If the provision had stated that the incapacity must prevent the director from performing "his functions" as a director or that the incapacity must prevent the director from performing the functions of "the director" this would have been a subjective standard. If the incapacitated director is unable to perform the functions of a director, objectively ascertained, and he is unlikely to regain that capacity within a reasonable time, he may validly be removed from office by the board of directors.[283]

[282] Refer to chapter 2, para 2 where s 66(1) of the Companies Act is discussed.

[283] The objective assessment of the functions of a director is discussed in para 6.3.1 below.

6.2.3 The Director must be Unlikely to Regain that Capacity within a Reasonable Time

Section 71(3)(*a*)(ii) does not provide any guidance on what a "reasonable time" would be for an incapacitated director to regain his capacity. It is submitted that whether the duration of the incapacity is reasonable or unreasonable would depend on the circumstances of each case, and particularly whether the director is an executive director or a non-executive director. A non-executive director is not bound to give continuous attention to the affairs of the company and his duties are of an intermittent nature to be performed at periodic board meetings.[284] Accordingly, a longer duration of incapacity may be reasonable in the case of a non-executive director, compared to that which may be acceptable for an executive director.

Item 10 of the LRA Code of Good Practice distinguishes between temporary and permanent illness or injury. If the incapacity is temporary, the employer is required, by item 10(1) of the LRA Code of Good Practice, to investigate the extent of the incapacity or the injury. If the period of incapacity is likely to be unreasonably long, the employer must investigate all the possible alternatives, short of dismissal, before considering dismissal itself. When alternatives are considered, relevant factors would include the nature of the job, the period of absence, the seriousness of the illness or injury and the possibility of securing a temporary replacement for the ill or injured employee.[285]

In the case of a permanent incapacity, different considerations are relevant. Here, the employer is required, in terms of item 10(1) of the LRA Code of Good Practice, to ascertain the possibility of securing alternative employment for the employee, or adapting the duties or work circumstances of the employee in order to accommodate the employee's disability. Item 10(3) of the LRA Code of Good Practice provides further that both the degree of incapacity and the cause of the incapacity are relevant to the fairness of any dismissal. For example, in the case of alcoholism or drug abuse, counselling and rehabilitation may be appropriate steps for an

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[284] *In re City Equitable Fire Insurance Co Limited* [1925] 1 Ch 407 at 429; *Fisheries Development Corporation of SA Ltd v Jorgensen; Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd* 1980 (4) SA 156 (W) at 165; *Howard v Herrigel and Another NNO* 1991 (2) SA 660 (A) at 678; *AWA Ltd v Daniels t/a Deloitte Haskins & Sells and Others* (1992) 7 ACSR 759 at 867; *Protect a Partner (Pty) Ltd v Laura Machaba-Abiodun and Others* [2013] JOL 31048 (LC) para 48. For examples of distinguishing features between executive and non-executive directors see Esser & Havenga "Directors and Other Officers" in Loubser & Mahony *Company Secretarial Practice* 8-7. See further para 6.3.1 below and chapter 5 paras 2 and 2.1 on executive and non-executive directors.

[285] Item 10(1) of the LRA Code of Good Practice.

employer to consider instead of dismissal.[286] There is an onerous duty on an employer to accommodate the incapacity of an employee who is injured at work or who is incapacitated by a work-related illness.[287] In ascertaining whether a dismissal arising from ill health or injury is unfair, one must consider, in terms of item 11 of the LRA Code of Good Practice, whether or not the employee is capable of performing the work. If the employee is not so capable, one must consider the extent to which the employee is able to perform the work, the extent to which his work circumstances might be adapted to accommodate his disability, or where this is not possible the extent to which his duties might be adapted, and the availability of any suitable alternative work.[288]

Since dismissal for incapacity is a form of no-fault dismissal under the LRA the process for dismissal is more accommodating and collaborative compared to the process for dismissal on the basis of misconduct.[289] Items 10 and 11 of the LRA Code of Good Practice, dealing with incapacity and dismissals arising from incapacity, aim to provide job security in that they compel an employer to consider alternatives before dismissal and to obtain input from the employee on alternatives before the employee is dismissed.[290] The Labour Courts tend to adopt an empathetic approach to incapacity arising from ill health.[291] Thus in *Spero v Elvey International (Pty) Ltd*[292] the medical evidence indicated that if the employee in question, who had suffered from depression and stress, were to take his medication correctly he would be able to do his work. The court found that the employee's incapacity was of a temporary nature. It held that the dismissal of the employee by the employer because of his depression had been unfair.

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[286] Item 10(3) of the LRA Code of Good Practice; B Jordaan & Stander *Effective Workplace Solutions: Employment Law from a Business Perspective* 168-169.

[287] Item 10(4) of the LRA Code of Good Practice.

[288] For a detailed discussion of these factors see B Jordaan & Stander *Effective Workplace Solutions: Employment Law from a Business Perspective* 166-169.

[289] McGregor et al *Labour Law Rules!* 177.

[290] McGregor et al *Labour Law Rules!* 178. For a further discussion on dismissals based on incapacity under the LRA see Du Toit et al *Labour Relations Law: A Comprehensive Guide* 461-472; Van Niekerk et al *Law@work* 293-310; Bendix *Labour Relations: A Southern African Perspective* 311-314 and B Jordaan & Stander *Effective Workplace Solutions: Employment Law from a Business Perspective* 164-186.

[291] *Nehawu & Another v SA Institute for Medical Research* [1997] 2 BLLR 146 (IC) at 149.

[292] (1995) 16 *ILJ* 1201 (IC).

It was shown above that incapacity in the employment law context is a form of no-fault dismissal. It is submitted that a similar approach should be adopted with regard to removing a director from office on the basis of incapacity. The board of directors has a discretion whether or not to remove a director from office on the basis of his incapacity,[293] and accordingly there is scope for the board of directors to consider other alternatives before removing an incapacitated director from office. According to section 71(5) of the Companies Act, a director who has been removed from office by the board of directors in terms of section 71(3) because he is incapacitated or a person who appointed that director as contemplated in section 66(4)(*a*)(i) of the Companies Act may apply to a court within twenty business days to review the determination of the board of directors.[294] Since the board's decision to remove a director from office on the basis of his incapacity is subject to review by a court, it is important to be aware of the policy adopted by the courts to dismissal arising from incapacity, albeit with regard to matters of labour law.

On this account, some guidance may be obtained under the LRA with regard to removing a director of a company on the ground of incapacity. For instance, before the board of directors removes a director on the ground of incapacity, it should consider the degree of the incapacity, the cause of the incapacity and the possibility of securing a temporary replacement for the ill or injured director. A viable alternative to consider, as directed by the LRA Code of Good Practice with regard to employees who are likely to be absent for an unreasonably long time, is whether an alternative director may be appointed to serve on the board in substitution for the particular director, while he recovers from his incapacity. Section 1 of the Companies Act defines an "alternate director" as a person elected or appointed to serve, as the occasion requires, as a member of the board of a company in substitution for a particular elected or appointed director of that company. An alternate director does not serve as an agent of the director who appointed him,[295] is subject to all the duties a director owes to the company, and must exercise and discharge all the powers and functions of a director.[296] An alternate director

[293] Section 71(3) of the Companies Act states that the board of directors "may" remove a director whom it has determined to be incapacitated.

[294] Section 71(5) of the Companies Act is discussed further in chapter 4, para 4.1 and chapter 7, para 2.

[295] *Australian Securities & Investments Commission v Doyle* [2001] WASC 187.

[296] *Markwell Bros Pty Ltd v CPN Diesels (Qld) Pty Ltd* (1982) 7 ACLR 425 (SC) (Qld) 433.

may only be appointed if the Memorandum of Incorporation makes provision for a director to nominate an alternate director to act in his stead and he may act as a director only in the absence of the director who appointed him.[297]

In terms of item 10(2) of the LRA Code of Good Practice, the employer must give the employee an opportunity to state his case before the employee is dismissed on the ground of incapacity. Section 71(4)(*b*) of the Companies Act similarly gives the director an opportunity to make a presentation to the meeting before the resolution for his removal is put to the vote.[298] The presentation could be to dispute an allegation of incapacity against him, or to dispute whether the incapacity renders him unable to perform the functions of a director, or whether he is unlikely to regain his capacity within a reasonable time. Considering the fact that incapacity is largely a question of fact, the opportunity provided to a director by section 71(4)(*b*) of the Companies Act to make a presentation to the board meeting before his removal, is of considerable importance. It is here that a director would be able to provide the board of directors with any relevant medical information which may assist in preventing his removal from office.

6.2.4 Assessment of Incapacity

Under section 71(3)(*a*)(ii) of the Companies Act the assessment whether a director is incapacitated to the extent that he is unable to perform the functions of a director, is left in the hands of the board of directors. Whether or not a director is incapacitated is a question of fact. In certain instances, a medical assessment may be necessary to ascertain whether a director is physically or mentally incapacitated. It is imperative that the board of directors does not invoke this ground malevolently where tension or conflicts arise between the directors.[299] Evidence must be presented to substantiate an allegation 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.[300] In light of the fact that the board of directors may not be properly qualified in all instances to make an assessment regarding whether or not a fellow board member is

[297] Section 66(4)(*a*)(iii) of the Companies Act.

[298] Refer to para 8.4 below where a director's presentation to the board meeting is discussed.

[299] Ncube "You're Fired! The Removal of Directors under the Companies Act 71 of 2008" 42.

[300] Ncube "You're Fired! The Removal of Directors under the Companies Act 71 of 2008" 42.

indeed incapacitated and whether he is unlikely to regain that capacity within a reasonable time, it is submitted that it would be preferable for a medical practitioner or for a court to make this assessment.

Under Article 18(d) of the UK Model Articles for Private Companies Limited by Shares and Article 22(d) of the Model Articles for Public Companies[301] a person will cease to be a director if a registered medical practitioner who is treating that person gives a written opinion to the company stating that the person has become physically or mentally incapable of acting as a director and may remain so for more than three months. Article 18(e) of the Model Articles for Private Companies Limited by Shares and Article 22(e) of the Model Articles for Public Companies state further that a person ceases to be a director if, by reason of that person's mental health, a court makes an order which wholly or partly prevents that person from personally exercising any powers or rights which that person would otherwise have. Under these provisions, a registered medical practitioner or the court must be involved in ascertaining the physical and mental capabilities of the director in question. In the USA, in the States of Ohio,[302] California,[303] Alaska[304] and Pennsylvania[305] a director may be removed from office by the board of directors if by order of court he is found to be of unsound mind. None of the above mentioned jurisdictions leave the determination of the incapacity of a director in the hands of the board of directors but they involve a medical practitioner or the court in this assessment.

It is submitted that the (South African) Companies Act ought also to require the input of a registered medical practitioner or a court in assessing whether a director is indeed incapacitated

[301] The Model Articles for Private Companies Limited by Shares and the Model Articles for Public Companies are found in Schedules 1 and 3 respectively of the Companies (Model Articles) Regulations 2008 (which came into force on 1 October 2009). The Model Articles automatically form the articles of association for companies formed under the UK Companies Act of 2006 which, on their formation, either do not register their own articles of association with the Registrar of Companies under that Act, or, if articles are registered, they do not exclude or modify the Model Articles in whole or in part (see s 20 of the UK Companies Act of 2006).

[302] Section 1701.58 of the Ohio Revised Code, codified in Chapter 1701 (General Corporation Law), Title 17 (Corporations – Partnerships) of the Ohio Revised Code.

[303] Section 302 of the California Corporations Code, codified in Chapter 3 (Directors and Management), Title 1 (Corporations), Division 1 (General Corporation Law) of the California Corporations Code.

[304] Section 10.06.458 of the Alaska Corporations Code, codified in Chapter 10.01 (Alaska Corporations Code), Title 10 (Corporations and Associations) of the Alaska Statutes.

[305] Section 1726(b) of the Pennsylvania Business Corporation Law.

and is unlikely to regain that capacity within a reasonable time. This would guard against this ground of removal being improperly applied in instances where the board of directors is not properly qualified to make the relevant incapacity assessment. It would also guard against this ground of removal being abused where conflicts arise between the directors. Furthermore, it would bring section 71(3)(*a*)(ii) of the (South African) Companies Act in line with the equivalent provisions of the foreign jurisdictions considered that have influenced many of the provisions of the (South African) Companies Act. It is, however, important to balance the company's interests with those of the director's since damage may potentially be done to the company by the director pending his assessment by a registered medical practitioner or by a court. For this reason it is important to take steps to guard against damage being done to the company by the director pending this process.

6.3 Neglected, or been Derelict in, the Performance of the Functions of Director

Under section 71(3)(*b*) of the Companies Act a further ground which may be raised by a director or a shareholder of a company, as a basis to remove a director from office, is that the director has neglected or has been derelict in the performance of "the functions of director". These requirements are discussed below.

6.3.1 The Functions of Director

In order for this ground of removal to apply, the director must have neglected or have been derelict in the performance of "the functions of director". The phrase "the functions of director" indicates that an objective standard of assessment is used, and not a subjective standard. Consequently, in order to ascertain whether a director has neglected or has been derelict in the performance of the functions of a director, one would have to ascertain whether he has failed to fulfil the functions of a director objectively, and not whether he has failed to fulfil his own specific functions as a director of the particular company.

The phrases "perform the functions of director" and "performance of the functions of director" are also used in sections 76(3) and 76(4) of the Companies Act. Section 76(3) requires a director, when acting in that capacity, to exercise the powers and perform "the functions of

director" in accordance with the standards set out in section 76(3).[306] Section 76(4) provides that in respect of any particular matter arising in the exercise of the powers or the performance of "the functions of director", a particular director of a company will be deemed to have acted in the best interests of the company and with the necessary degree of care skill and diligence, if he meets the requirements set out in that provision.[307] Accordingly, a director is required to perform the functions of a director in compliance with the standards of directors' conduct set out in section 76(3) of the Companies Act. He will be deemed to have acted in the best interests of the company and with the necessary degree of care, skill and diligence if he complies with the requirements set out in the business judgment rule in section 76(4) of the Companies Act. While these provisions set out how a director must perform his function of managing the business and affairs of the company, the question still remains: what are the functions of a director?

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[306] Section 76(3) of the Companies Act is a partial codification of the fiduciary duties of directors. It states that a director of a company, when acting in that capacity, must exercise the powers and perform the functions of director in good faith and for a proper purpose, in the best interests of the company, and with the degree of skill and diligence that may reasonably be expected of a person carrying out the same functions in relation to the company as those carried out by that director and having the general knowledge, skills and experience of that director (see *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd and Others* 2014 (5) SA 179 (WCC) para 74-80; Delport *Henochsberg on the Companies Act 71 of* 2008 295-298(7); FHI Cassim "The Duties and the Liability of Directors" in FHI Cassim et al *Contemporary Company Law* 523-528 and 554-561; Mongalo "Directors' Standards of Conduct under the South African Companies Act and the Possible Influence of Delaware Law" 1-16; Esser & Havenga "Directors and Other Officers" in Loubser & Mahony *Company Secretarial Practice* 8-23-8-25 and Mupangavanhu BM "Fiduciary Duty and Duty of Care under Companies Act 2008: Does South African Law Insist on the Two Duties being kept Separate?" 148-163.

[307] Section 76(4) provides that in respect of any particular matter arising in the exercise of the powers or the performance of the functions of director, a particular director will have satisfied the obligations of s 76(3)(*b*) and (*c*) if: (i) the director had taken reasonably diligent steps to become informed about the matter; (ii) either the director had no material personal financial interest in the subject matter of the decision and had no reasonable basis to know that any related person had a personal financial interest in the matter, or the director complied with the requirements of s 75 with regard to any material personal financial interest; and (iii) the director made a decision or supported the decision of a board committee, with regard to the matter, and the director had a rational basis for believing and did believe that the decision was in the best interests of the company. This is known as the business judgment rule (see Lombard "Importation of a Statutory Business Judgment Rule into South African Company Law: Yes or No?"; Havenga M "The Business Judgment Rule — Should we Follow the Australian Example?" 25-37; Kennedy-Good & Coetzee "The Business Judgment Rule (Part 1)" 62-74; Kennedy-Good & Coetzee "The Business Judgment Rule (Part II)" 277-292; J Du Plessis "A Comparative Analysis of Directors' Duty of Care, Skill and Diligence in South Africa and in Australia" 263-289; Delport *Henochsberg on the Companies Act 71 of 2008* 298(18)-298(21); FHI Cassim "The Duties and the Liability of Directors" in FHI Cassim et al *Contemporary Company Law* 563-566; Stevens & De Beer "The Duty of Care and Skill, and Reckless Trading: Remedies in Flux?" 250-284; Mongalo "Directors' Standards of Conduct under the South African Companies Act and the Possible Influence of Delaware Law" 1-16; Esser & Havenga "Directors and Other Officers" in Loubser & Mahony *Company Secretarial Practice* 8-26 and Mupangavanhu BM "Fiduciary Duty and Duty of Care under Companies Act 2008: Does South African Law Insist on the Two Duties being kept Separate?" 148-163).

In *AWA Ltd v Daniels t/a Deloitte Haskins & Sells and Others*[308] the Supreme Court of New South Wales stated that, apart from statutory functions, the board's functions are said to be usually four-fold: (i) to set goals for the corporation; (ii) to appoint the corporation's chief executive; (iii) to oversee the plans of managers for the acquisitions and organisation of financial and human resources towards attainment of the corporation's goals; and (iv) to review, at reasonable intervals, the corporation's progress towards attaining its goals.

While these may be the general broad functions of the board of directors, it is difficult to state with accuracy the functions of a specific director of a particular company. There is no profession of directors.[309] The functions of a director would vary depending on the type of company of which he is a director, the type of director he is, and on the nature of the company's business. For instance, the functions of a director of a public company would differ from those of a director of a private company. The board of directors of a public company would be unable to manage the company's day-to-day business to the same extent as the board of directors of a private company.[310] In a public company the board of directors would delegate certain matters to the managers and other staff members while in a private company such matters may be attended to by the directors themselves.[311] It is submitted that this fact is acknowledged by

[308] (1992) 7 ACSR 759 at 866-867.

[309] In *Gihwala and Others v Grancy Property Limited and Others* 2017 (2) SA 337 (SCA) para 146 the Supreme Court of Appeal stated that the proposition that a director of companies is an occupation, trade or profession "is by no means obvious." This was stated in the context of the Supreme Court of Appeal ascertaining whether s 162(5) of the Companies Act infringes the constitutional right to freely choose a trade, occupation or profession. See chapter 6 para 3.9 where this is discussed further.

[310] *AWA Ltd v Daniels t/a Deloitte Haskins & Sells and Others* (1992) 7 ACSR 759 at 866.

[311] *In re City Equitable Fire Insurance Co Limited* [1925] 1 Ch 407 at 426; *AWA Ltd v Daniels t/a Deloitte Haskins & Sells and Others* (1992) 7 ACSR 759 at 866. Individual directors only have such authority as the board delegates to them, or that are delegated to them by someone authorised to do so (*Makate v Vodacom (Pty) Limited* (08/20980) [2014] ZAGPJHC 135 (1 July 2014) para 166). In *Kaimowitz v Delahunt* 2017 (3) SA 201 (WCC) the applicant was an executive director of the company but was informed by the board of directors that, as a result of the termination of his employment, his status was reduced to that of a non-executive director, that he would no longer be entitled to participate in any management meetings and further, that he would no longer be involved in the day-to-day management of the company's business. As a result of his exclusion from the daily management of the company's business, the applicant launched legal proceedings against the company and its directors. The Western Cape Division of the High Court, Cape Town was required to determine the extent to which the powers of a director include involvement in the day-to-day management of a company's business. The court held that the board of directors is not required to be engaged in the day-to-day management of the company's affairs but it must monitor the management of the company (para 19). It held further that the overall supervision of the management of a company resided in its board of directors, as opposed to individual directors, which may delegate such management powers to a managing director and/or to a committee of the board (paras 21 and 27). An individual director is accordingly not as of right entitled to participate in the day-to-day management of the company's business (paras 21, 26 and 27). In coming to this conclusion the court (see para 19) relied on the Australian cases of *Daniels (formerly practising as Deloitte Haskins & Sells) v Anderson* (1995) 16 ACSR 607

section 66(1) of the Companies Act which states that the business and affairs of a company must be managed "by or under the direction of its board".[312] In other words, the board may manage the business or affairs of the company directly or it may direct how this is to be done. Thus the extent to which the board manages the business or affairs of a company would vary from company to company.

By the same token, the functions of an executive director would differ from those of a non-executive director. An executive director, who is a full-time director and an employee of the company, would be more involved in the day-to-day running of the business of a company compared to a non-executive director, who is a part-time director, is not an employee of the company, and is not involved in the management of the company.[313] Non-executive directors play an important role in providing objective judgment, and independent of management, on issues facing the company.[314] They are not bound to give continuous attention to the affairs of

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and *Australian Securities and Investments Commission v Healey* [2011] FCA 717. In the former case the New South Wales Court of Appeal stated that "[d]irectorial management does not require a detailed inspection of day-to-day activities, but rather a general monitoring of corporate affairs and policies" (at 667). In the latter case the Federal Court of Australia endorsed this sentiment and asserted that "[d]irectors are required to take reasonable steps to place themselves in a position to guide and monitor the management of the company" (para 166).

[312] Section 66(1) is discussed further in chapter 2 para 2. Section 66(1) of the Companies Act is very similarly worded to s 8.01(b) of the MBCA, which states that "the business and affairs of the corporation shall be managed *by or under the direction*, [emphasis added] and subject to the oversight, of the board of directors." Section 8.01(b) of the MBCA was amended in 1974 to include the words "or under the direction of" the board of directors. The reason for the amendment was due to increasing concern that the traditional words "managed by the board of directors" could be interpreted to mean that directors were required to become involved in the detailed day-to-day administration of the company's affairs (see *Model Business Corporation Act with Official Comments and Reporter's Annotations* 8-9). It was recognised that, at least for public companies, this language did not accurately describe the role of directors (see Olson & Briggs "The Model Business Corporation Act and Corporate Governance: An Enabling Statutes Moves Towards Normative Standards" 32). In order to eliminate any ambiguity as to the director's role in formulating management policy, as opposed to direct involvement in the day-to-day management of companies, the wording was amended to include the words "under the direction of" the board of directors. The MBCA went further in 2005 and inserted the phrase "subject to the oversight" of the board of directors in s 8.01(b) of the MBCA. These words were inserted in s 8.01(b) of the MBCA in order to reflect a contemporaneous amendment to s 8.30(b) of the MBCA (dealing with the standards of conduct for directors) in order to differentiate between the board's decision-making functions and its oversight functions (see *Model Business Corporation Act with Official Comments and Reporter's Annotations* 8-10).

[313] See Annex 2.2 and 2.3 of the King III Report where the distinction between executive and non-executive directors is set out.

[314] See Annex 2.3 of the King III Report. According to the King IV Report non-executive directors may be categorised by the board as independent if it concludes that there is no interest, position, association or relationship which, when judged from the perspective of a reasonable and informed third party, is likely to influence unduly or cause bias in decision-making in the best interests of the organisation (King IV Report, principle 7, recommended practice 27).

the company, and their duties are of an intermittent nature to be performed at periodic board meetings and at other meetings which may require their attention.[315]

In order to ascertain the functions of a director, it is also necessary to consider the nature of the company's business. The example given in *In re City Equitable Fire Insurance Co Limited*[316] is that the position of a director carrying on a small retail business would be very different from that of a director of a railway company. Likewise, the functions of a director of a bank may differ widely from those of a director of an insurance company, and the functions of a director of one insurance company may differ from those of a director of another insurance company. In *In re City Equitable Fire Insurance Co Limited*[317] Romer CJ proclaimed that it "is indeed impossible to describe the duty of directors in general terms, whether by way of analogy or otherwise."[318]

Section 71(3)(*b*) of the Companies Act, in imposing an objective test, and not a subjective one, does not distinguish between the functions of a director of a public, private, personal liability, non-profit or state-owned company, or between an executive and a non-executive director, and furthermore does not require that the nature of the company's business be considered in ascertaining whether the director in question has neglected or has been derelict in the performance of the functions of a director.

In striking contrast, a subjective standard has been imposed with regard to ascertaining the delinquency of directors. Section 162(5)(*c*)(iv)(*aa*) of the Companies Act provides that a court must make an order declaring a person to be a delinquent director if the person, while a director, acted in a manner that amounted to gross negligence, wilful misconduct or breach of trust in

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[315] *In re City Equitable Fire Insurance Co Limited* [1925] 1 Ch 407 at 429; *Fisheries Development Corporation of SA Ltd v Jorgensen; Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd* 1980 (4) SA 156 (W) at 165; *Howard v Herrigel and Another NNO* 1991 (2) SA 660 (A) at 678; *AWA Ltd v Daniels t/a Deloitte Haskins & Sells and Others* (1992) 7 ACSR 759 at 867; *Protect a Partner (Pty) Ltd v Laura Machaba-Abiodun and Others* [2013] JOL 31048 (LC) para 48. For examples of distinguishing features between executive and non-executive directors see Esser & Havenga "Directors and Other Officers" in Loubser & Mahony *Company Secretarial Practice* 8-7. See further chapter 5 paras 2 and 2.1 on executive and non-executive directors.

[316] [1925] 1 Ch 407 at 426.

[317] [1925] 1 Ch 407 at 426.

[318] See further *AWA Ltd v Daniels t/a Deloitte Haskins & Sells and Others* (1992) 7 ACSR 759 at 866 where the Supreme Court of New South Wales agreed with this dictum in *In re City Equitable Fire Insurance Co Limited* [1925] 1 Ch 407 at 426.

relation to the "performance of the director's functions within, and duties to, the company." This latter standard is a subjective one because it requires one to assess the performance of the particular director's functions within the specific company. It is odd that the legislature imposed an objective standard in section 71(3)(*b*) but imposed a subjective standard in section 162(5)(*c*)(iv)(*aa*), when both provisions require one to assess the director's performance and whether his performance has been deficient.

It is submitted that, in light of the fact that the functions of a director would vary depending on the type of company of which he is a director, the type of director he is, and the nature of the company's business, a subjective standard and not an objective standard ought to be imposed in section 71(3)(*b*) of the Companies Act. A subjective standard should also be imposed in section 71(3)(*a*)(ii) of the Companies Act in assessing the incapacity of a director.[319] It is accordingly submitted that sections 71(3)(*a*)(ii) and 71(3)(*b*) should be amended to read as follows:

> "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) ...
>
> (ii) incapacitated to the extent that the director is unable to perform the ~~functions of a director~~director's functions within the company, 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 director's functions within the company,"[320]

The addition of the words "the director's functions within the company" in sections 71(3)(*a*)(ii) and 71(3)(*b*) would make the standard of assessment subjective in that they would require one to take into account the type of company, the type of director and the nature of the company, in assessing whether the director has neglected or has been derelict in the performance of his

[319] See chapter 3, para 6.2.2.

[320] The recommended insertions to ss 71(3)(*a*)(ii) and 71(3)(*b*) of the Companies Act are underlined, while the recommended deletion of specific wording is "struck out."

functions, or to ascertain the extent of his incapacity. The suggested amendment would furthermore result in there being consistency between sections 71(3)(*b*) and 162(5)(*c*)(iv)(*aa*) of the Companies Act. It is essential that there be consistency between these two provisions since, as affirmed in section 71(10) of the Companies Act, the right of removal of a director is in addition to the right of a person to apply to a court in terms of section 162 of the Companies Act for an order declaring a director delinquent.

6.3.2 The Meaning of the Terms "Neglected" and "Been Derelict"

The terms "neglected" and "been derelict" have not been defined in the Companies Act in terms of the director's performance. The precise conduct to which "neglect" and "derelict" relate are not clear. It is accordingly necessary to consider other authorities which have defined these terms, in order to ascertain the type of conduct that would allow section 71(3) of the Companies Act to be legitimately relied upon as a ground for the removal of a director by the board of directors.

The *Oxford Dictionary of English* defines "neglect" as meaning "the failure to do something"[321] while *Stroud's Judicial Dictionary of Words and Phrases* defines the term "neglect" as meaning the "omission to do some duty which the party is able to do".[322] One may conceivably neglect the functions of a director by acting negligently or by acting intentionally. For example, a director may fail to attend to some task which the board requested him to do because he forgets to attend to it (which would be a negligent neglect of the functions of director) or a director may deliberately and consciously decide not to attend to that task (which would be an intentional neglect of the functions of director).

What is the difference in meaning between the terms "neglect" and "derelict", and does the fault element of "derelict" encompass a negligent and/or an intentional act? *The Oxford English Dictionary* defines the word "derelict" as meaning to "abandon, forsake", and it defines the term "dereliction" as meaning the "action of leaving or forsaking (with intention not to resume); abandonment" and as "implying a morally wrong or reprehensible

[321] *Oxford Dictionary of English* 1177.

[322] James *Stroud's Judicial Dictionary of Words and Phrases* 1668.

abandonment or neglect; chiefly in the phr. *dereliction of duty*."[323] The *Collins Dictionary* defines the term "derelict" as meaning "neglectful of duty or obligation; remiss", while the term "dereliction" is defined as the "deliberate, conscious, or wilful neglect (esp in the phrase dereliction of duty)".[324] *The Wolters Kluwer Bouvier Law Dictionary* defines the phrase "dereliction of duty" as follows:

> "Failure to perform a duty. Dereliction of duty, or to be derelict in one's duties, is the failure to perform a duty without excuse or justification for the non-performance."[325]

In *O'Neill v Printing Industry Employees Union of Australia*[326] the court stated the following with regard to the meaning of the term "dereliction":

> "The *Shorter Oxford English Dictionary* defines 'dereliction' as 'a reprehensible abandonment or neglect', and uses the phrase 'dereliction of duty' to exemplify its use. We think this phrase in this context involves the notion that not only has a duty not been performed but that the non-performance is fairly to be regarded as reprehensible, blameworthy, or worthy of censure, as opposed to trivial or due to excusable inadvertence or some other extenuating factor."

It is evident from the above definitions that "derelict" is more serious and blameworthy than "neglect", and that, under a "dereliction" of one's functions, the neglect of such functions must be reprehensible, blameworthy and worthy of censure. It must not be trivial.

What is not clear though is whether the term "derelict" as used in section 71(3)(*b*) of the Companies Act would encompass the fault element of negligence and/or intention. As set out above, the *Collins Dictionary* defines the term "dereliction" as the "deliberate, conscious, or wilful neglect (esp in the phrase dereliction of duty)".[327] This envisages that the fault element must be that of intention. On the other hand, *The Wolters Kluwer Bouvier Law Dictionary* states that "dereliction may be either wilful or negligent".[328]

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[323] *The Oxford English Dictionary* 497.

[324] *Collins Dictionary* 453.

[325] *The Wolters Kluwer Bouvier Law Dictionary* 326.

[326] (1965) 7 FLR 488 at 492.

[327] *Collins Dictionary* 453.

[328] *The Wolters Kluwer Bouvier Law Dictionary* 326.

The phrase "derelict in the performance of the functions of director" is similar to the phrase "dereliction of duty", which is frequently used in the labour law context with regard to the conduct of employees. In the labour law context, the term "dereliction of duty" is understood to mean an intentional or conscious failure of an employee to do his duty.[329] In order for an employer to bring a charge of dereliction of duty against an employee there must be an element of intent or consciousness on the part of the employee in failing to do his duty.

However it appears from case law that courts envisage that a dereliction of duty may also be negligent, and not necessarily intentional. For example, one of the issues before the Supreme Court of Appeal in *Universiteit van Stellenbosch v JA Louw (Edms) Bpk en Andere*[330] was whether a building contractor had committed a negligent dereliction of duty by not properly supervising a sub-contractor. In *Minister of Justice and Constitutional Development v X*[331] the Supreme Court of Appeal found that there was a negligent dereliction of duty by a prosecutor in failing to put all the relevant information before the court in a bail application.

It is consequently not clear whether the term "derelict" as used in section 71(3)(*b*) of the Companies Act is to be interpreted in the manner in which it is used in the labour law context, that is, with the element of fault being intention, or whether, as defined in *The Wolters Kluwer Bouvier Law Dictionary* in the USA context, a director could be found guilty of being derelict in the performance of the functions of director if he had acted negligently. In the absence of any guidelines from the Companies Act, and in light of the fact that a negligent dereliction of duty is recognised in our case law, it is submitted that, until the courts clarify this matter, a negligent dereliction of duty would suffice as a valid ground of removal under section 71(3)(*b*) of the Companies Act, provided that both the elements of "negligence" and "dereliction" are clearly present, based on the facts and circumstances of the case. If these elements are not clearly present, then a director or a shareholder under section 71(3)(*b*) of the Companies Act

[329] Israelstam "Dereliction of duty charges must be proven" *The South African Labour Guide* available at http://www.labourguide.co.za/discipline-dismissal/244-dereliction-is-a-serious-offence-know-what-it-is (accessed on 8 June 2016).

[330] 1983 (4) SA 321 (A).

[331] 2015 (1) SA 25 (SCA).

should rely on the ground of "neglect" rather than that of "derelict" as a ground for proposing the removal of a director from office.

Due to the vagueness and imprecision of the term "derelict", until the legislature or our courts clarify the meaning of this term, it is important to guard against this ground being invoked vexatiously by shareholders or by the directors as a ground for the removal of a director in the case of conflicts arising between the shareholders and the directors or between the directors themselves. It is further important to guard against this ground being used as a "catch-all" ground where cases are pushed into the mould of "dereliction of duty" when they do not really fit there.

In *National Transport Commission and Another v Chetty's Motor Transport (Pty) Ltd*[332] the Supreme Court of Appeal, per Holmes JA, laid down as a general principle that "one does not readily impute dereliction of duty to a responsible body". The "responsible body" in this case was the National Transport Commission. This general principle has been applied in several subsequent cases and to several other "responsible bodies". For instance, in *Bester v Easigas (Pty) Ltd and Another*[333] the court applied this principle in assessing the decision of an arbitrator. In *Cape Teachers Professional Association and Others v Minister of Education and Others*[334] the court applied this principle with regard to a decision of the Minister of Education.[335] It is arguable that a board of directors is likewise a "responsible body" because, as set out in section 66(1) of the Companies Act, it is responsible for managing the business and affairs of a company and has the authority to exercise all the powers and perform any of the functions of the company (save to the extent that this may be restricted by the Companies Act or the company's Memorandum of Incorporation). On this basis and on the basis of the principle laid down by the Supreme Court of Appeal in *National Transport Commission and Another v Chetty's Motor Transport (Pty) Ltd*[336] that one does not readily impute dereliction of

[332] 1972 (3) SA 726 (A) at 735.

[333] 1993 (1) SA 30 (C) at 38.

[334] 1986 (4) SA 412 (C) at 419-420.

[335] See further *Johannesburg Local Road Transportation Board v David Morton Transport (Pty) Ltd* 1976 (1) SA 887 (A) at 895 and *South African Allied Workers' Union and Others v De Klerk NO and Others* 1990 (3) SA 425 (E) at 437-438.

[336] 1972 (3) SA 726 (A) at 735.

duty to a responsible body, it is submitted that the imputation of a dereliction of duty should not be readily or lightly made against the board of directors or an individual director. There must be a clear and strong basis before the board of directors finds that one of its members has been derelict in the performance of the functions of director.

6.4 "Negligence" as a Ground for the Removal of a Director

Section 71(3) of the Companies Act states that if an allegation by a shareholder or a director is made against another director the board of directors must determine the matter by resolution and that it may remove a director whom it has determined to be "ineligible or disqualified, incapacitated, or *negligent* or derelict, as the case may be" (emphasis added). Curiously, it is not neglect but negligence that is referred to in section 71(3) of the Companies Act.

Likewise, section 71(5) of the Companies Act states that if the board of a company has determined that a director is "ineligible, disqualified, incapacitated, or has been *negligent* or derelict, as the case may be," (emphasis added) the director concerned or a person who appointed that director as contemplated in section 66(4)(*a*)(i) may apply within twenty business days to a court to review the determination of the board. Again, it is the word "negligent" which has been provided for in section 71(5) but this ground is not referred to at all in section 71(3)(*a*) or (*b*) as one of the grounds for the removal of a director.

Section 71(6)(*a*) of the Companies Act also provides that if the board of a company has determined that a director is not "negligent or derelict" a director who voted otherwise on the resolution or a shareholder with voting rights entitled to be exercised in the election of that director may apply to a court to review the board's determination. A further reference to the term "negligent" appears in section 71(6)(*b*)(ii) of the Companies Act, which states that a court may, on an application in terms of section 71(6)(*a*), confirm the determination of the board of directors not to remove the director from office or 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 added).

It is odd that the legislature used the term "negligent" in sections 71(3), 71(5), 71(6)(*a*) and 71(6)(*b*)(ii) instead of the term "neglect", when the term "neglect" is used in section 71(3)(*b*) as a ground for the proposed removal of a director. The terms "neglect" and "negligent" do not

have the same meaning. As discussed earlier, "neglect" refers to the failure to do something[337] or the omission to do some duty which the party is able to do.[338] While "neglect" is the act, negligence is an element of fault.[339]

On the wording of section 71(3) read with sections 71(5), or 71(6)(*a*) or 71(6)(*b*)(ii), it appears that in order to determine if a director has neglected the performance of the functions of director, one must ascertain whether he has been negligent in the performance of his functions. It is submitted that this would be anomalous because a director could conceivably neglect his functions by acting negligently or by acting intentionally, as discussed above. Since the terms "neglect" and "negligence" have different meanings, the term "negligent" cannot properly be substituted for the term "neglect", as the legislature seems to have done.

It is not clear whether the legislature has confused the terms "neglect" and "negligent" by referring to the term "negligent" in sections 71(3), 71(5), 71(6)(*a*) and 71(6)(*b*)(ii) and omitting to refer to the term "neglect" in these provisions. In light of the fact that "negligence" is not listed as one of the grounds in section 71(3) of the Companies Act, one wonders whether the legislature intended to use the term "neglectful" in sections 71(3), 71(5), 71(6)(*a*) and 71(6)(*b*)(ii), but inadvertently used the term "negligence" instead. This confusion must be clarified by the legislature. Until this perplexity is clarified, it appears that there may well be an additional statutory ground which a shareholder or director may invoke for the removal of a director, that is, that the director of the company has been negligent.[340]

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[337] *Oxford Dictionary of English* 1177.

[338] James *Stroud's Judicial Dictionary of Words and Phrases* 1668.

[339] See also Delport *Henochsberg on the Companies Act 71 of 2008* 274(2).

[340] The general test for negligence was authoritatively formulated in *Kruger v Coetzee* 1966 (2) SA 428 (A) at 430 as follows: (i) would a reasonable person, in the same circumstances as the defendant, have foreseen the possibility of harm to the plaintiff; (ii) would a reasonable person have taken steps to guard against that possibility; (iii) did the defendant fail to take steps which he should have taken to guard against it? If each part is confirmed, then the defendant is said to have failed to measure up to the standard of a reasonable person, and is consequently negligent. The criterion of the reasonable man embodies an objective standard of care, but the general approach does not exclude allowance being made for subjective and personal characteristics in certain cases (Van der Walt & Midgley *Principles of Delict* 166-167). Conduct is accordingly negligent if a reasonable person in the same position as the defendant would have foreseen the possibility of harm and would have taken steps to avoid it, and the defendant failed to take such steps (see further *Sea Harvest Corporation (Pty) Ltd v Duncan Dock Cold Storage (Pty) Ltd* 2000 (1) SA 827 (SCA) and *MEC for Education: Mpumalanga v Skhosana* (523/11) [2012] ZASCA 63 para 10).

6.5 Additional Grounds for the Removal of a Director

Section 71(3) of the Companies Act does not state whether the grounds for the removal of a director by the board of directors are limited to those provided in that section, or whether a company may include any additional grounds of removal in its Memorandum of Incorporation. The section also does not give any indication whether the grounds set out in it are the sole grounds upon which a director or a shareholder may rely to initiate the removal process of a director or whether additional grounds may validly be inserted in the Memorandum of Incorporation of a company.

It is arguable that additional grounds for the removal of a director may be included in the Memorandum of Incorporation in terms of section 15(2)(*a*)(iii) of the Companies Act. This provision states that the Memorandum of Incorporation of a company may impose on the company a higher standard, greater restriction, longer period of time or any similarly more onerous requirement than would otherwise apply to the company in terms of an unalterable provision of the Companies Act. It is a question of statutory interpretation, but it is arguable that additional grounds for the removal of a director could well qualify under section 15(2)(*a*)(iii) of the Companies Act on the basis that they impose a higher standard than would otherwise apply to the company under section 71(3) of the Companies Act.[341]

As discussed earlier,[342] section 69(6)(*a*) of the Companies Act states that the Memorandum of Incorporation of a company may impose additional grounds of ineligibility or disqualification of directors. For example, a company may state in its Memorandum of Incorporation that a director will be disqualified to be a director of a company if he is, for more than six months, absent without consent of the directors from meetings of directors held during that period. Should a director be so absent for more than six months, then a director or a shareholder would be entitled to invoke section 71(3)(*a*)(i) of the Companies Act as a ground for the proposed removal of that director from office on the basis that he has become disqualified to be a director. In *Re London and Northern Bank; McConnell's Claim*[343] the court held that for companies

[341] See also R Cassim "Contesting the Removal of a Director by the Board of Directors under the Companies Act" 157.

[342] See chapter 3, para 6.1.2.3.

[343] [1901] 1 Ch 251 at 253.

which have such a provision in their constitutions, the period of six months commences from the date of the first meeting from which the director is absent without the permission of the other directors.[344]

Accordingly, additional grounds of ineligibility or disqualification may be inserted by a company in its Memorandum of Incorporation, and in this way, additional grounds for the removal of a director may indirectly be imposed. Whether additional grounds for the removal of a director may be directly inserted in the Memorandum of Incorporation of a company, is not clear. This must be clarified by the legislature or the courts.

In contrast, most States in the USA which permit directors to remove fellow board members do not set out specific or limited grounds for the removal, but state that the removal must be "for cause".[345] In other words, there must be sufficient cause for the removal of a director. The statutes are silent on the meaning of the term "cause", but the common law in the USA has provided some guidelines on the meaning of this term.

"For cause" means that there must be a justifiable reason for the removal, while "without cause" means removal for any reason whatsoever.[346] As a general proposition, a director must be guilty

[344] The court in *Re London and Northern Bank; McConnell's Claim* [1901] 1 Ch 251 (at 253) remarked that the words "absent himself" imply voluntary or deliberate absence and do not cover cases of involuntary absence such as that caused by illness or due to causes beyond his control.

[345] A few States in the USA list specific grounds for the removal of a director. For example, under s 1701.58(B)(1) of the Ohio Revised Code a director may be removed from office if by order of court he was found to be of unsound mind, or if he was adjudicated to be bankrupt. Under s 1701.58(B)(2) of the Ohio Revised Code the directors are further empowered to remove directors from office if, within sixty days or within any other time period as is prescribed in the articles or regulations, from the date of the director's election he does not qualify by accepting in writing his election to that office or by acting at a meeting of the directors, and by acquiring the qualifications specified in the articles or regulations; or if, for such period as is prescribed in the articles or regulations, the director ceases to hold the required qualifications. Under s 302 of the California Corporations Code a director may be removed from office by the board of directors if by order of court he is found to be of unsound mind or if he has been convicted of a felony. The Alaska Corporations Code also makes provision for a director to be removed by the board of directors if he has been declared of unsound mind by a court order (see s 10.06.458 of the Alaska Corporations Code). Section 1726(b) of the Pennsylvania Business Corporation Law permits the board of directors to remove directors from office under certain specified grounds, unless provided otherwise in a by-law adopted by the shareholders. These grounds are (i) the director has been judicially declared of unsound mind; or (ii) has been convicted of an offence punishable by imprisonment for a term of more than one year; or (iii) for any other proper cause which the by-laws may specify; or (iv) if, within sixty days or such other time as the by-laws may specify after notice of his selection, he does not accept the office either in writing or by attending a meeting of the board of directors and fulfill such other requirements of qualification as the by-laws may specify.

[346] Ferber *Corporation Law* 40-41. To remove a director without cause all that is needed are sufficient votes for the removal.

of some abuse of trust or malfeasance or nonfeasance[347] in office to justify the removal for cause.[348] In *Fox v Cody*,[349] the New York Supreme Court held that the removal of a director may not be based on whim, caprice, mistake or misunderstanding, but must be based on substantial grounds showing breach of trust. For instance, cause will lie if a director accepts a managerial or executive position with a direct competitor of the corporation,[350] or engages in a competing business,[351] or allows payment of rebates contrary to the board's decision,[352] or harasses fellow officers and employees in the transaction of the company's business.[353] On the other hand, a desire to change corporate policy or a mere difference of opinion is not sufficient cause,[354] nor is a desire to take control of the corporation or a failure to co-operate with the president of the corporation.[355] The fact that a director has been verbally abusive to other directors or has used disrespectful and contemptuous language would also not constitute sufficient cause for removal.[356]

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[347] Malfeasance is a term for an act of wrongdoing or unjust action, but is reserved to depict a serious breach of obligation. An act of malfeasance must be knowing and deliberate, otherwise it would constitute misfeasance. A misfeasance, or improper performance, is an error in the performance of a duty. A misfeasance is an act or conduct that is generally allowed under the law but was not performed according to the required criteria and as a result of the error caused harm. In other words, a misfeasance is an improper performance of some essentially lawful act. Nonfeasance is a failure to perform an act which one is bound by law to do. It is essentially a failure of a duty, particularly by a person who holds public office or a position of trust, such as a fiduciary, to act or to perform a task that a reasonable person with such a duty would have performed (see *Osborn's Concise Law Dictionary* 263; *The Wolters Kluwer Bouvier Law Dictionary* 423; *The Longman Dictionary of Law* 304 and 321).

[348] See *Petition of Korff* 198 App Div 553 (1921) at 559; Fletcher *Cyclopedia of the Law of Corporations* § 356; Bolling "Removal of Directors in Closely Held Corporations" 234; Cox & Hazen *Corporations* 168.

[349] 141 Misc. 552, 252 N.Y.S 395 (Sup. Ct. 1930) at 554.

[350] *Eckhaus v Ma* 635 F.Supp 873 (S.D.N.Y. 1986) at 874; *Fells v Katz* 175 N.E. 516 (N.Y. 1931).

[351] *Fells v Katz* 175 N.E. 516 (N.Y. 1931).

[352] *Koppitz-Melchers, Inc v Koppitz* 24 N.W.2d 220 (Mich. 1946).

[353] *Markovitz v Markovitz* 8 A.2d 46 (Pa. 1939) at 48*; Campbell v Loew's Inc*. 134 A.2d 852 (1957) at 860-861.

[354] Bolling "Removal of Directors in Closely Held Corporations" 234.

[355] *Campbell v Loew's Inc*. 134 A.2d 852 (1957) at 860. The Delaware Court of Chancery in this case stated that a desire of directors to take over control of the corporation is a perfectly legitimate objective which is a part of the very fabric of corporate existence (at 860).

[356] *Fuller v the Trustees of the Academic School in Plainfield* 6 Conn. 532 (1827) at 546.

Several cases have held that the failure of a director to attend board meetings is not sufficient cause to remove him from office.[357] In *Halpin v Mutual Brewing Co*[358] the Appellate Division of New York held that mere neglect to attend directors' meetings for several months does not constitute such a long-continued neglect of duty as to justify removal proceedings, while in *Alliance Co-op. Ins Co. v Gasche*[359] the court held that an absence from the State and a failure to attend some of the board meetings does not show a refusal to accept the office of director so as to authorise the removal. In *Petition of Korff*[360] the New York Appellate Division rejected an attempted removal of a director which was based on temporary financial difficulties which he was experiencing in his own independent business and on the director's temporary absence from the State. The court found that the director had not been guilty of any act of misfeasance or nonfeasance which would justify his removal from office.[361] The court was influenced by the fact that no business of the corporation had arisen during the director's absence which had required his vote and presence or his signature as an officer when the notice of the meeting was given or the meeting itself held.[362] In *Fuller v the Trustees of the Academic School in Plainfield*[363] too the court found that the refusal of a director to attend meetings of the building committee, to which he had been appointed by the board, was insufficient grounds for his removal.

The Indiana Business Corporation Law goes so far as to permit the removal of directors by the board of directors without cause. Section 23-1-33-8(a) of the Indiana Business Corporation Law states that directors may be removed in any manner provided in the articles of incorporation. The provision states further that shareholders or directors may remove one or more directors "with or without cause unless the articles of incorporation provide otherwise."

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[357] See for instance *Fuller v the Trustees of the Academic School in Plainfield* 6 Conn. 532 (1827); *Halpin v Mutual Brewing Co* 20 App Div. 583 (1897); *Alliance Co-op. Ins Co. v Gasche* 142 P.882 (1914) and *Petition of Korff* 198 App Div 553 (1921). See further Fletcher *Cyclopedia of the Law of Corporations* § 356 and Travers "Removal of the Corporate Director During his Term of Office" 409.

[358] 20 App Div. 583 (1897).

[359] 142 P.882 (1914) at 882.

[360] 198 App Div 553 (1921).

[361] *Petition of Korff* 198 App Div 553 (1921) at 559.

[362] *Petition of Korff* 198 App Div 553 (1921) at 559.

[363] 6 Conn. 532 (1827) at 546.

This statute treats the removal of directors by shareholders and by the board of directors in the same manner, and permits both groups to remove directors without cause. In *Murray v Conseco Inc.*[364] the Supreme Court of Indiana commented that section 23-1-33(8)(a) of the Indiana Business Corporation Law is "highly unusual, and perhaps unique to Indiana." The Indiana Court of Appeals in *Murray v Conseco Inc.*[365] remarked that it had reviewed the corporate law statutes of the other USA States and that it had not found any provision concerning the removal of directors by the board that is worded as broadly as that of Indiana's provision. The Supreme Court of Indiana did not appear to approve of section 23-1-33(8)(a) of the Indiana Business Corporation Law but ruled that in the absence of any constitutional challenge, the wisdom of the policy in permitting the board of directors to remove one of its members without cause was not for it to resolve.[366] It is submitted that to permit the board of directors to remove fellow board members without cause would permit directors to remove fellow board members arbitrarily and would open the door for potential abuse of this power. For instance, if the board of directors were unable to garner sufficient support to pass a certain resolution, they could simply remove from office a director who was opposed to their proposed resolution, and they could do so without cause. Section 23-1-33(8)(a) of the Indiana Business Corporation Law has even been described as being "bizarre".[367]

Indiana is not the only State in the USA that empowers directors to remove fellow board members without cause, as intimated by the Supreme Court of Indiana in *Murray v Conseco Inc.*[368] Section 302A.223(2) of the Minnesota Business Corporation Act and section 10-19.1-41 of the North Dakota Business Corporation Act also empower directors to remove other directors with or without cause.[369] However, unlike the Indiana Business Corporation Law, section 302A.223(2) of the Minnesota Business Corporation Act and section 10-19.1-41 of the

[364] 795 N.E.2d 454 (Ind.2003) at 456.

[365] 766 N.E.2d 38 (Ind. Ct. App. 2002) at 44.

[366] *Murray v Conseco Inc.* 795 N.E.2d 454 (Ind.2003) at 457.

[367] Gevurtz *Corporation Law* at 188.

[368] 795 N.E.2d 454 (Ind.2003).

[369] This may be done if the director was appointed by the board to fill a vacancy, the shareholders have not elected directors in the interval between the time of appointment to fill a vacancy and the time of removal, and a majority of the directors approve the removal.

North Dakota Business Corporation Act empower the directors to remove only those directors whom they have appointed to fill a vacancy. The board may not remove directors who were appointed by the shareholders.

Based on the common law meaning of "cause" in the USA, it is arguable that the threshold to justify a removal of a director from office by the board of directors under the (South African) Companies Act is lower than that required in many USA States. While in those USA States that permit the board of directors to remove fellow board members, a director must be guilty of some abuse of trust or malfeasance or nonfeasance in office to justify removal for cause, under the (South African) Companies Act this is not a requirement. If a director has neglected the functions of director, whether or not such neglect amounts to a breach of trust or malfeasance or nonfeasance, would not be relevant. The mere neglect or dereliction of the functions of a director are sufficient grounds for the removal of a director. Whilst in the USA a director may not be removed from office by the board of directors on the basis of a mistake made by the director since, as discussed earlier, a mistake is not regarded as being a substantial ground showing breach of trust,[370] under the (South African) Companies Act if a mistake were the reason for a director neglecting his duties, it would be a sufficient ground for his removal from office.

While a failure to attend board meetings would not constitute sufficient cause in most USA States, as discussed above, under the (South African) Companies Act a failure to attend board meetings would arguably justify the removal of a director on the basis that the director in question has neglected or has been derelict in the performance of the functions of director. Travers has criticised the findings by courts in the USA that the failure to attend board meetings would be insufficient cause for the removal of a director.[371] The author contends that although a tangible injury would be required if it is sought to remove a director from office in the USA, the absence of a tangible injury should not be an obstacle to removing a director for cause.[372] Travers argues further that the failure of the director's inattendance at board meetings to cause

[370] See *Fox v Cody* 141 Misc. 552, 252 N.Y.S 395 (Sup. Ct. 1930) at 554.

[371] Travers "Removal of the Corporate Director During his Term of Office" at 411.

[372] Travers "Removal of the Corporate Director During his Term of Office" at 411.

injury to the corporation should be irrelevant in determining whether cause for removal existed.[373]

It is evident that the threshold for triggering the removal of a director from office by the board of directors is lower in South Africa than in the USA, and that the position of a director of a corporation in the USA is more entrenched than that of a director of a company in South Africa. The exceptions are the States of Indiana, Minnesota and North Dakota, which permit the board of directors to remove directors without cause.

On the other hand, the grounds for the removal of a director in the USA States which permit directors to remove fellow board members are much wider compared to the grounds under the (South African) Companies Act. The term "cause" is a wide catch-all term. There is scope for a broad spectrum of grounds for the removal of a director to fall under this term. In contrast, under the (South African) Companies Act the grounds for the removal of a director by the board of directors are limited to the grounds explicitly specified in section 71(3) of the Companies Act or to additional grounds of ineligibility or disqualification specified in the company's Memorandum of Incorporation. Accordingly if there is a valid reason to remove a director from office but this reason does not fall within the scope of the grounds listed in section 71(3) of the Companies Act, the board of directors would not be able validly to remove the offending director from office.

The USA concept of "good cause" for the removal of a member of the board of directors is used in the Armscor Act. In terms of section 8(*c*) of this statute, a member of the board of directors of Armscor must vacate his office if his services are terminated by the Minister of Defence and Military Veterans on "good cause" shown. Regarding the meaning of the phrase "good cause", in *Minister of Defence and Military Veterans v Motau and Others*[374] the Constitutional Court defined the concept as follows:

> "Good cause may be defined as a substantial or 'legally sufficient reason' for a choice made or action taken. Assessing whether there is good cause for a decision is a factual determination dependent upon the particular circumstances of the case at hand. It goes without saying that what constitutes good cause must be understood in the context of the

[373] Travers "Removal of the Corporate Director During his Term of Office" at 411.

[374] 2014 (5) SA 69 (CC) para 54. This case is discussed in para 4.3 above.

> Armscor Act as a whole, with a particular focus on the objectives and functions of Armscor and the important role played by the members of the board."

In *Cohen Brothers v Samuels*[375] Innes CJ stated, on the meaning of "good cause" that "it is hardly possible, and certainly undesirable, for the Court to attempt to" define the term "good cause". The learned judge asserted further that "[n]o general rule which the wit of man could devise would be likely to cover all the varying circumstances which may arise . . . [w]e can only deal with each application on its merits, and decide in each case whether good cause has been shown".[376] It is evident from the above dicta that in order to assess cause, one would have to make a determination based on the particular facts and circumstances of each case. The applicable relevant legislation must also be considered as a whole in making this determination, as well as the role played by the members of the board of directors.

Travers points out that despite the importance of the concept of cause for removal in USA statutes, sophisticated practitioners and legal scholars have suggested that it is not possible to give a meaningful comprehensive definition of the concept of "cause".[377] Most writers confine their analysis of the meaning of "cause" to cataloguing instances in which a court has made a determination whether a particular ground for removal was sufficient.[378] This categorisation approach has been criticised by Travers on the ground that the categories are too abstract in that they summarise in a word or phrase a complete factual situation, but, at the same time, they are not abstract enough because they are unrelated to any principle which would enable one to predict the result of a case which does not fit any existing precedent.[379]

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[375] 1906 TS 221 at 224.

[376] *Cohen Brothers v Samuels* 1906 TS 221 at 224. The court was dealing with an application for the extension of time within which to appeal based on a Rule of Court providing that leave could be granted on good cause shown. See further Delport *Henochsberg on the Companies Act 71 of 2008* 557 for a discussion of this case in the context of s 160(2) of the Companies Act. Section 160(1) of the Companies Act deals with disputes concerning the reservation or registration of company names. In terms of s 160(2)(*b*) of the Companies Act an application in terms of s 160(1) may be made on good cause shown at any time after the date of the reservation or registration of the name that is the subject of the application.

[377] Travers "Removal of the Corporate Director During his Term of Office" at 408-409.

[378] See Travers "Removal of the Corporate Director During his Term of Office" 409.

[379] Travers "Removal of the Corporate Director During his Term of Office" 409.

As pointed out by the Constitutional Court in *Minister of Defence and Military Veterans v Motau and Others*[380] "cause" entails a factual determination dependent on the particular circumstances of the case at hand. It is difficult to apply a particular category to every situation as each situation will differ depending on its particular facts. Consequently a certain category may constitute cause in one factual situation, but would not constitute cause in another situation. For these reasons it is submitted that a general ground permitting directors to be removed for "cause" should not be adopted in section 71(3) of the Companies Act. However, in order to ensure that directors may be removed from office by the board of directors in appropriate circumstances that do not fall under any of the grounds listed in section 71(3) of the Companies Act, it is submitted that the Companies Act should explicitly permit companies to insert in their Memorandums of Incorporation additional grounds for the removal of directors of office over and above the grounds specified in section 71(3) of the Companies Act. In this manner, if any particular type of conduct by a director is considered to be a ground for the removal of a director, in light of the nature and particular business of the company, the company would validly be entitled to list this ground as an additional ground for the removal of a director from office by the board of directors. The option of providing additional grounds for the removal of a director by the board of directors is particularly important in light of the fact that the term "derelict" has not been defined in the Companies Act, and its meaning is not altogether clear, as discussed above. Permitting companies to state specific additional grounds for the removal of directors from office by the board of directors would moreover introduce a level of flexibility in section 71(3) of the Companies Act that is currently lacking compared to the equivalent provisions in the UK, Australia[381] and the statutes of many USA States which permit directors to remove fellow directors from office.

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[380] 2014 (5) SA 69 (CC) para 54.

[381] As is the position under s 71 of the (South African) Companies Act, s 203D of the Australian Corporations Act of 2001 (removal of directors in public company by shareholders) does not contain a provision to the effect that nothing in the provision would be taken as derogating from any power to remove a director. There is controversy in Australia regarding the mandatory nature of s 203D. For instance, in *Allied Mining & Processing Ltd v Boldbow Pty Ltd* 160 FLR 369 (W.A.S.C. 2002) at 378-379 the Supreme Court of Western Australia held that s 203D is not mandatory. In *Scottish & Colonial Ltd v Australian Power & Gas Company Ltd* [2007] NSWSC 1266 para 37 the New South Wales Supreme Court asserted that it did not agree with this view expressed in *Allied Mining & Processing Ltd v Boldbow Pty Ltd* 160 FLR 369 (W.A.S.C. 2002) and that s 203D is mandatory. See chapter 3, note 20 and Austin & Ramsay *Ford, Austin and Ramsay's Principles of Corporations Law* para 7.230 at 284-286 for a discussion on the conflicting views regarding the mandatory nature of s 203D of the Australian Corporations Act of 2001. As discussed (see chapter 3, para 2.2) s 203C of the Australian Corporations Act of 2001 (removal of directors in private company by shareholders) is a replaceable rule. Consequently, for private companies it is possible to displace this rule with a provision in the constitution of the company permitting the board of directors to remove a director from office. Thus, with regard to private companies in Australia, there is flexibility in that the board of directors may remove directors from office if empowered to do so by the constitution of the company.

As suggested earlier, section 71(3) of the Companies Act ought to be an alterable and not a mandatory provision.[382] A company may "extend", and not only limit, the effect of an alterable provision, according to its definition in section 1 of the Companies Act. If section 71(3) were to be an alterable provision, a company would then clearly be empowered to insert specific additional grounds for the removal of a director in order to suit the particular needs of the company. It is accordingly submitted that if the phrase "Except to the extent that the company's Memorandum of Incorporation provides otherwise" were to precede section 71(3) of the Companies Act, as previously submitted,[383] it would enable companies to provide for additional specific grounds for the removal of directors to suit their particular needs.

7. DISCRETION OF THE BOARD OF DIRECTORS TO REMOVE A DIRECTOR FROM OFFICE

Section 71(3) of the Companies Act states that the board of directors "may" remove a director whom it has determined to be ineligible or disqualified, incapacitated, or negligent or derelict. Even though the board of directors is not given a choice whether or not to convene a board meeting once an allegation is made by a shareholder or a director under section 71(3),[384] the board is given a discretion whether or not to remove the director from office.

It is, however, questionable whether the board of directors would have a discretion whether or not to remove the director in question in all instances. For instance, if the board of directors finds that, on the facts, a director has become ineligible or disqualified to be a director, it is submitted that it would not have any discretion whether or not to remove the director in question from office. Under section 69(4) of the Companies Act 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) of the Companies Act.[385]

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[382] See para 3 above.

[383] Refer to chapter 3, para 3.

[384] See chapter 3, para 5 where this is discussed.

[385] Section 69(4) of the Companies Act. Section 70(2) of the Companies Act provides that where the board of directors has removed a director a vacancy on the board would not arise until the later of the expiry of the time for filing an application for review of the decision or the granting of an order by the court on such an application. The director would, however, be suspended from office during that time.

Therefore, despite the fact that section 71(3) of the Companies Act states that the board may remove a director whom it has determined to be ineligible or disqualified it is submitted that if the board of directors were to choose not to remove a director whom it has factually determined to be ineligible of disqualified, the board would infringe section 69(4) of the Companies Act as well as section 69(3) which prohibits a company from knowingly permitting an ineligible or disqualified person to serve or act as a director.[386]

The board of directors may have some discretion whether or not to remove a director whom it has found to be incapacitated, or who has neglected or has been derelict in the performance of his functions, or who has been negligent. Importantly though, if the board of directors were to retain in office a director who has been found to have neglected or to have been derelict in the performance of the functions of a director, it may run the risk of being in breach of its fiduciary duty to act in the best interests of the company.[387] If the board were to retain such a director in office, it should record and justify its decision and the reasons for it.

8. THE PROCEDURE FOR REMOVAL OF A DIRECTOR BY THE BOARD OF DIRECTORS

The removal of a director by the board of directors is often a contentious matter. The board of directors must therefore ensure that it follows the proper procedures to remove a fellow board member from office so as to avoid recourse being taken by the removed director. The procedure to remove a director by the board of directors under sections 71(3) and 71(4) of the Companies Act is discussed below.

8.1 Board Resolution

In terms of section 71(3) of the Companies Act if a director or a shareholder alleges that any of the grounds set out in sections 71(3)(*a*) or (*b*) are applicable, then the board must determine the matter by resolution. It may remove a director whom it has determined to be ineligible or

[386] See para 6.1.1 above.

[387] See s 76(3)(*b*) of the Companies Act; Ncube "You're Fired! The Removal of Directors under the Companies Act 71 of 2008" 44 and Masinire "A Critical Analysis of the Role and Protection of Shareholders in the Removal of Directors in the South African Companies Act 71 of 2008"1994. The fiduciary duties of directors in removing fellow board members is discussed further in chapter 4, para 2.

disqualified, incapacitated, negligent or derelict, as the case may be. The director against whom the allegation has been made would not, in terms of section 71(3), be permitted to participate in the vote on the question of his removal. This is logical, because such a director would naturally be inclined to vote against his removal.[388]

In the Australian decision in *Claremont Petroleum NL v Indosuez Nominees Pty Ltd*[389] the shareholders of a public company purported to remove all the directors of a public company and to appoint three directors in their place. A public company, in terms of section 219 of the Companies (Queensland) Code, had to have at least three directors on its board of directors. The appellant contended that a resolution seeking the removal of all the directors at once was invalid because if the resolution were passed it would result in a contravention by the company of section 219 of the Companies (Queensland) Code because there would be a moment in time when there would in fact be no directors of the company. The court held that if the removal of the existing directors were to take effect only on the election of their successors, this difficulty of the company not having any directors for a period until new directors were elected, would be overcome.[390] In line with this dictum, it is submitted that if the removal of a director or the removal of one or more directors under section 71(3) of the Companies Act would result in the company having fewer than the minimum number of directors on its board of directors, at least for a short period of time until new directors are elected or appointed, for practical purposes, the resolution should be framed so that the removal would take effect only on the election or appointment of the successors, or, in the case of a profit company upon the temporary filling of the vacancy by the board of directors in terms of section 68(3) of the Companies Act

[388] If a shareholders' resolution for the removal of a director is in issue, and if the director in question is a shareholder, he would be entitled to vote on the question of his own removal in his capacity as a shareholder (see also R Cassim "Governance and the Board of Directors" in FHI Cassim et al *Contemporary Company Law* 445). It is of interest that the provisions of s 75 of the Companies Act (Director's personal financial interest) do not apply to a director in respect of a proposal to remove that director from office as contemplated in s 71 of the Companies Act (s 75(2)(*a*)(ii)). In terms of s 75(5)(*d*) if a director has a personal financial interest in respect of a matter to be considered at a board meeting he must disclose the interest to the board before the matter is considered at the meeting and he must leave the meeting immediately after making any such disclosure. The provisions of s 75(2)(*a*)(ii) of the Companies Act are sound because a director who is the subject of a proposal to remove him from office must be permitted to be present at the meeting and to make a presentation to the meeting in order to defend himself against his proposed removal from office, despite the fact that he has a personal financial interest in the matter.

[389] [1987] 1 Qd R 1.

[390] *Claremont Petroleum NL v Indosuez Nominees Pty Ltd* [1987] 1 Qd R 1 at 3.

(provided this is permitted by the Memorandum of Incorporation of a profit company).[391] If the resolution were to be framed in this way, the director or directors who have been removed could be suspended from office until their successors are elected or appointed or the vacancy has been temporarily filled by the directors.

Section 73(5) of the Companies Act states that, except to the extent that the company's Memorandum of Incorporation provides otherwise, a majority of the votes cast on a resolution is sufficient to approve that resolution. Accordingly, directors of each company may themselves decide on the level of support that is required in order for a board resolution to be passed to remove a fellow board member from office. Section 65(8) of the Companies Act specifically prohibits the threshold for an ordinary resolution for the removal of a director by the shareholders to be increased to more than fifty one per cent of the voting rights exercised on the resolution, but the legislature did not prohibit the threshold for a *board resolution* to remove a director from being higher than fifty one per cent. Instead, the legislature left it to the board of directors to determine the relevant threshold for the board resolution to be passed. Accordingly, the percentage of support that would be required in order for a board resolution to be passed to remove a director from office would depend on the provisions of the company's Memorandum of Incorporation and may vary from company to company. The board of directors could even decide that a board resolution to remove a director from office must be unanimously approved.

It is important to note that the vote of the majority of the directors is a vote of the majority of the directors forming a quorum for purposes of the board meeting, and not a vote of the majority of all the directors on the board of directors. Section 71(3) of the Companies Act does not impose any special quorum requirement for a meeting at which the board removes a director. The default position with regard to a quorum for directors' meetings, in terms of section 73(5)(*b*) of the Companies Act, is that a majority of the directors must be present at a meeting before a vote may be called at a meeting of the directors. Accordingly, unless the Memorandum of Incorporation provides otherwise, only a majority of the directors need to be present to vote on the resolution to remove a fellow board member. Of the majority of the board members

[391] In terms of s 68(3) of the Companies Act, unless the Memorandum of Incorporation of a profit company provides otherwise, the board may appoint a person who satisfies the requirements for election as a director to fill any vacancy and serve as a director of the company on a temporary basis until the vacancy has been filled by an election of the shareholders. During that period the person so appointed has all of the powers, functions and duties of any other director of the company and is subject to all of the liabilities of any other director of the company.

present, unless the Memorandum of Incorporation provides otherwise, a majority of the votes cast on the resolution to remove a board member would be sufficient to approve that resolution.[392] To use an example, in a board comprising ten board members, the default position is that six board members must be present to form a quorum, and that four board members would be required to approve the board resolution to remove a fellow board member. In this example, the approval of less than half of the board members is in effect required to remove a fellow board member from office.

In sharp contrast, section 351.317 of the Missouri General Business Corporation Law[393] states that a director of the corporation may be removed for cause by the action of a majority of the *entire* board of directors if at the time of removal the director has failed to meet the qualifications stated in the articles of incorporation or by-laws for election as a director or is in breach of any agreement between such director and the corporation relating to such director's services as a director or employee of the corporation. Section 48-18-108(d) of the Tennessee Business Corporation Act[394] likewise states that, if provided by the charter, any or all of the directors may be removed for cause by a vote of a majority of the *entire* board of directors.

In light of the significance and the gravity of the removal of a director by his fellow board members, it would be preferable if a majority of the entire board of directors, and not merely a majority of the directors forming a quorum, were to vote in favour of the removal of a fellow board member before such resolution is validly passed. This would ensure that all the board members consider and participate in the proposed resolution to remove a fellow board member. Nevertheless, even if directors are given the option of participating in a board meeting by electronic communication,[395] it may not always be practical for the entire board of directors to

[392] Section 73(5)(*d*) of the Companies Act.

[393] Section 351.317 is codified in Chapter 351 (General and Business Corporations) of the Missouri General Business Corporations Law, Title 23 (Corporations Associations and Partnerships) of the Missouri Revised Statutes.

[394] Section 48-18-108 is codified in Chapter 18 (Directors and Offices), Title 48 (Corporations and Associations For-Profit Business Corporations) of the Tennessee Code.

[395] Under s 73(3), except to the extent that the Companies Act or a company's Memorandum of Incorporation provides otherwise, board meetings may be conducted by electronic communication and one or more directors may participate in a meeting by electronic communication, so long as the electronic communication facility employed ordinarily enables all persons participating in that meeting to communicate concurrently with each other without an intermediary and to participate effectively in the meeting.

timeously meet in order to vote on the removal of the director in question. If there are valid grounds to remove a director from office, it is advisable not to delay the board vote on such removal lest any actions of the director in question are detrimental to the company pending the board meeting to vote on his removal from office. For this reason it is submitted that a majority of the quorum should vote in favour of the removal of the director and not a majority of the entire board of directors, as is the case under the Missouri General Business Corporation Law and the Tennessee Business Corporation Act, as discussed above. However, in the interests of good corporate governance, it is submitted that the entire board of directors ought to use its best endeavours to be present at the board meeting to vote on the removal of the director in question.

When the shareholders of a company remove a director from office in terms of section 71(1) of the Companies Act[396] they may exercise their vote to do so in any way they please because it is well established that their right to vote is a proprietary right, and that they are entitled to exercise their right of property in whatever way they desire.[397] Accordingly, a resolution by the shareholders to remove a director from office may not be impeached on the ground that it was not passed in good faith and in the interests of the company.[398] In contrast, when the board of directors exercises the power to remove a director it must do so *bona fide* in the best interests of the company and not for ulterior motives.[399] Directors who exercise their power to remove

[396] In terms of s 71(1) of the Companies Act, 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 s 71(2). Section 71(2) sets out the procedure that must be followed before the shareholders may consider such a resolution.

[397] *Pender v Lushington* (1877) 46 ChD 317 at 319. See further *Re HR Harmer Ltd* [1959] 1 WLR 62 at 82; *Sammel and Others v President Brand Gold Mining Co Ltd* 1969 (3) SA 629 (A) at 680; *Desai and Others v Greyridge Investments (Pty) Ltd* 1974 (1) SA 509 (A) at 519; *Kuwait Asia Bank EC v National Mutual Life Nominees Ltd* [1991] 1 AC 187 (PC) at 221; *CDH Invest NV v Petrotank South Africa (Pty) Ltd and Another* [2018] 1 All SA 450 (GJ) and chapter 4, para 2 where this is discussed further.

[398] Blackman et al *Commentary on the Companies Act* 8-285.

[399] *Lee v Chou Wen Hsien* [1984] 1 WLR 1202 at 1206. On the fiduciary duties of directors to act in the best interests of the company see *Shuttleworth v Cox Brothers & Co (Maidenhead) Ltd* [1927] 2 KB 9; *Re Smith & Fawcett Ltd* [1942] Ch 304 at 306; *Charterbridge Corporation Ltd v Lloyd's Bank* [1970] Ch 62; *Regentcrest plc (in liquidation) v Cohen* [2001] 2 BCLC 80 at 105; *Extrasure Travel Insurances Ltd v Scattergood* [2003] 1 BCLC 598 (ChD) at 618-619; *Liwszyc and Another v Smolarek and Others* (2005) 55 ACSR 38 at 46-47; *Da Silva and Others v CH Chemicals (Pty) Ltd* 2008 (6) SA 620 (SCA) para 18 and chapter 4, para 3.1.

a director for an improper purpose or for ulterior reasons may be held to be in breach of their fiduciary duties.[400]

Finally, it is important to be aware that section 73(5)(*c*) of the Companies Act gives each director one vote on a matter before the board, unless the company's Memorandum of Incorporation provides otherwise. In other words, a director may have more than one vote on a matter before the board of directors, if this is specifically stated in the Memorandum of Incorporation of a company. If a director were to be given more than one vote on a proposed resolution to remove a fellow board member, this would confer substantial influence on the director with regard to the proposed removal resolution.[401]

8.2 Notice of the Board Meeting

Before the board of directors may consider a resolution to remove a fellow board member, the director must be given notice of the board meeting, including a copy of the proposed resolution to remove him from office.[402]

The resolution to remove a director may not be passed by means of a round robin resolution of the directors in terms of section 74 of the Companies Act without holding a formal meeting.[403] Doing so would deprive the director of his entitlement to be heard on the proposed resolution to remove him from office before the voting takes place.

Section 71(4)(*a*) of the Companies Act does not specify the notice period of the meeting to consider the resolution to remove a director from office. A director who is the subject of the

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[400] See *Punt v Symons & Co Ltd* [1903] 2 Ch 506; *Piercy v Mills* [1920] 1 Ch 77; *Hogg v Cramphorn Ltd* [1967] Ch 254; *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821 (PC); *Extrasure Travel Insurances Ltd v Scattergood* [2003] 1 BCLC 598 (ChD) at 619; *Liwszyc and Another v Smolarek and Others* (2005) 55 ACSR 38 at 47 and chapter 4 para 3.2 on the fiduciary duty of directors to exercise their powers for a proper purpose.

[401] The topic of loaded voting rights is discussed further in chapter 5, para 3.

[402] Section 71(4)(*a*) of the Companies Act.

[403] In terms of s 74 of the Companies Act, except to the extent that the Memorandum of Incorporation provides otherwise, a decision that could be voted on at a board meeting may instead be adopted by written consent of a majority of directors, given in person or by electronic communication, provided that each director has received notice of the matter to be decided. A resolution to remove a director from office under s 168 of the UK Companies Act of 2006 may not be passed as a written resolution either (see s 288(2)(a) of the UK Companies Act of 2006).

board resolution ought at least to receive reasonable notice of the meeting,[404] in order to give him sufficient time to prepare a presentation to be given to the meeting. In *South African Broadcasting Corporation Ltd v Mpofu and Another*[405] the South Gauteng High Court stated that fair and reasonable notice to attend a directors' meeting depends on the circumstances and on the structure, practice and affairs of the company.

In contrast, with regard to the removal of a director by the shareholders in terms of section 71(1) of the Companies Act, section 71(2)(*a*) states clearly that shareholders are required to give the director in question notice of the meeting which is at least equivalent to that which a shareholder is entitled to receive, irrespective of whether the director is a shareholder of the company. It is noteworthy that section 220(2) of the Companies Act 61 of 1973 required special notice to be lodged with the company of any proposed resolution to remove a director by the shareholders. Special notice comprised twenty eight days' notice, and the company was required to give not less than twenty one days' notice of the meeting to its shareholders.[406] The UK Companies Act of 2006, which makes provision for a director to be removed by shareholders only but not by the board of directors, also requires special notice to be given to the company (comprising twenty eight days' notice)[407] of a resolution to remove a director.[408] On receipt of an intended resolution to remove a director under section 168 of the UK Companies Act of 2006 the company must forthwith send a copy of the notice to the director concerned.[409]

Under section 203D(2) of the Australian Corporations Act of 2001, when the shareholders purport to remove a director from office, the director must receive at least two months' prior notice of the removal before the shareholders' meeting.[410] In *Scottish & Colonial Ltd v*

[404] FHI Cassim "The Division and Balance of Power" 163.

[405] [2009] 4 All SA 69 (GSJ) para 39.

[406] Section 186(3) of the Companies Act 61 of 1973. Under s 62(1) of the Companies Act, unless the Memorandum of Incorporation provides otherwise, the notice period for a shareholders' meeting of a public company is fifteen business days while the notice period for a shareholders' meeting of a private company is ten business days.

[407] Section 312 of the UK Companies Act of 2006.

[408] Section 168(2) of the UK Companies Act of 2006.

[409] Section 169(1) of the UK Companies Act of 2006.

[410] In terms of s 203D(2) of the Australian Corporations Act of 2001, if the company calls a meeting after the notice of intention to move the resolution is given, the meeting may pass the resolution even though the meeting is held less than two months after the notice of intention is given.

Australian Power & Gas Co Ltd[411] a director of the Australian Power and Gas Co Ltd requisitioned a shareholders' meeting for the purpose of removing some of the directors of the company under the constitution of the company. The director had failed to follow the procedure set out in section 203D of the Australian Corporations Act of 2001 as he had not given the requisite two months' notice to the directors concerned. The New South Wales Supreme Court found that the attempt of the director to remove the directors from office was invalid for failure to follow the process in section 203D of the Australian Corporations Act of 2001.[412] It consequently granted an order restraining the company from considering the resolution to remove the directors from office.[413]

In the interests of clarity and to avoid any ambiguity or controversy regarding the notice period to be given to a director who is to be removed from office, and to ensure that the notice period is fair and reasonable, it is submitted that a director ought to receive notice of the meeting which is at least equivalent to the notice period of any board meeting. In terms of section 73(4)(*a*) of the Companies Act the board of a company may determine the form and time for giving notice of its meetings but such determination must comply with any requirements set out in the Memorandum of Incorporation or rules of the company. It is submitted that a provision similar to section 71(2)(*a*) of the Companies Act must be included in section 71(4)(*a*) of the Companies Act in order to ensure that directors are given notice of the meeting which is at least equivalent to the notice period of any board meeting.

In order for the CIPC to record the removal of a director of a company by the board of directors, Practice Note 40 of 2015 states that when a director is removed by the board on the grounds of being ineligible or disqualified, or due to incapacity, neglect or dereliction, the company must lodge with the CIPC proof that a notice was sent to the director concerned with the detailed information stated in section 71(4)(*a*) of the Companies Act (that is, a copy of the resolution

[411] [2007] NSWSC 1266.

[412] *Scottish & Colonial Ltd v Australian Power & Gas Co Ltd* [2007] NSWSC 1266 para 43.

[413] *Scottish & Colonial Ltd v Australian Power & Gas Co Ltd* [2007] NSWSC 1266 para 45.

and a statement of the reasons for the proposed resolution).[414] A copy of the meeting attendance register must also be lodged with the CIPC.[415]

8.3 Statement of Reasons

Included in the notice of the meeting must be a copy of the proposed resolution to remove the director from office, as well as a statement setting out the reasons for the proposed resolution.[416] The statement of reasons must support the allegation or allegations made against the director. They must be set out with "sufficient specificity"[417] to reasonably permit the director to prepare and present a response. The phrase "sufficient specificity" is not defined in the Companies Act, and it is not clear how much detail must be provided in the statement of reasons in order to meet the "sufficient specificity" standard.

The meaning of the phrase "sufficient specificity" was considered by the Western Cape High Court in *Pretorius v PB Meat (Pty) Ltd*.[418] The facts, briefly, are that the first and second applicants were directors and employees of the company, PB Meat (Pty) Ltd. They had resigned as employees of the company but had refused to resign as directors, notwithstanding repeated requests to do so and a clause to the contrary in their respective service agreements. The clause in question required the applicants to resign as directors on termination of their employment and on the request of the company. The applicants contended that this clause had been inserted in their service agreements as a result of a common mistake, but this was denied by the company. As a consequence of the refusal of the applicants to resign as directors of the company, a director on the board of directors had caused letters to be served upon the applicants to attend a meeting of the board of directors. This meeting had been convened to consider a proposed resolution to remove the applicants as directors on the basis that they had been derelict in the performance of the functions of directors. The statement of reasons for the

[414] See para 2 of Practice Note 40 of 2015 entitled "Removal of director in terms of s 71 of Companies Act, 71 of 2008".

[415] Para 2 of Practice Note 40 of 2015 entitled "Removal of director in terms of s 71 of Companies Act, 71 of 2008."

[416] Section 71(4)(*a*) of the Companies Act. It is noteworthy that shareholders are not required to furnish reasons for seeking to remove a director from office in terms of s 71(1) of the Companies Act.

[417] Section 71(4)(*a*) of the Companies Act.

[418] [2013] ZAWCHC 89.

proposed removal of the applicants stated that the applicants had unlawfully removed certain equipment owned by the company from its premises and had installed such equipment at their own premises in order to use it for private purposes; that the applicants had unlawfully disposed of equipment owned by the company and had retained the proceeds of such disposal instead of paying them to the company, and that the applicants unlawfully had made a secret profit from the sale of certain products, which profit ought to have accrued to the company. After the receipt of the proposed resolution and statement of reasons, the attorney for the applicants delivered an eight page "Request for Further Particulars and Specificity in terms of s 71(4)" of the Companies Act. The company had furnished a written response to the request for further particulars. The applicants, in turn, were of the view that these further particulars fell short of what was reasonably required to enable them to prepare a response for their presentation at the impending board meeting. The applicants also wished to have sight of certain financial and commercial records of the company.

The Western Cape High Court in *Pretorius v PB Meat (Pty) Ltd*[419] per Cloete J, held that the phrase "sufficient specificity" meant "sufficiently detailed reasons to mount a response" to the case for the proposed removal.[420] The court stated that it is inherent in this formulation that each case must ultimately depend upon its own particular facts.[421] It found that the allegations made in the company's statement of reasons for the applicants' removal were quite simple and uncomplicated and that there was no suggestion by the company that the applicants were "guilty of complex commercial fraud".[422] In light of this finding, the court held that access to the financial and commercial records of the company, as sought by the applicants, would not assist them in any meaningful way in relation to the allegations levelled against them, and their application was refused. According to the court, the applicants effectively were seeking to embark on a "full-scale forensic audit"[423] of the company — an ordering of the production of the documents was likely to escalate the matter into a "full-blown, costly, elaborate and lengthy

[419] [2013] ZAWCHC 89 para 10.

[420] See Ncube "You're Fired! The Removal of Directors under the Companies Act 71 of 2008" 43.

[421] *Pretorius v PB Meat (Pty) Ltd* [2013] ZAWCHC 89 para 10.

[422] *Pretorius v PB Meat (Pty) Ltd* [2013] ZAWCHC 89 para 44.

[423] *Pretorius v PB Meat (Pty) Ltd* [2013] ZAWCHC 89 para 45.

exercise"[424] which, the court asserted, is not what was envisaged by section 71(4)(*a*) of the Companies Act.[425] Consequently, the court ruled that the company had met the "sufficient specificity" requirement in section 71(4)(*a*) of the Companies Act, and that the applicants had been given sufficiently detailed reasons to mount a response to the allegations levelled against them.

The principle which emerges from *Pretorius v PB Meat (Pty) Ltd*[426] is that the more complicated the case for the removal of a director, the more detailed the reasons, information and documentation must be in order to meet the sufficient specificity standard.[427] Accordingly in a simple case fewer reasons, information and documentation would be required in order to meet the "sufficient specificity" standard. Notably, in interpreting the phrase "sufficient specificity" the court did not consider the purposes of the Companies Act, as required by section 5(1) of the Companies Act. Section 7(*b*)(iii) of the Companies Act states that one of the purposes of the Companies Act is to encourage transparency and high standards of corporate governance. Another purpose of the Companies Act, as set out in section 7(*j*), is to encourage the efficient and responsible management of companies. Arguably, these two purposes require fairly detailed reasons and information to be provided to a director for his proposed removal, even when the allegations made against him are simple and uncomplicated.[428]

It is submitted, in agreement with the court in *Pretorius v PB Meat (Pty) Ltd*,[429] that section 71(4)(*a*) of the Companies Act does not envisage a "full-blown, costly, elaborate and lengthy exercise"[430] but, at the same time, in order to promote transparency and the efficient and responsible management of companies, directors ought to be fully informed of the full and

[424] *Pretorius v PB Meat (Pty) Ltd* [2013] ZAWCHC 89 para 45.

[425] *Pretorius v PB Meat (Pty) Ltd* [2013] ZAWCHC 89 para 45.

[426] [2013] ZAWCHC 89.

[427] R Cassim "Contesting the Removal of a Director by the Board of Directors under the Companies Act" 143-144.

[428] R Cassim "Contesting the Removal of a Director by the Board of Directors under the Companies Act"145.

[429] [2013] ZAWCHC 89.

[430] *Pretorius v PB Meat (Pty) Ltd* [2013] ZAWCHC 89 para 45.

detailed reasons why the board of directors is considering their removal from office. Information should not be withheld from directors on the basis that the allegations made against them are simple and uncomplicated.[431] In considering the level of detail required in order to meet the "sufficient specificity" standard in section 71(4)(*a*) of the Companies Act, it is submitted that the board of directors must consider whether they are satisfying the above purposes of the Companies Act.

The Australian Corporations Act of 2001 does not require a company to provide a statement setting out reasons for the proposed resolution to remove a director from office when a director of a private company is removed whether by the shareholders or by the directors, nor when a director of a public company is removed by the shareholders. The UK Companies Act of 2006 likewise does not require a director to be given a statement setting out reasons for the proposed resolution to remove him from office. The relevant statutes of those USA States which allow the board of directors to remove directors similarly do not make provision for a statement of reasons to accompany the notice of the board meeting to be sent to the director in question. This requirement seems to be quite unique to the (South African) Companies Act. It is submitted that it is an innovative and commendable requirement that enables the impugned director to prepare a response to the allegations made against him, prior to the proposed board meeting to remove him from office.

8.4 Presentation

Section 71(4)(*b*) of the Companies Act requires that a director be given a reasonable opportunity to make a presentation, in person or through a representative, to the board meeting before the resolution for his removal is voted upon. The director does not have to give the presentation himself; he may be represented by any representative of his choice, including a legal representative. The purpose of the presentation is to give the director an opportunity to state his case and to ensure that a director is not removed from office on an impulsive vote.[432]

[431] For an analysis of *Pretorius v PB Meat (Pty) Ltd* [2013] ZAWCHC 89 see R Cassim "Contesting the Removal of a Director by the Board of Directors under the Companies Act"133-159.

[432] Davies & Worthington *Gower Principles of Modern Company Law* 381.

In *Minister of Defence and Military Veterans v Motau and Others*[433] the Constitutional Court stated that the purpose of sections 71(1) and (2) of the Companies Act on the removal of a director by the shareholders was not only to ensure that a majority of shareholders assent to a decision to dismiss a director, but also to ensure that those whose interests are materially affected by the decisions taken are given an opportunity to put forward relevant information, and to ensure that the decision-makers are appropriately informed before making a far-reaching decision. The Constitutional Court in this case found that the Minister of Defence and Military Veterans had failed to observe the procedure prescribed in sections 71(1) and (2) of the Companies Act in terminating the membership of two board members of the board of Armscor without first affording the board members a reasonable opportunity to make representations.[434] In light of the fact that the procedures set out in section 71(2) of the Companies Act relating to the shareholder removal of a director are almost identical[435] to those set out in section 71(4) of the Companies Act relating to the board removal of a director, the dictum of the Constitutional Court relating to the rationale of section 71(2) of the Companies Act would likewise apply to the provisions of section 71(4) of the Companies Act.

With regard to the removal of directors by shareholders under section 220(3) of the Companies Act 61 of 1973,[436] a director was entitled to make written representations in response to the proposed resolution to remove him from office. He could also request that his written

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[433] 2014 (5) SA 69 (CC) para 79.

[434] *Minister of Defence and Military Veterans v Motau and Others* 2014 (5) SA 69 (CC) para 80. This case is discussed further in para 4.3 above.

[435] A difference in the procedure between the removal of directors by shareholders (in s 71(2) of the Companies Act) and the removal of directors by the board of directors (in s 71(4) of the Companies Act) is that with the removal of a director by the board of directors the director in question must be given a statement setting out reasons for the proposed resolution. This is not a requirement when the shareholders purport to remove a director from office. The other difference is that the shareholders must give the director in question notice of the meeting which is at least equivalent to that which a shareholder is entitled to receive. While the board of directors must give the director in question notice of the meeting, s 71(4) does not specify the duration of the notice period.

[436] Section 220(3) of the Companies Act 61 of 1973 stated as follows:

> "Where notice is given of a proposed resolution to remove a director under this section, and the director concerned makes representations with respect thereto not exceeding a reasonable length in writing to the company and requests their notification to members of the company, the company shall, unless the representations are received by it too late for it to do so –
> (a) in any notice of the resolution given to members of the company, state that such representations have been made; and
> (b) send a copy of the representations to every member of the company to whom notice of the meeting is sent, whether such notice is sent before or after receipt of the representations by the company."

representations be circulated to the shareholders of the company. In order for the written reasons to be circulated to the shareholders, they had to have been received by the company timeously, they could not exceed a reasonable length, and they could not be defamatory.[437] In addition, a director was entitled to be heard at the shareholders' meeting on the proposed resolution to remove him from office.[438] A director was thus given an opportunity to make both written representations as well as a verbal presentation regarding his removal from office.

Similarly, in terms of section 169(3) of the UK Companies Act of 2006 directors may make written representations in their defence to their proposed removal by the shareholders of the company. The written representations must be circulated to the shareholders of the company as long as they are not received too late.[439] If the written representations are not sent out by the company because they were received too late or because of the company's default the director may, without prejudice to his right to be heard orally, require that the representations be read out at the meeting.[440] Copies of the written representations need not be circulated and the representations need not be read out at the meeting if, on the application of either the company[441] or any other person who claims to be aggrieved, the court is satisfied that the rights conferred by section 169 of the UK Companies Act of 2006 are being abused.

Section 203D(4)(*a*) of the Australian Corporations Act of 2001 likewise entitles a director to present his case to the shareholders by submitting to the company a written statement for circulation to the shareholders. In terms of section 203D(5) the written statement must be circulated to the shareholders by sending a copy to everyone to whom notice of the meeting is sent if there is time to do so. If there is no time to do so, then the statement must be read out at the meeting before the resolution is voted on. The statement does not have to be circulated to the shareholders if it is more than one thousand words or it is defamatory.[442] The director in

[437] Sections 220(3) and (5) of the Companies Act 61 of 1973.

[438] Section 220(2) of the Companies Act 61 of 1973.

[439] Section 169(5) of the UK Companies Act of 2006.

[440] Section 169(4) of the UK Companies Act of 2006.

[441] The court may order the company's costs on such an application to be paid in whole or in part by the director, notwithstanding that he is not a party to the application (s 169(6) of the UK Companies Act of 2006).

[442] Section 203D(6) of the Australian Corporations Act of 2001.

question is also entitled to address the meeting on the proposed resolution, whether or not he is a shareholder of the company.[443]

In contrast, the (South African) Companies Act does not make explicit provision for a director to make written representations, irrespective of whether he is to be removed by an ordinary resolution of the shareholders in terms of section 71(1) of the Companies Act or by the board of directors under section 71(3) or by the Companies Tribunal under section 71(8). Section 71(4)(*b*) of the Companies Act states that a director must be given a reasonable opportunity to make a "presentation" to the board meeting or the Companies Tribunal, in person or through a representative, before the resolution is put to a vote. It is not clear whether the reference to a "presentation" in section 71(4)(*b*) of the Companies Act would include a written presentation or whether it is confined to a verbal presentation. It is noteworthy that section 220(3) of the previous Companies Act 61 of 1973 referred to a director making "representations" with respect to the proposed resolution to remove him from office, while section 71(4)(*b*) of the Companies Act (71 of 2008) refers to a director making a "presentation" to the meeting, before the resolution is put to the vote. Semantically, there is a difference between a "presentation" and "representations". The *Oxford Dictionary of English* defines the term "presentation" as "a speech or a talk in which a new product, idea or piece of work is shown and explained to an audience",[444] while "representation" is defined as "formal statements made to an authority, especially so as to communicate an opinion or register a protest".[445] This adds to the uncertainty whether a "presentation" in section 71(4)(*b*) of the Companies Act includes a written presentation. It is arguable that under section 71(4)(*b*) of the Companies Act (71 of 2008) a director could make a written presentation to the company and request the company to circulate the written presentation to the board prior to the board meeting. Nevertheless the company could refuse such a request[446] on the basis that section 71(4)(*b*) of the Companies Act envisages a verbal presentation only. The issue awaits clarification by the courts.

[443] Section 203D(4)(b) of the Australian Corporations Act of 2001.

[444] *Oxford Dictionary of English* 1391.

[445] *Oxford Dictionary of English* 1494.

[446] See Ncube "You're Fired! The Removal of Directors under the Companies Act 71 of 2008" 39.

There are several advantages to permitting a director to make written representations to be circulated to the board members prior to the board meeting. The right to circulate written representations confers on the board members an opportunity to consider and reflect on the director's defence before the meeting is convened.[447] It gives board members an opportunity to investigate the impugned director's defence and to prepare pertinent questions for him at the board meeting in order to satisfy themselves on the merits of his defence. In addition, written representations may be more effective than a verbal presentation in a meeting that becomes disorderly or rowdy.[448] While a director must be given a reasonable opportunity, in terms of section 71(4)(*b*) of the Companies Act, to make a presentation to the board meeting before the board members vote on the proposed resolution, when a board meeting becomes disorderly, unruly or hostile, it would be difficult and ineffective for a director to make a comprehensive verbal presentation, particularly where he is representing himself and is not represented by a representative.

In light of the advantages of a written representation, it is submitted that, in the interests of clarity and certainty, section 71(4)(*b*) of the Companies Act should make explicit provision for the right of a director to make written representations to the board meeting, which must be circulated to the board members prior to the board meeting. In order to ensure that the option of circulating written representations is not abused, it is suggested that, in accordance with section 203D(6) of the Australian Corporations Act of 2001, the written representations need not be circulated if they exceed one thousand words or if they are defamatory. It is submitted further that, as was the case under the Companies Act 61 of 1973, in addition to the right to make written representations, a director should also be entitled to make a verbal presentation to the board meeting, either in person or through a representative, before the resolution is put to the vote. Since the written representations would be circulated to the board of directors only (and not to the shareholders) the costs thereof could easily be borne by the director concerned.

Whether the opportunity given to a director or his representative to make a presentation is "reasonable" would depend on the facts of each case. The director must be given a fair opportunity to address the allegations made against him and the reasons set out in the statement

[447] Ncube "You're Fired! The Removal of Directors under the Companies Act 71 of 2008" 50; FHI Cassim "The Division and Balance of Power" 163.

[448] Ncube "You're Fired! The Removal of Directors under the Companies Act 71 of 2008" 50.

of reasons in support of such allegation. If, for instance, the board of directors were to disallow a director to complete his presentation, this would arguably be a violation of the director's right to be given a reasonable opportunity to make a presentation to the board of directors.

Since the purpose of the presentation is to give the director an opportunity to state his case and to ensure that he is not removed from office on an impulsive vote, it should address the allegations made against the director in the statement of reasons provided to him in terms of section 71(4)(*a*) of the Companies Act. As discussed,[449] the director concerned must be given a statement setting out reasons for the proposed resolution with sufficient specificity to reasonably permit him to prepare and present a response. If a director has not been presented with a statement of reasons with sufficient specificity to reasonably permit him to prepare for and present the presentation to which he is entitled, he could request the company to provide him with more detailed reasons, provided he complies with the relevant requirements to do so. *Pretorius v PB Meat (Pty) Ltd*[450] is an example of a case where two directors had requested further particulars to be provided to them regarding the reasons for their proposed removal by the board of directors. The company had furnished a written response to the request for further particulars. The directors were of the view that the further particulars fell short of what was reasonably required to enable them to prepare a response for their presentation at the board meeting. Their attorney subsequently delivered a request for access to records in terms of section 53(1) of the Promotion of Access to Information Act 2 of 2000. Among the documents requested by the directors were the company's financial statements, stock sheets, purchase invoices, value-added tax invoices and monthly management accounts of the company.

The Western Cape High Court, Cape Town found that the documents requested by the directors did not have to be produced by the company in order to satisfy the sufficient specificity requirement of section 71(4)(*a*) of the Companies Act. The court held that the directors were not entitled as of right, in their capacities as directors, to the documents requested by them.[451] The court pointed out that section 26 of the Companies Act did not confer on directors a statutory right to inspect the records of a company. The applicants consequently relied on

[449] See para 8.3 above.

[450] [2013] ZAWCHC 89.

[451] *Pretorius v PB Meat (Pty) Ltd* [2013] ZAWCHC 89 para 28.

section 50 of the Promotion of Access to Information Act 2 of 2000 in order to be allowed to inspect the documents and records of the company.

In terms of section 50(1) of the Promotion of Access to Information Act 2 of 2000, a requester must be given access to any record of a private body if (a) that record is required for the exercise or protection of any rights; (b) that person complies with the procedural requirements of the Promotion of Access to Information Act 2 of 2000 relating to a request for access to that record; and (c) access to that record is not refused in terms of any ground for refusal contemplated in Chapter 4 of Part 3 of the Promotion of Access to Information Act 2 of 2000.[452] The High Court in *Pretorius v PB Meat (Pty) Ltd*[453] found that the directors had duly stated the right that they wished to protect, which was the right to safeguard their removal as directors from the company, and that they had duly set out the information which they required. They had however failed to show how the information would assist them in protecting that right.[454] It was not sufficient for the directors to merely show that they had a *prima facie* right of protection, but the directors also had to explain the relevance of each document on which they intended to rely.[455] This they had failed to do, and for this reason their request for the documents and records of the company was denied. The court found further that the production of the documents would not in this case assist the directors in a meaningful way in relation to the allegations levelled against them or assist them in exercising or protecting their rights.[456] The court accordingly ruled that the applicants had been provided with sufficiently detailed reasons

[452] In *Nova Property Group Holdings Ltd and Others v Cobbett and Another* 2016 (4) SA 317 (SCA) para 21 the Supreme Court of Appeal remarked that the Promotion of Access to Information Act 2 of 2000 is a general statute which regulates access to innumerable types of information held by a wide range of bodies, with various different types of interests at stake. For this reason, the court stated, Parliament had to lay down general rules to balance the competing interests at stake by means of threshold requirements, grounds of refusal and public-interest overrides (para 21).

[453] [2013] ZAWCHC 89 para 33.

[454] For a discussion of the requirements to be satisfied under s 50(1) of the Promotion of Access to Information Act 2 of 2000, see *Cape Metropolitan Council v Metro Inspection Services (Western Cape) CC* 2001 (3) SA 1013 (SCA) para 28; *Clutchco (Pty) Ltd v Davis* 2005 (3) SA 486 (SCA); *Unitas Hospital v Van Wyk* 2006 (4) SA 436 (SCA) paras 16 and 30; *Claase v Information Officer, South African Airways (Pty) Ltd* 2007 (5) SA 469 (SCA) para 8 and *Loest v Gendac and Another* 2017 (4) SA 187 (GP) paras 26-29.

[455] *Pretorius v PB Meat (Pty) Ltd* [2013] ZAWCHC 89 para 31.

[456] *Pretorius v PB Meat (Pty) Ltd* [2013] ZAWCHC 89 para 44.

to mount a response to the allegations levelled against them. Their application for access to the additional documents was consequently dismissed.[457]

As may be seen from the application of the requirements of section 50(1) of the Promotion of Access to Information Act 2 of 2000 in *Pretorius v PB Meat (Pty) Ltd*[458] the requirements to access information of a company are specific and must be strictly complied with. Importantly, a director must explain the relevance of each document on which he intends to rely, and show that the documents requested would assist him in a meaningful way to respond, in his presentation to the board of directors, to the allegations levelled against him.

Directors may also have a common law right to inspect the books and records of a company. A court has a discretion whether or not to grant the request to inspect the books and records of the company.[459] Although the court in *Pretorius v PB Meat (Pty) Ltd*[460] did not discuss in any detail the common law right of inspection given to directors, the court appeared to have exercised its discretion against the directors' request for inspection on the basis that their request had been made for an improper purpose.[461] The common law of right of inspection of the books and records of a company enables a director to perform his duties as a director and to fulfil his duties for the benefit of the company.[462] Since the books and records of a company are a primary source of information on the state of affairs of a company, it follows that unless a director has access to these sources of information, he would be inhibited in the proper performance of his duties.[463] These duties include the protection of the interests of the company

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[457] *Pretorius v PB Meat (Pty) Ltd* [2013] ZAWCHC 89 para 46. For a discussion of this case and the right of directors to inspect the books and records of a company see R Cassim "Contesting the Removal of a Director by the Board of Directors under the Companies Act" 133-159.

[458] [2013] ZAWCHC 89.

[459] Blackman et al *Commentary on the Companies Act* 8-26.

[460] [2013] ZAWCHC 89.

[461] See *Pretorius v PB Meat (Pty) Ltd* [2013] ZAWCHC 89 para 27 where the court found that that the directors' request for documentation was not for the purpose of exercising their powers and performing their functions in the best interests of the company but was for the purpose of protecting themselves as individual directors. The court held that the directors wished to exercise their powers not for the benefit of the company, as they had claimed, but for their own benefit (para 27).

[462] *Conway v Petronius Clothing Co Ltd* [1978] 1 All ER 185 at 201-202; *Wuu Khek Chiang George v ECRC Land Pte Ltd* [1999] 3 SLR 65 para 33; *Oxford Legal Group Ltd v Sibbasbridge Services Ltd* [2008] EWCA Civ 387 para 23.

[463] *Wuu Khek Chiang George v ECRC Land Pte Ltd* [1999] 3 SLR 65 para 33.

and its shareholders.[464] If a director were to invoke the right to inspect the books and records of a company for a purpose other than that of carrying out his duties as a director, this would constitute an improper purpose.[465]

With regard to whether a court would exercise its discretion to permit a director who is about to be removed from the board of directors, to inspect the books of a company, in *Conway v Petronius Clothing Co Ltd*[466] the Chancery Division asserted that where there is no reason to suppose that a director is about to be removed from office, the discretion to withhold an order for inspection would be exercised very sparingly. In other words, where a director is about to be removed from office, a court may exercise its discretion to withhold an order of inspection. The court however did not make a prospective vote of removal an absolute bar to an inspection order. Each case must depend on its own special facts.[467] The court commented further that it is conceivable that in particular circumstances, a court may consider it essential for the protection of the company or the personal protection of the director that he be allowed to inspect the company's books notwithstanding his impending removal from office.[468]

Prentice has criticised the legal principle laid down by the court in *Conway v Petronius Clothing Co Ltd*[469] and has questioned whether a prospective removal of a director should indeed be allowed to curtail his right of inspection.[470] Prentice contends that a prospective vote to remove a director from office should be ignored when a court exercises its discretion whether to grant an order for inspection of the company's books because "often[,] it may be nothing more than a tactical move by wrongdoers to stifle a conscientious director".[471] Moreover, as Prentice points out, it may well be the case that a director would be able to show that the order of inspection is necessary for the protection of the company only after he has perused its

[464] *Oxford Legal Group Ltd v Sibbasbridge Services Ltd* [2008] EWCA Civ 387 para 33.

[465] *Oxford Legal Group Ltd v Sibbasbridge Services Ltd* [2008] EWCA Civ 387 para 23.

[466] [1978] 1 All ER 185 at 201.

[467] *Conway v Petronius Clothing Co Ltd* [1978] 1 All ER 185 at 202.

[468] *Conway v Petronius Clothing Co Ltd* [1978] 1 All ER 185 at 202.

[469] [1978] 1 All ER 185.

[470] Prentice "A Director's Right of Access to Corporate Books of Account" 186.

[471] Prentice "A Director's Right of Access to Corporate Books of Account" 186.

books.[472] It is submitted that in exercising its discretion to grant an order of inspection under the common law, a court must carefully consider whether a prospective vote of removal of a director is indeed a tactical manoeuvre to stifle a conscientious director.[473] A court must not be too hasty in refusing access to the company's records to a director whose removal has been proposed by the board of directors.[474]

8.5 Procedures in Australia, the UK and the USA in Removing Directors

The Australian Corporations Act of 2001 does not address the procedure for the board of directors to remove a fellow board member of a private company. As discussed, the board of directors of a public company is prohibited from removing fellow board members, while the board of directors of a private company may remove a fellow board member only if authorised to do by the constitution of a company.[475] Section 203D of the Australian Corporations Act of 2001 sets out the procedure for the removal of a director of a public company by the shareholders of the company but does not address the procedure for the shareholders to remove a director of a private company nor for the board of directors to remove a fellow board member from office. Presumably, the procedure for the board of directors to remove a director of a private company would be set out in the constitution of the company. The procedure would therefore vary from company to company.

As is the position under the Australian Corporations Act of 2001, the UK Companies Act of 2006 does not deal with the procedure for the board of directors to remove a director from office. Section 168 of the UK Companies Act of 2006 only regulates the procedure that must be followed if the shareholders are to remove a director from office. As discussed, the UK Companies Act of 2006 does not make provision for the board of directors to remove a fellow board member from office but the articles of association of both public and private companies

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[472] Prentice "A Director's Right of Access to Corporate Books of Account" 186.

[473] R Cassim "Contesting the Removal of a Director by the Board of Directors under the Companies Act" 149-150.

[474] See further *Conway v Petronius Clothing Co Ltd* [1978] 1 All ER 185 at 201 and Blackman et al *Commentary on the Companies Act* 8-26 for a discussion on the common law right of a director to inspect the books and records of a company.

[475] See ss 203E and 203C of the Australian Corporations Act of 2001 and para 2.2 above where this is discussed.

in the UK may make provision for the board of directors to remove fellow board members.[476] Presumably, the articles of association of a UK company would address the procedure for the board of directors to remove a fellow board member. As is the case in Australia, such procedures would vary from company to company.

Some statutes of the States in the USA that permit the board of directors to remove directors from office do not prescribe the procedure to do so at all.[477] Other statutes do so to a limited extent only. For instance, section 351.317 of the Missouri General Business Corporation Law states that notice of the proposed removal must be given to all directors of the corporation prior to the removal of the director. Section 8.08(e) of the Massachusetts Business Corporation Act and section 48-18-108(e) of the Tennessee Business Corporation Act both state that a director may be removed by the directors only at a meeting called for the purpose of removing the director, and that the notice of the meeting must state that the purpose or one of the purposes of the meeting is the removal of a director. These statutes do not deal with other aspects of the meeting or whether the impugned director may be given a hearing and an opportunity to make oral or written representations to the board before the removal vote is taken.

It seems, however, that under the USA common law due process must nevertheless be followed. For example, in *Costello v Thomas Cusack*[478] the New Jersey Court of Chancery voided a proposed amendment to the articles of incorporation authorising "immediate" removal of a director for cause on the basis that in proceedings to remove a director the board must act judicially. The court held that the board is without power to remove a director for cause without giving him a hearing with reasonable opportunity to prepare.[479] In *Bruch v National Guarantee Credit Corp*[480] the Delaware Court of Chancery stated as follows:

> "It is contended that under the statute of this state and the articles of incorporation and by-laws of this defendant corporation, the board of directors have the power to remove a

[476] See para 2.3 above where this is discussed.

[477] For example, s 706 of the New York Business Corporation Law, s 7-1.2-805 of the Rhode Island Business Corporation Act and s 14A:6:6 of the New Jersey Business Corporation Act do not address the procedure to remove a director from office.

[478] 124A 615 (N.J. Ch. 1922) at 618.

[479] *Costello v Thomas Cusack* 124A 615 (N.J. Ch. 1922) at 618.

[480] 116 Atl 738 (Ch.1922) at 741.

> director for cause. If this be conceded, it cannot be successfully contended that such power may be exercised in an arbitrary manner. The accused director would be entitled to be heard in his own defense. There was no pretence, in this case, of according to Callans an opportunity to be heard in opposition to the proposal that he be removed from his office of director."

Generally, in the USA, if the removal of the director is for cause, notice of the charges and an opportunity to the director to defend himself must be given.[481] In *State v Adams*[482] the Supreme Court of Missouri remarked that when the power to remove directors of a corporation is exercised the matter must be decided judicially and fairly. The court stated further that it is essential that charges be made and that the director to be removed is notified of his proposed removal from office and that he is given a full opportunity for defence.[483] In *Alliance Co-op. Ins Co. v Gasche*[484] the Supreme Court of Kansas likewise stated that a director of a corporation could not be removed without notice and an opportunity to be heard, in the absence of a specific provision covering the matter.

Section 71(4) of the (South African) Companies Act regulates in more detail the procedures for the board of directors to remove a director from office compared to the equivalent procedures in the Australian Corporations Act of 2001, the UK Companies Act of 2006 and the statutes of the various USA States that permit the board of directors to remove directors. The prescribed procedures in the (South African) Companies Act are clear, binding on all companies and standardised for all companies (save to the extent that the notice period for board meetings varies for each company and to the extent that the Memorandum of Incorporation of a company alters the alterable provisions relating to the threshold for passing board resolutions and the quorum for board meetings).

8.6 Failure to Comply with Procedural Requirements to Remove a Director

The question arises whether a director who is removed by the board of directors under procedures that are defective is entitled to be reinstated to the board of directors. The removed

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[481] See *Campbell v Loew's Inc*. 134 A.2d 852 (1957) at 859-860.

[482] 44 Mo 570 (1869) at 585-586.

[483] *State v Adams* 44 Mo 570 (1869) at 585-586.

[484] 142 P.882 (1914) at 882.

director or any person who appointed that director as contemplated in section 66(4)(*a*)(i) of the Companies Act is entitled, in terms of section 71(5) of the Companies Act, to apply to a court, within twenty business days of the decision, to review the determination of the board of directors.[485]

It does not follow that a court would inevitably reinstate a director or award compensation in instances where the procedures followed to remove a director from office are defective.[486] For instance, in *Minister of Defence and Military Veterans v Motau and Others*[487] even though the Constitutional Court found that the actions of the Minister of Defence and Military Veterans in removing two directors from the board of Armscor had been unlawful because of the failure of the Minister to comply with section 71(2) of the Companies Act, it nevertheless ruled that the two board members were not to be reinstated to the board of Armscor. The Constitutional Court stated that while the setting aside of the Minister's decision and the reinstatement of the directors or an award of compensation would usually follow from a finding that a dismissal was procedurally defective, the exceptional circumstances of the case meant that it would not be just and equitable for it to award such remedies in this case.[488] The court asserted that despite the procedural defects of her decision, the Minister had substantively good and compelling reasons for terminating the membership of the two board members,[489] who were aware of the Minister's dissatisfaction with their conduct.[490] It found further that the relationship between the Minister and the two board members who had been removed from office had disintegrated irreparably.[491] The Constitutional Court ruled that a declaration would be sufficient to address the flaws in the Minister's conduct and to draw the attention of the Minister to the importance of complying with the Companies Act and of adopting a fair process in making such decisions.[492]

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[485] Section 71(5) of the Companies Act is discussed further in chapter 4, para 4.1 and chapter 7, para 2.

[486] The orders that a court may make under a s 71(5) review are discussed further in chapter 7, para 2.2.

[487] 2014 (5) SA 69 (CC).

[488] *Minister of Defence and Military Veterans v Motau and Others* 2014 (5) SA 69 (CC) para 86.

[489] *Minister of Defence and Military Veterans v Motau and Others* 2014 (5) SA 69 (CC) para 89.

[490] *Minister of Defence and Military Veterans v Motau and Others* 2014 (5) SA 69 (CC) para 87.

[491] *Minister of Defence and Military Veterans v Motau and Others* 2014 (5) SA 69 (CC) para 90.

[492] *Minister of Defence and Military Veterans v Motau and Others* 2014 (5) SA 69 (CC) para 86. See chapter 3, para 4.3 where this case is discussed further.

For these reasons, despite the procedural defects in the Minister's decision in removing the two board members from the board of Armscor, the Constitutional Court held that it would be fair and just in the circumstances for the two board members not to be reinstated to the Armscor board.[493] In light of the fact that the procedures set out in section 71(2) of the Companies Act are almost identical to those set out in section 71(4) of the Companies Act, the dictum of the Constitutional Court with regard to the application of the procedures in section 71(2) of the Companies Act would arguably also apply to the application of the procedures in section 71(4) of the Companies Act.

Fletcher comments that even though it is said in the USA that in proceedings to remove a director the board must act judicially,[494] it is well-settled that in proceedings for the removal of a director, the directors are not bound to act with the strict regularity required in judicial proceedings.[495] In *State ex rel. Blackwood v Brast*[496] the Supreme Court of Appeals of West Virginia stated as follows:

> "It is well settled that corporate bodies, in the proceedings taken for the removal of a director, or an officer in a corporation, are not bound to act with strict regularity which obtains in judicial proceedings, but that the courts will limit themselves to inquiring whether they have acted within their powers after giving notice to the accused and affording him opportunity of making his defense, and whether they have exercised their powers fairly and in good faith. All questions beyond this are questions of which the courts have no cognizance."

9. REMOVAL OF A DIRECTOR BY THE COMPANIES TRIBUNAL

If a company has fewer than three directors the board of directors may not remove a director from office and section 71(3) of the Companies Act would not apply to that company.[497] Instead, any director or shareholder may apply to the Companies Tribunal for a determination

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[493] *Minister of Defence and Military Veterans v Motau and Others* 2014 (5) SA 69 (CC) paras 85, 86 and 89.

[494] See for example *Costello v Thomas Cusack* 124A 615 (N.J. Ch. 1922) at 618 where the court stated that in proceedings to remove a director the board must act judicially, and *State v Adams* 44 Mo 570 (1869) at 586 where the court also asserted that when the power to remove directors of a corporation is exercised the matter must be decided judicially.

[495] Fletcher *Fletcher Cyclopedia of the Law of Corporations* § 360.

[496] 127 SE 507 (1925) at 510.

[497] Section 71(8)(*a*) of the Companies Act.

concerning the removal of a director from office.[498] Since a public company, a state-owned company and a non-profit company must have at least three directors on their board of directors,[499] the Companies Tribunal would not determine whether a director may be removed from office in such companies, unless such companies for some reason fail to have the requisite number of directors on their board of directors.[500] The removal of directors of private companies and personal liability companies which have two directors on their board of directors would be determined by the Companies Tribunal.

In any circumstances contemplated in section 71(3) of the Companies Act, that is, where a director has become ineligible or disqualified to be a director, incapacitated, has neglected or has been derelict in the performance of the functions of a director, or has been negligent, a director or a shareholder of the company may apply to the Companies Tribunal for a determination whether the director in question should be removed from office.[501] Sections 71(4), 71(5) and 71(6) of the Companies Act, read with the changes required by the context, would apply to the determination of this matter by the Companies Tribunal.[502] Accordingly, the director concerned must receive notice of the meeting, a copy of the proposed removal resolution and a statement setting out the reasons for the removal resolution with sufficient specificity to reasonably permit him to prepare and present a response. The impugned director must be afforded a reasonable opportunity to make a presentation to the Companies Tribunal,

[498] Section 71(8)(*b*) of the Companies Act. The procedure to file an application for the removal of a director from office is set out in regulations 141-148 of the Companies Regulations, 2011. A Form CTR 142 (Application for Relief) must be filed with the recording officer of the Companies Tribunal together with a supporting affidavit setting out the facts on which the application is based (regulation 142(1)). The applicant must serve a copy of the application and affidavit on the respondent within five business of filing it (regulation 142(2)). If the respondent wishes to oppose the application he must, within twenty business days, serve a copy of an answering affidavit on the applicant (regulation 143(1)). The applicant may reply to the answering affidavit, within fifteen business days (regulation 144(1)). Once the exchange of documents has been completed the Companies Tribunal will set the matter down for hearing (regulation 147(2)). Hearings of the Companies Tribunal are governed by ss 180-184 of the Companies Act. The proceedings must be conducted in accordance with the principles of natural justice, and may be conducted informally (s 180(1)). The Companies Tribunal may direct or summon any person to appear at any specified time and place, may question any person under oath or affirmation, and summon or order any person to produce any document or item necessary for the purposes of the hearing (s 182)). At the conclusion of the proceedings the presiding member must issue a decision together with written reasons for the decision (s 180(3)).

[499] See ss 66(2)(*b*) and 9(1) of the Companies Act and para 4 of chapter 3.

[500] For instance, if the directors of a public company, state-owned company or non-profit company were to resign and only two directors remain on the board of directors pending the appointment of an additional director to the board of directors.

[501] Section 71(8)(*b*) of the Companies Act.

[502] Section 71(8)(*c*) of the Companies Act.

personally or through a representative, before the Companies Tribunal determines the matter.[503] If the Companies Tribunal removes the director from office, the director or a person who appointed that director as contemplated in section 66(4)(*a*)(i) of the Companies Act, may apply to court within twenty business days to review the decision of the Companies Tribunal.[504]

If the Companies Tribunal decides not to remove the director from office then a shareholder with voting rights entitled to be exercised in the election of that director may apply to court to review the decision of the Companies Tribunal.[505] On such an application, the court may confirm the decision of the Companies Tribunal not to remove the director from office or it may decide to remove the director from office if it finds that any of the relevant grounds for the removal of a director under section 71(3) are applicable.[506] It should be noted that section 71(6)(*a*) states that "any director who voted otherwise on the resolution" may apply to court to review the determination by the board not to remove the director in office. If this provision were applied to the removal of a director by the Companies Tribunal, it becomes unclear whether the remaining director in the company (whose removal is not in issue) may apply to court to review the determination of the Companies Tribunal, or whether only a shareholder may do so.[507] This is because the remaining director would not have "voted otherwise on the resolution" because the matter would have been determined by the Companies Tribunal and not by the directors.

In *Talisman Compressed Air (Pty) Ltd v Dykman*[508] the court affirmed the right of a director or a shareholder to apply to the Companies Tribunal to determine whether a director was guilty of neglect or dereliction.[509] The court stated that this right to apply to the Companies Tribunal is "subject to the right of any party, as provided in subsection (6), to review the determination

[503] See s 71(4) of the Companies Act.

[504] See s 71(5) of the Companies Act.

[505] See s 71(6)(*a*) of the Companies Act.

[506] See s 71(6)(*b*) of the Companies Act.

[507] R Cassim "Governance and the Board of Directors" in FHI Cassim et al *Contemporary Company Law* 450.

[508] [2016] JOL 36461 (GNP).

[509] *Talisman Compressed Air (Pty) Ltd v Dykman* [2016] JOL 36461 (GNP) para 17.

by a court of law."[510] The word "any" may be interpreted to indicate that the remaining director of the company may also apply to a court to review the determination of the Companies Tribunal by a court of law. It must be conceded though that whether or not the remaining director may apply to court to review the determination of the Companies Tribunal was not in issue before the court. Undue weight should not therefore be attached to this *obiter dicta* of the court. It is submitted that in light of the fact that section 71(8)(*c*) of the Companies Act states that section 71(6) would apply to the determination of the removal of a director by the Companies Tribunal as "read with the changes required by the context" the remaining director ought to have the right to apply to court to review the determination of the Companies Tribunal in this regard. Clarity is, however, required on this point by either the legislature or the court.

Section 70(2) of the Companies Act states that if the board of a company has removed a director in terms of section 71(3) of the Companies Act a vacancy on the board would not arise until the later of the expiry of the time for filing an application for a review of the board's decision in terms of section 71(5) of the Companies Act (which time period is twenty business days), or the granting of an order by the court on such an application. The director would, however, be suspended from office during that time. The legislature did not impose a similar requirement with regard to the removal of a director by the Companies Tribunal.[511] This may well be an oversight.[512] In the interests of clarity and consistency and to remove any ambiguity, it is submitted that section 70(2) of the Companies Act must be amended to include a reference to a removal of a director by the Companies Tribunal in terms of section 71(8) of the Companies Act.[513]

Section 158(*b*)(i) of the Companies Act requires the Companies Tribunal to promote the "spirit, purpose and objects" of the Companies Act when determining any matter brought before it in terms of the Companies Act or when making an order contemplated in the Companies Act.[514]

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[510] *Talisman Compressed Air (Pty) Ltd v Dykman* [2016] JOL 36461 (GNP) para 17.

[511] Ncube "You're Fired! The Removal of Directors under the Companies Act 71 of 2008" 46.

[512] R Cassim "Contesting the Removal of a Director by the Board of Directors under the Companies Act 154.

[513] See further Ncube "You're Fired! The Removal of Directors under the Companies Act 71 of 2008" 46.

[514] Section 158 also applies to a court which determines any matters brought before it in terms of the Companies Act. Refer to chapter 7, para 1 where s 158 is discussed further.

Some of the relevant purposes of the Companies Act which the Companies Tribunal must consider when deciding whether to remove a director from office, as set out in section 7 of the Companies Act, are the purposes of promoting compliance with the Bill of Rights as provided for in the Constitution, in the application of company law;[515] encouraging transparency,[516] encouraging the efficient and responsible management of companies,[517] balancing the rights and obligations of shareholders and directors within companies,[518] and providing a predictable and effective environment for the efficient regulation of companies.[519] While the purposes of the Companies Act are set out in section 7 of the Companies Act, the "spirit" and "objects" of the Companies Act have not been defined.[520] The *Memorandum on the Objects of the Companies Bill, 2008* may provide some guidance on the objects of the Companies Act. For instance, this document sets out specific objectives and goal statements of the Companies Act, being simplification, flexibility, corporate efficiency, transparency and predictable regulation.[521] Two objectives which may be particularly relevant to the removal of directors by the Companies Tribunal would be that of corporate efficiency and transparency. On the objective of corporate efficiency, the *Memorandum on the Objects of the Companies Bill, 2008* states that there should be clarification of director responsibilities, duties and liabilities, while the objective of transparency provides that company law must ensure the proper recognition of director accountability.[522] These are some of the considerations that must be taken into account by the Companies Tribunal when considering an application to remove a director from office.

[515] Section 7(*a*) of the Companies Act.

[516] Section 7(*b*)(iii) of the Companies Act.

[517] Section 7(*j*) of the Companies Act.

[518] Section 7(*i*) of the Companies Act.

[519] Section 7(*l*) of the Companies Act.

[520] Delport *Henochsberg on the Companies Act 71 of 2008* 550(2).

[521] *Memorandum on the Objects of the Companies Bill, 2008*, Companies Bill [B 61D-2008] para 1.

[522] *Memorandum on the Objects of the Companies Bill, 2008*, Companies Bill [B 61D-2008] para 1.2.4(a).

10. CONCLUSIONS AND RECOMMENDATIONS

Section 71(3) of the Companies Act is unique in that the board's power to remove fellow board members is a mandatory, and not an alterable power.[523] In contrast to the Companies Act, the MBCA and the DGCL do not make any provision for the board of directors to remove a director from office.[524] The approaches in the MBCA and the DGCL represent the most common approaches to the removal of directors in the USA. Most USA States reserve the power to remove a member of the board to the shareholders who elected the director. There are approximately thirteen USA States which empower the board of directors to remove directors in certain circumstances.[525] Of those USA States which have conferred on the board of directors the power to remove fellow board members, the majority of them have made this power alterable and not mandatory, either by providing that the board of directors may remove fellow board members only if empowered to do so by the articles of incorporation or the by-laws, or by providing that the board of directors may remove fellow board members unless the articles of incorporation or the by-laws provide otherwise.[526] Both the UK Companies Act of 2006 and the Australian Corporations Act of 2001 have adopted similar positions with regard to the removal of directors by the board of directors in that the board of directors may remove directors only if empowered to do so by the constitution of the company.[527] It is submitted that there are merits in permitting the board of directors to remove fellow board members, and, provided the board of directors acts transparently and there are acceptable safeguards against abuse of the power to remove fellow board members, this power should remain in the Companies Act.[528]

A further notable respect in which section 71(3) of the Companies Act is unique is that with regard to the removal of directors by the board of directors, the section does not distinguish between the directors appointed by the directors and directors appointed by the shareholders,

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[523] See paras 2.1 and 2.5 above.

[524] See para 2.4 above.

[525] See para 2.4 above.

[526] See para 2.4 above.

[527] See paras 2.2 and 2.3 above.

[528] See para 2.5 above.

nor does it make any provision to protect the shareholder representatives, or the minority shareholder representatives, on the board of directors from removal by the board of directors.[529] Accordingly the board of directors is empowered to remove any director from office, regardless of who appointed that director.[530] In contrast, the corporation laws of those USA States which permit directors to remove fellow board members distinguish between directors who were appointed by the board of directors and those who were appointed by the shareholders, and contain provisions designed to protect minority shareholder representatives on the board from removal by the board of directors.[531]

It was argued in this chapter that the board of directors should be empowered to remove any director from office, including those directors appointed by the shareholders or a third party in terms of section 66(4)(*a*)(i) of the Companies Act.[532] It was argued further that the power to remove directors in section 71(3) of the Companies Act should be an alterable power rather than a mandatory power.[533] More specifically, the provision should be an "opt-out" provision, in that the board's power to remove a director should apply unless the company opts out of it by expressly so stipulating.[534] It is submitted that section 71(3) of the Companies Act should be preceded by the words "Except to the extent that the company's Memorandum of Incorporation provides otherwise."[535] The company would then be empowered to determine whether it wishes to retain the default provision under the Companies Act empowering the board of directors to remove fellow board members or whether to alter this default provision to suit its particular needs by negating, restricting, limiting, qualifying, or extending the board's power to remove fellow board members. If section 71(3) of the Companies Act were an alterable provision a company would further be empowered to insert in section 71(3) of the Companies Act provisions to protect the minority shareholder representatives on the board of directors, should this be deemed necessary based on the specific needs and requirements of the

[529] See para 3 above.

[530] See para 3 above.

[531] See para 3 above.

[532] See para 3 above.

[533] See para 3 above.

[534] See para 3 above.

[535] See paras 3 and 6.5 above.

company.[536] It is submitted that if section 71(3) of the Companies Act were an alterable provision in the Companies Act it would also bring the provision in line with the equivalent provisions in the foreign jurisdictions considered which do not make the board's power to remove fellow board members compulsory, and which incorporate some protection for minority shareholder representatives on the board of directors.[537] An alterable power of removal conferred on the board of directors, as opposed to a compulsory power of removal, would also go some way in satisfying the purpose of section 7(*i*) of the Companies Act of balancing the rights and obligations of shareholders and directors within companies.[538]

Other suggestions to strengthen and improve the provisions on the removal of a director in the Companies Act are as follows:

- Section 69(6) of the Companies Act, which provides that the Memorandum of Incorporation of a company may impose additional grounds of ineligibility or disqualification or minimum qualifications to be met by directors of a company, must specify that any additional grounds of ineligibility or disqualification or additional minimum qualifications must be reasonable as applied to the company and must be lawful.[539]

- Section 71(3)(*a*) of the Companies Act, which provides that a director may be removed by the board of directors if he is ineligible or disqualified to be a director, must contain provisions guarding against this ground being used for improper purposes, such as a means to remove directors from office who do not meet any new ground of ineligibility or disqualification or a new qualification requirement which is introduced during their term of office. It is submitted that section 69(6) must incorporate a requirement which guards against the misuse of the timing of the qualification requirements by providing that a new ground of ineligibility or disqualification or a new minimum qualification

[536] See para 3 above.

[537] See para 3 above.

[538] See para 3 above.

[539] See para 6.1.2.3 above.

prescribed during a director's term shall not apply to that director before the end of that director's term.[540]

- It would be too disruptive to the running of a company's business and its affairs if the past acts of an ineligible or disqualified director were not regarded as valid. It is submitted that a provision similar to section 214 of the previous Companies Act 61 of 1973 and section 161 of the UK Companies Act of 2006 should be inserted in the Companies Act, to the effect that the acts of a person acting as a director will be valid notwithstanding that it is afterwards discovered that there was a defect in his appointment or that he was disqualified from holding office.

- The ground of removal of a director on the basis of incapacity, contained in section 71(3)(*a*)(ii) of the Companies Act, must make provision for the input of a registered medical practitioner or a court in assessing whether a director is incapacitated to the extent that he is unable to perform the functions of a director and whether he is incapacitated to the extent that he is unlikely to regain that capacity within a reasonable period of time.[541] This would guard against this ground of removal being improperly applied where the board of directors is not properly qualified to make the relevant incapacity assessment.[542] It would also guard against this ground of removal being abused where conflicts arise between the directors, and, furthermore, would bring section 71(3)(*a*)(ii) in line with the equivalent provisions in the foreign jurisdictions considered.[543]

- In light of the fact that the functions of a director vary depending on the type of company of which he is a director, the type of director he is, and the nature of the company's business, a subjective standard of assessment must be imposed in sections 71(3)(*a*)(ii) and 71(3)(*b*) of the Companies Act, instead of an objective standard.[544] A subjective standard would furthermore result in there being consistency between

[540] See para 6.1.2.3 above.

[541] See para 6.2.4 above.

[542] See para 6.2.4 above.

[543] See para 6.2.4 above.

[544] See para 6.3.1 above.

sections 71(3)(*b*) and section 162(5)(*c*)(iv)(*aa*) of the Companies Act, which imposes a subjective standard in ascertaining whether a director is delinquent.[545] It is essential that there be consistency between these two provisions since the right of removal of a director is in addition to the right of a person to apply to a court in terms of section 162 for an order declaring a director delinquent.[546] It is submitted that sections 71(3)(*a*)(ii) and 71(3)(*b*) should read as follows:

> "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) ...
>
> (ii) incapacitated to the extent that the director is unable to perform the ~~functions of a director~~director's functions within the company, and is unlikely to regain that capacity within a reasonable time, as assessed by a registered medical practitioner or by a court; or
>
> *(b)* has neglected, or been derelict in the performance of, ~~the functions of director~~the director's functions within the company,"[547]

- Clarity must be provided on whether the ground of negligence is an additional ground for the removal of a director by the board of directors, or whether the legislature inadvertently confused the terms "neglect" and "negligent" by referring to the term "negligent" in sections 71(3), 71(5), 71(6)(*a*) and 71(6)(*b*)(ii) but omitting to refer to the term "neglect" in these provisions.[548]

- Clarity must be provided on whether the grounds for the removal of a director by the board of directors are limited to those grounds set out in section 71(3) of the Companies Act or whether additional grounds of removal may explicitly be provided by a company

[545] See para 6.3.1 above.

[546] See para 6.3.1 above.

[547] See para 6.3.1 above.

[548] See para 6.4 above.

in its Memorandum of Incorporation.[549] If section 71(3) of the Companies Act were to be an alterable provision, as suggested, a company would clearly be entitled to extend the grounds for the removal of a director by the board of directors in order to suit its particular needs.[550]

The Companies Act is much clearer with regard to the procedures for the board of directors to remove fellow board members than the equivalent procedures in those USA States which permit the removal of directors by board members, the Australian Corporations Act of 2001 and the UK Companies Act of 2006.[551] There is nevertheless room to improve the procedures for the removal of directors by the board of directors under the Companies Act. The following submissions are made in this regard:

- In the interests of clarity and to avoid any ambiguity or controversy regarding the notice period to be given to a director who is to be removed from office, and to ensure that the notice period is fair and reasonable, it is submitted that section 71(4)(*a*) of the Companies Act should provide that a director must receive notice of the board meeting which is at least equivalent to the notice period of any board meeting.[552]

- It is submitted that, in the interests of both clarity and certainty, section 71(4)(*b*) of the Companies Act should make explicit provision for the right of a director to make written representations to the board meeting, which must be circulated to the board members prior to the board meeting.[553] This would remove any uncertainty whether a director is entitled to make written representations to the board meeting or whether the "presentation" referred to in section 71(4)(*b*) of the Companies Act is confined to an oral presentation.[554] In order to ensure that the option of circulating written representations is not abused, it is suggested that, in accordance with section 203D(6)

[549] See para 6.5 above.

[550] See paras 3 and 6.5 above.

[551] See para 8.5 above.

[552] See para 8.2 above.

[553] See para 8.4 above.

[554] See para 8.4 above.

of the Australian Corporations Act of 2001, the written representations need not be circulated if they exceed one thousand words or if they are defamatory. It is submitted further that, as was the case under the Companies Act 61 of 1973, in addition to the right to make written representations, a director should also be entitled to make a verbal presentation to the board meeting, in person or through a representative, before the resolution is put to the vote. Since the written representations would be circulated to the board of directors only (and not to the shareholders) the costs thereof could easily be borne by the director concerned.

A challenge a director may face with regard to the presentation is that he would not be entitled to receive detailed reasons for his proposed removal if the allegations made against him are simple and uncomplicated.[555] This may make it difficult for him to respond in detail, in his presentation, to the statement of reasons for his proposed removal, which the board of directors must give to him in terms of section 71(4)(*a*) of the Companies Act. A director moreover does not have a statutory right to access the books and records of a company.[556] Such access would assist a director in his presentation to respond to the statement of reasons provided to him for his proposed removal from office.[557] In order to access such books and records a director would have to rely on the common law or on section 50 of the Promotion of Access to Information Act 2 of 2000, which has specific and stringent requirements that must be satisfied.[558]

It is noteworthy that the Companies Act does not specify whether the removal of a director by a person named in or determined in terms of the Memorandum of Incorporation, pursuant to section 66(4)(*a*)(i), must be carried out in accordance with the procedures specified in section 71(2) applicable to the removal of directors by the shareholders or in accordance with the procedures specified in section 71(4) applicable to the removal of a director by the directors. In fact, it does not specify whether any procedural requirements are statutorily required to be complied with if a person named in or determined in terms of the Memorandum of Incorporation removes a director from office. Presumably the Memorandum of Incorporation of a company which empowers a specific person to appoint and remove a director would set

[555] See para 8.3 above.

[556] See para 8.4 above.

[557] See para 8.4 above.

[558] See para 8.4 above where these requirements are discussed.

out fair procedural requirements to remove such a director, but there is nothing compelling a company to make provision for such procedures in its Memorandum of Incorporation.

In the interests of clarity and certainty, it is submitted that the Companies Act must clearly state that the removal of a director by a person named in or determined in terms of the Memorandum of Incorporation, pursuant to section 66(4)(*a*)(i) of the Companies Act, must follow a fair procedure. These procedural requirements would presumably differ from those set out in sections 71(2) and 71(4) of the Companies Act because an ordinary resolution or a board resolution for the removal of a director would not be applicable since the director would have been appointed by the specific person named in the Memorandum of Incorporation. Nevertheless it is submitted that the director in question must at least be provided with the reasons for his removal from office by the person who appointed him, as well as a reasonable opportunity to make a presentation to such person before the decision to remove him is taken.

Regarding the removal of a director by the Companies Tribunal in circumstances where a company has two directors, it must be clarified whether the remaining director may apply to court to review the determination of the Companies Tribunal where the Companies Tribunal has decided not to remove the impugned director from office, or whether only a shareholder may do so.[559] It is further suggested that, in the interests of clarity and consistency and to remove any ambiguity, section 70(2) of the Companies Act must be amended to include a reference to a removal of a director by the Companies Tribunal in terms of section 71(8) of the Companies Act.[560] This amendment would have the effect that if the Companies Tribunal has removed a director from office in terms of section 71(8) of the Companies Act, a vacancy on the board would not arise until the later of the expiry of the time for filing an application for a review of the decision of the Companies Tribunal, or the granting of an order by the court on such an application, and that the director in question would be suspended from office during that time.[561]

[559] See para 9 above.

[560] See para 9 above.

[561] See para 9 above.

CHAPTER 4 DIRECTORS' FIDUCIARY DUTIES AND THE REMOVAL OF DIRECTORS

1. **INTRODUCTION**
2. **APPLICATION OF FIDUCIARY DUTIES IN THE REMOVAL OF DIRECTORS BY SHAREHOLDERS AND BY THE BOARD OF DIRECTORS**
3. **FIDUCIARY DUTIES OF DIRECTORS WHEN REMOVING A DIRECTOR FROM OFFICE**
4. **CONSEQUENCES OF A BREACH OF FIDUCIARY DUTY IN REMOVING A DIRECTOR FROM OFFICE**
5. **CONCLUSIONS AND RECOMMENDATIONS**

1. INTRODUCTION

The relationship between a director and his company is one of the well-established examples of commercial fiduciary relationships accepted in South African law.[1] The fiduciary duties of directors are derived from the Companies Act as well as the common law. Section 76 of the Companies Act, which partially codifies the fiduciary duties of directors, does not exclude the common law. Accordingly, the common law fiduciary duties of directors that are not expressly amended by section 76 of the Companies Act or those that are not in conflict with section 76 of the Companies Act are still applicable.[2] This chapter examines the fiduciary duties of directors which apply when the board removes a director from office under section 71(3) of the Companies Act. The discussion of directors' fiduciary duties in this chapter is restricted to

[1] See Havenga "Breach of Directors' Fiduciary Duties: Liability on what Basis" 366; *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168; *S v De Jager and Another* 1965 (2) SA 616 (A); *S v Hepker* 1973 (1) SA 472 (W) at 475; *Bellairs v Hodnett and Another* 1978 (1) SA 1109 (A); *Atlas Organic Fertilizers (Pty) Ltd v Pikkewyn Ghwano (Pty) Ltd and Others* 1981 (2) SA 173 (T); *Sibex Construction (SA) (Pty) Ltd v Injectaseal CC & Others* 1988 (2) SA 54 (T); *Howard v Herrigel & Another NNO* 1991 (2) SA 660 (A) at 678; *Da Silva and Others v CH Chemicals (Pty) Ltd* 2008 (6) SA 620 (SCA); *Omar v Inhouse Venue Technical Management (Pty) Ltd and Others* 2015 (3) SA 146 (WCC) paras 59-61; *Mthimunye-Bakoro v Petroleum and Oil Corporation of South Africa (SOC) Ltd and Another* 2015 (6) SA 338 (WCC).

[2] *Mthimunye-Bakoro v Petroleum and Oil Corporation of South Africa (SOC) Ltd and Another* 2015 (6) SA 338 (WCC) para 61; *Omar v Inhouse Venue Technical Management (Pty) Ltd and Others* 2015 (3) SA 146 (WCC) para 61; *CDH Invest NV v Petrotank South Africa (Pty) Ltd and Another* [2018] 1 All SA 450 (GJ) para 61; Delport *Henochsberg on the Companies Act 71 of 2008* 295; FHI Cassim "The Duties and the Liability of Directors" in FHI Cassim et al *Contemporary Company Law* 547; Havenga "Directors' Exploitation of Corporate Opportunities and the Companies Act 71 of 2008" 262; Delport *New Entrepreneurial Law* 145; Esser & Havenga "Directors and Other Officers" in Loubser & Mahony *Company Secretarial Practice* 8-19 and 8-21.

the application of the principles in situations where directors are removed from office. The consequences of directors breaching their fiduciary duties in removing a director from office under section 71(3) of the Companies Act are also considered.

2. APPLICATION OF FIDUCIARY DUTIES IN THE REMOVAL OF DIRECTORS BY SHAREHOLDERS AND BY THE BOARD OF DIRECTORS

The right of shareholders to vote is a proprietary right.[3] As Lord Jessel MR in *Pender v Lushington*[4] expressed it, a shareholder "has a right to say, whether I vote with the majority or with the minority, you shall record my vote; that is a right of property belonging to my interest in this company, and if you will not, I shall institute legal proceedings to compel you. It seems to me that such an action could be maintained, without any technical difficulty." It follows, the court proclaimed, that if a shareholder votes in a manner that is adverse to the interests of the company as a whole, he cannot on that ground be restrained from giving his vote in whatever way he pleases.[5]

The difference between voting by shareholders and voting by directors was concisely enunciated by Walton J in *Northern Counties Securities Ltd v Jackson & Steeple Ltd*[6] as follows:

> "When a director votes as a director for or against any particular resolution in a directors' meeting, he is voting as a person under a fiduciary duty to the company for the proposition that the company should take a certain course of action. When a shareholder is voting for or against a particular resolution he is voting as a person owing no fiduciary duty to the company who is exercising his own right of property to vote as he thinks fit. The fact that the result of the voting at the meeting (or a subsequent poll) will bind the company cannot affect the position that in voting he is voting simply as an exercise of his own property rights. Perhaps another (and simpler) way of putting the matter is that a director is an agent, who casts his vote to decide in what manner his principal shall act through the collective

[3] *Pender v Lushington* (1877) 46 ChD 317 at 321; *Re HR Harmer Ltd* [1959] 1 WLR 62 at 82; *Sammel and Others v President Brand Gold Mining Co Ltd* 1969 (3) SA 629 (A) at 680; *Kuwait Asia Bank EC v National Mutual Life Nominees Ltd* [1991] 1 AC 187 (PC) at 221. In *Desai and Others v Greyridge Investments (Pty) Ltd* 1974 (1) SA 509 (A) at 519 the Appellate Division emphasised that a shareholder's right to vote, being a proprietary right of his shareholding, can ordinarily be exercised by him in any way he pleases.

[4] (1877) 46 ChD 317 at 321.

[5] *Pender v Lushington* (1877) 46 ChD 317 at 319. See also *Sammel and Others v President Brand Gold Mining Co Ltd* 1969 (3) SA 629 (A) at 680 and *CDH Invest NV v Petrotank South Africa (Pty) Ltd and Another* [2018] 1 All SA 450 (GJ) para 44.

[6] [1974] 2 All ER 625 at 635.

> agency of the board of directors; a shareholder who casts his vote in general meeting is not casting it as an agent of the company in any shape or form. His act, therefore, in voting as he pleases cannot in any way be regarded as an act of the company."

It follows that when the shareholders of a company vote to remove a director from office under section 71(1) of the Companies Act, they may exercise their vote in any way they please. A resolution by the shareholders to remove a director from office may not be impeached on the ground that it was not passed in good faith or in the interests of the company.[7] In contrast, when the board of directors exercises the power to remove a director from office it must not breach its fiduciary duties to the company.[8] In *Murray v Conseco Inc*[9] the Supreme Court of Indiana differentiated between the removal of directors by the shareholders, and the removal of directors by the board of directors by proclaiming that shareholders may validly remove a director for any reason or for no reason at all or for a reason grounded solely in their own perceived interests, but removal by directors "is another story".

3. FIDUCIARY DUTIES OF DIRECTORS WHEN REMOVING A DIRECTOR FROM OFFICE

The specific fiduciary duties which apply to the removal of a director by the board of directors are discussed below.

3.1 The Duty to Act in Good Faith and the Duty to Act in the Best Interests of the Company

Under section 76(3)(*a*) of the Companies Act directors must exercise their powers and perform their functions as directors in good faith. Section 76(3)(*b*) of the Companies Act provides that directors have a duty to exercise their powers and perform their functions in the best interests of the company. It was affirmed by the Supreme Court of Appeal in *Da Silva and Others v CH*

[7] Blackman et al *Commentary on the Companies Act* 8-285.

[8] *Murray v Conseco Inc.* 795 N.E.2d 454 (Ind. 2003) at 461; *Liwszyc & Anor v Smolarek & Ors* [2005] ACSR 38 at 47; *Jackson v Dear* 2013 WL 617163 para 3.

[9] 795 N.E.2d 454 (Ind. 2003) at 461.

Chemicals (Pty) Ltd[10] that the duty of directors to exercise their powers in good faith and in the best interests of the company is a well-established duty under the common law. This is the overarching and paramount fiduciary duty of directors from which all the other fiduciary duties flow.[11] Directors owe the duty to act in the best interests of the company to the company as a whole, being the collective body of shareholders, and not to individual shareholders.[12] In *Minister of Water Affairs and Forestry v Stilfontein Gold Mining Co Ltd*[13] the court lucidly enunciated this duty as follows:

> "At all material times the second to fifth respondents [the directors] were under a duty to act *bona fide* in the interests of the first respondent [the company]. This is the fundamental duty which qualifies the exercise of any powers which the directors in fact have. The 'interests' in this context, are only those of the company itself as a corporate entity and those of its members as a body."

The duty of good faith is a subjective duty.[14] As laid down in *Re Smith & Fawcett Ltd*[15] directors are bound to exercise the powers conferred upon them *bona fide* in what they, and not what a court may, consider is in the interests of the company.[16] It is not for the courts to review the merits of a decision that the directors arrived at in honesty.[17] While the test for good faith is subjective, and not objective, there must nevertheless be reasonable grounds for the directors'

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[10] 2008 (6) SA 620 (SCA) para 18. For a discussion of this decision see MF Cassim "*Da Silva v Ch Chemicals (Pty) Ltd*: Fiduciary Duties of Resigning Directors" 61-70 and R Cassim "Post-Resignation Duties of Directors: The Application of the Fiduciary Duty not to Misappropriate Corporate Opportunities" 731-753.

[11] *Fisheries Development Corporation of SA Ltd v Jorgensen; Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd* 1980 (4) SA 156 (W) at 163; *Liwszyc and Another v Smolarek and Others* (2005) 55 ACSR 38 at 46; *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd and Others* 2014 (5) SA 179 (WCC) para 80; *CDH Invest NV v Petrotank South Africa (Pty) Ltd and Another* [2018] 1 All SA 450 (GJ) para 47; Havenga *Fiduciary Duties of Company Directors with Specific Regard to Corporate Opportunities* (Unpublished LLD Thesis) 332; Havenga "Directors' Fiduciary Duties under our Future Company-Law Regime" 311-312; FHI Cassim "The Duties and the Liability of Directors" in FHI Cassim et al *Contemporary Company Law* 523.

[12] *Parke v The Daily News Ltd and Others* [1962] 2 All ER 929 at 948; *South African Fabrics Ltd v Millman NO and Another* 1972 (4) SA 592 (A); *Minister of Water Affairs and Forestry v Stilfontein Gold Mining Co Ltd* 2006 (5) SA 333 (W) para 16.6.

[13] 2006 (5) SA 333 (W) para 16.6.

[14] *Shuttleworth v Cox Brothers & Co (Maidenhead) Ltd* [1927] 2 KB 9; *Re Smith & Fawcett Ltd* [1942] Ch 304 at 306; *Hogg v Cramphorn Ltd* [1967] Ch 254; *Regentcrest plc (in liquidation) v Cohen* [2001] 2 BCLC 80 at 105; *Extrasure Travel Insurances Ltd v Scattergood* [2003] 1 BCLC 598 (ChD) at 618-619; *Liwszyc and Another v Smolarek and Others* (2005) 55 ACSR 38 at 46-47; *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd and Others* 2014 (5) SA 179 (WCC) para 74.

[15] [1942] Ch 304 at 306.

[16] See also *Regentcrest plc (in liquidation) v Cohen* [2001] 2 BCLC 80 at 105.

[17] *Hogg v Cramphorn Ltd* [1967] Ch 254.

belief that they were acting in the best interests of the company.[18] These duties are owed to the company by both executive and non-executive directors.[19]

In *Murray v Conseco Inc.*[20] the Supreme Court of Indiana proclaimed that by empowering directors to remove board members, the Indiana Business Corporation Law did not exempt directors from the standards applicable to them in the action they take, and that directors are indeed obliged to act in the interests of the corporation in removing a board member from office. In *Liwszyc & Anor v Smolarek & Ors*[21] the Supreme Court of Western Australia likewise held that in appointing directors and removing them from office, the directors must exercise their powers as directors in good faith and in accordance with their fiduciary responsibilities. In a similar vein in *Jackson v Dear*[22] the UK Court of Appeal remarked that when exercising the power to remove a board member from office the directors must act in good faith in the interests of the company, and in accordance with all the directors' fiduciary duties to the company.

Based on the above, one may state that when the board of directors votes to remove a director from office under section 71(3) of the Companies Act, it must do so in good faith and in the best interests of the company. Even though the test for good faith may be subjective, there must be reasonable grounds for a director's belief that in voting to remove another director from office, he is acting in the best interests of the company. In the assessment of the duty to exercise their powers *bona fide* in the best interests of the company, a court will determine the propriety of the motive upon which the directors acted.[23] Therefore if a director removes a fellow board member under section 71(3) of the Companies Act with ulterior motives he will be in breach of his fiduciary duty to the company to act in good faith and in the best interests of the company.

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[18] *Shuttleworth v Cox Brothers & Co (Maidenhead) Ltd* [1927] 2 KB 9; *Regentcrest plc (in liquidation) v Cohen* [2001] 2 BCLC 80 at 105; *Extrasure Travel Insurances Ltd v Scattergood* [2003] 1 BCLC 598 (ChD) at 618-619; *Liwszyc and Another v Smolarek and Others* (2005) 55 ACSR 38 at 46-47; *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd and Others* 2014 (5) SA 179 (WCC) para 74.

[19] *Howard v Herrigel NNO* 1991 (2) SA 660 (A) at 678.

[20] 795 N.E.2d 454 (Ind. 2003) at 461.

[21] [2005] ACSR 38 at 47.

[22] 2013 WL 617163 para 33. The facts of this case are discussed in chapter 3, para 2.3.

[23] Havenga *Fiduciary Duties of Company Directors with Specific Regard to Corporate Opportunities* (Unpublished LLD Thesis) 333.

3.2 The Duty to Exercise Powers for a Proper Purpose

Section 76(3)(*a*) of the Companies Act not only states that directors must act in good faith, but also that they must exercise their powers and perform their functions for a proper purpose. This duty is also a common law duty. "Proper purpose" has not been defined in the Companies Act but at common law it is taken to mean that directors must exercise their powers for the objective purpose for which the power was given to them, and not for a collateral or ulterior purpose.[24] While the duty of good faith is subjective,[25] the test for proper purpose is objective.[26]

Where there are dual purposes for the exercise of a power, the court must determine what the dominant or primary purpose was. If the dominant purpose is found to be improper, the exercise of the power will be in breach of the fiduciary duty to act with a proper purpose, and will be regarded as voidable.[27] Directors breach the duty to act for a proper purpose when their dominant or primary purpose is not to further the interests of the company.[28] Where a director's dominant or primary purpose was improper, he will have acted in breach of his fiduciary duty notwithstanding that he acted also for other purposes which were proper.[29]

In *Extrasure Travel Insurances Ltd v Scattergood*[30] the Chancery Division laid down the following four-part test to be applied by a court in ascertaining whether directors had acted for a proper purpose:

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[24] See FHI Cassim "The Duties and the Liability of Directors" in FHI Cassim et al *Contemporary Company Law* 525.

[25] *Shuttleworth v Cox Brothers & Co (Maidenhead) Ltd* [1927] 2 KB 9; *Re Smith & Fawcett Ltd* [1942] Ch 304 at 306; *Hogg v Cramphorn Ltd* [1967] Ch 254; *Regentcrest plc (in liquidation) v Cohen* [2001] 2 BCLC 80 at 105; *Extrasure Travel Insurances Ltd v Scattergood* [2003] 1 BCLC 598 (ChD) at 618-619; *Liwszyc and Another v Smolarek and Others* (2005) 55 ACSR 38 at 46-47; *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd and Others* 2014 (5) SA 179 (WCC) para 74.

[26] *Extrasure Travel Insurances Ltd v Scattergood* [2003] 1 BCLC 598 (ChD) at 619; *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd and Others* 2014 (5) SA 179 (WCC) para 80.

[27] *Mills and Others v Mills and Others* (1938) CLR 150 (HC of A) at 165 and 186; *Hogg v Cramphorn Ltd* [1967] Ch 254; *Lindgren and Others v L&P Estates Ltd* [1968] Ch 572 (CA); *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821 (PC) at 835; *Whitehouse and Another v Carlton Hotel Proprietary Limited* (1987) 162 CLR 285.

[28] Blackman et al *Commentary on the Companies Act* 8-66.

[29] *Hogg v Cramphorn Ltd* [1967] Ch 25; *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821 (PC).

[30] [2003] 1 BCLC 598 (ChD) at 619.

- The court must identify the power the exercise of which is in question;
- The court must identify the proper purpose for which the power was delegated to the directors;
- The court must identify the substantial purpose for which the power was in fact exercised; and
- The court must decide whether the purpose was proper.

In *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd and Others*[31] the Western Cape Division, Cape Town appears to have adopted this test to some extent, by stating that in applying the test to ascertain whether directors had acted for a proper purpose, once one has ascertained the actual purpose for which the power was exercised, it must be determined whether the actual purpose falls within the purpose for which the power was conferred.[32]

In *Extrasure Travel Insurances Ltd v Scattergood*[33] the Chancery Division noted that the third stage of the proper purpose test involves a question of fact, and turns on the motives of the directors at the time. Directors' powers may not be exercised for an ulterior or improper

[31] 2014 (5) SA 179 (WCC) para 80. The facts of this case are that Visser Sitrus (Pty) Ltd sought to transfer its shares in Goede Hoop Sitrus (Pty) Ltd to Mouton Sitrus. The board of Goede Hoop Sitrus (Pty) Ltd refused to approve the transfer. Visser Sitrus (Pty) Ltd consequently approached the High Court for an order amending the provisions of the Memorandum of Incorporation of Goede Hoop Sitrus (Pty) Ltd which permitted the board to decline to register a transfer of shares without giving any reasons. Visser Sitrus (Pty) Ltd furthermore sought an order compelling Goede Hoop Sitrus (Pty) Ltd to register the transfer of shares in terms of s 163 of the Companies Act. It argued that the refusal of the board to do so without any cogent reason constituted oppressive and unfairly prejudicial conduct (para 29). It based its claim under s 163 on the alleged breach by the directors of Goede Hoop Sitrus (Pty) Ltd of its fiduciary duties under s 76 of the Companies Act of acting for a proper purpose and in the best interests of the company (para 52). The Western Cape Division, Cape Town held that the restrictions in the Memorandum of Incorporation of Goede Hoop Sitrus (Pty) Ltd on the transfer of shares were common restrictions and were not prohibited by the Companies Act (paras 44 and 48). It found that the directors of Goede Hoop Sitrus (Pty) Ltd had acted in the best interests of the company by refusing to register the transfer of shares (para 82) and had acted for a proper purpose (para 84). Its actual purpose in refusing the transfer of the shares had been to prevent Mouton Sitrus increasing its shareholding (to above ten per cent) on the ground that this was against the best interests of the company (para 82). On the basis that the directors had complied with their fiduciary duties the court ruled that the refusal to approve the transfer of shares was not unlawful (para 95). The court held further that the refusal was not unfairly prejudicial to Visser Sitrus (Pty) Ltd under s 163 of the Companies Act since it had not established an informal arrangement which invariably allowed shareholders to transfer their shares to other shareholders, nor had it proven a legitimate expectation that the directors of Goede Hoop Sitrus (Pty) Ltd would not exercise their power to refuse a transfer of shares (para 96). Moreover, the court held, there was no authority of a shareholder obtaining relief under an oppression or unfair prejudice remedy in circumstances where the directors had exercised their power to refuse a transfer of shares in accordance with their fiduciary duties (para 96). The application was consequently dismissed.

[32] See further *Cook: Geoffrey v Hesber Impala (Pty) Ltd and Others* (2014/45832) [2016] ZAGPJHC 23 (19 February 2016) paras 47-48 where the Gauteng Local Division, Johannesburg agreed with and applied this test.

[33] [2003] 1 BCLC 598 (ChD) at 619.

purpose or motive, even if such act falls within the scope of the directors' powers.[34] As the High Court of Australia in *Whitehouse and Another v Carlton Hotel Proprietary Limited*[35] proclaimed, "the exercise of a power for an ulterior or impermissible purpose is bad notwithstanding that the motives of the donee of the power in so exercising it are substantially altruistic."[36]

It is submitted that the purpose of the power given to directors under section 71(3) of the Companies Act to remove a director from office is to empower the board of directors to remove from office a director whom it has determined to be ineligible, disqualified, incapacitated, neglectful, negligent[37] or derelict. It follows that a director must vote for or against the removal of a director for this purpose only, and not for an ulterior purpose. In voting on a removal resolution a director must consider whether, objectively, the impugned director has contravened any of the grounds stipulated in section 71(3) of the Companies Act. If a director has more than one purpose in voting in favour of the removal of a director, he will have breached his fiduciary duty if the dominant or substantial purpose is improper, even if his other purposes were proper.

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[34] *Piercy v Mills* [1920] 1 Ch 77; *Mears* v *African Platinum Mines* 1922 WLD 57 at 61; *S v Berliner* 1966 (4) SA 535 (W) at 536; *Hogg v Cramphorn Ltd* [1967] Ch 254 at 268-269; Havenga *Fiduciary Duties of Company Directors with Specific Regard to Corporate Opportunities* (Unpublished LLD Thesis) 341.

[35] (1987) 162 CLR 285 para 9.

[36] An example in this regard given by the court in *Whitehouse and Another v Carlton Hotel Proprietary Limited* (1987) 162 CLR 285 (para 9) emanates from the case of *Fraser v Whalley* (1864) 2 Hem & M 10, where the directors had allotted shares for the purpose of diluting the voting power of a contractor whom they believed to have conflicting interests in other companies. The court held that the directors' belief that they were acting in the interests of the company did not serve to overcome the invalidity of the allotment.

[37] As discussed in chapter 3, para 6.4 "negligence" has not been listed as a ground for the removal of a director in s 71(3) of the Companies Act. It is not clear whether "negligence" is an additional statutory ground which a shareholder or director may invoke for the removal of a director, or whether the legislature confused the terms "neglect" and "negligent" and intended to use the term "neglectful" in ss 71(3), 71(5), 71(6)(*a*) and 71(6)(*b*)(ii) of the Companies Act instead of the term "negligence". For the purposes of this thesis "negligence" is treated as an additional statutory ground which a shareholder or a director may invoke for the removal of a director. Refer to the discussion in chapter 3, para 6.4 on this point.

3.3 The Duty to Exercise an Unfettered Discretion

A further fiduciary duty of directors under the common law is to exercise an unfettered discretion, or conversely, a duty to exercise an independent judgment.[38] This duty, as a general rule, prohibits directors from contracting, undertaking or otherwise agreeing in advance to exercise their discretionary powers in a particular way.[39] This duty is not explicitly referred to in the Companies Act. It is regarded as being an aspect of the duty of a director to act in the best interests of the company.[40] In contrast, section 173(1) of the UK Companies Act of 2006 states expressly, as a separate duty, that a "director of a company must exercise an independent judgment."

In deciding what is in the best interests of the company, directors have a duty to consider the affairs of the company in an unbiased and objective manner, and to exercise an independent and unfettered discretion.[41] The duty to exercise an unfettered discretion is a critical element in the proper and effective discharge of a director's functions generally.[42] In fettering their discretion, directors might in effect be preventing themselves from ensuring that they act *bona fide* in the best interests of the company.[43] As was mentioned above,[44] in the assessment of the duty to exercise their powers *bona fide* in the best interests of the company a court will

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[38] *Fisheries Development Corporation of SA Ltd v Jorgensen; Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd* 1980 (4) SA 156 (W) at 163; *Mthimunye-Bakoro v Petroleum and Oil Corporation of South Africa (SOC) Ltd and Another* 2015 (6) SA 338 (WCC) at 340.

[39] *Kregor v Hollins* (1913) 109 LT 225 (CA); *Boulting and Another v Association of Cinematography, Television and Allied Technicians* [1963] 1 All ER 716; *Fisheries Development Corporation of SA Ltd v Jorgensen; Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd* 1980 (4) SA 156 (W) at 163; *John Crowther Group plc v Carpets International plc* [1990] BCLC 460; *Fulham Football Club Ltd v Cabra Estates Plc* [1992] B.C.C. 863; *Regentcrest plc (in liquidation) v Cohen* [2001] 2 BCLC 80. See further Keay "The Duty of Directors to Exercise Independent Judgment" 290-296 and Courtney "Fettering Director's Discretion" 227-236.

[40] FHI Cassim "The Duties and the Liability of Directors" in FHI Cassim et al *Contemporary Company Law* 529 and 532. See also Keay "The Duty of Directors to Exercise Independent Judgment" 290; Kershaw *Company Law in Context* 356 and Birds et al *Boyle and Birds' Company Law* 610.

[41] *Kregor v Hollins* (1913) 109 LT 225 (CA); Havenga *Fiduciary Duties of Company Directors with Specific Regard to Corporate Opportunities* (Unpublished LLD Thesis) 334; FHI Cassim "The Duties and the Liability of Directors" in FHI Cassim et al *Contemporary Company Law* 528.

[42] Keay "The Duty of Directors to Exercise Independent Judgment" 293.

[43] Keay "The Duty of Directors to Exercise Independent Judgment" 292.

[44] See para 3.1 above.

determine the propriety of the motive upon which the directors acted.[45] It consequently is imperative that directors consider the proposed removal of a director in an unbiased manner, and that they exercise an independent and unfettered discretion in voting on the resolution to remove a director from office.

To sum up, when the board of directors votes to remove a director from office under section 71(3) of the Companies Act, it must do so in good faith and for a proper purpose, and in the best interests of the company. Each director on the board must consider the proposed removal of a director in an unbiased manner, and must exercise an independent unfettered discretion in voting on the board resolution to remove a director.

3.4 Application of Fiduciary Duties in Voting Against the Removal of a Director from Office

It is submitted that the duty of a director to comply with his fiduciary duties when voting in favour of a resolution to remove a director also applies when the director votes against the resolution to remove a director. As discussed in chapter 3,[46] in light of the words "may remove a director" in section 71(3) of the Companies Act, the board of directors has a discretion whether or not to remove a director whom it has found to be incapacitated, or who has neglected or has been derelict in the performance of his functions, or who has been negligent. If the board of directors decides not to remove such a director from office, the board runs the risk of being in breach of its fiduciary duty to take decisions in the best interests of the company.

If a board member were to take steps to obstruct the removal of a director who has breached the provisions of section 71(3) of the Companies Act, the board member would be in breach of his fiduciary duties to act in good faith and for a proper purpose and to act in the best interests of the company. An obligation which seeks to fetter the exercise by directors of their fiduciary duties in the future is unenforceable as a matter of law.[47] It follows that an agreement amongst two directors to vote in a particular way in the future would not be enforced by a court because

[45] Havenga *Fiduciary Duties of Company Directors with Specific Regard to Corporate Opportunities* (Unpublished LLD Thesis) 333.

[46] See chapter 3, para 7.

[47] Courtney "Fettering Director's Discretion" 233.

such an agreement would infringe the fiduciary duty of directors to exercise an independent judgment and not to fetter their discretion.[48] This is so even if there is no improper motive or personal advantage gained by the directors under the agreement.[49] Accordingly, an agreement under which two or more directors undertake to vote against the removal of the other director so as to frustrate a threshold for the removal resolution, would not be valid or enforceable. The effect of such a voting agreement would be that the directors concerned would be disabling themselves from acting honestly in what they believe to be in the best interests of the company.[50]

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[48] *Fisheries Development Corporation of SA Ltd v Jorgensen; Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd* 1980 (4) SA 156 (W) at 163.

[49] Davies & Worthington *Gower Principles of Modern Company Law* 499.

[50] FHI Cassim "The Duties and the Liability of Directors" in FHI Cassim et al *Contemporary Company Law* 529. It should be noted however that when the entire board of directors enters into an agreement binding itself on how to vote in the future such an agreement may be acceptable. For instance, in the leading UK case *Fulham Football Club Ltd v Cabra Estates Plc* [1992] B.C.C. 863 a football club and its directors leased a football ground, and, in return for a considerable payment they contracted with the landlords of the ground that they would not oppose any future application to the planning authorities which the landlords may make for its development for residential purposes. At a later stage as a result of changed circumstances, the directors wished to renege on this agreement. The landlords argued that the directors were still bound to support their application. The directors contended that the undertakings given by them were an unlawful fetter on their ability to act in the best interests of the company in the future. The UK Court of Appeal rejected the contention that the board of directors (as a whole) may never bind themselves as to the future exercise of their fiduciary powers (at 876). The board of directors was binding itself under a commercial contract which had conferred benefits on the company and which at the time the board had honestly believed to be in the best interests of the company. The UK Court of Appeal stated (at 875) as follows:

> "It is trite law that directors are under a duty to act bona fide in the interest of their company. However, it does not follow from that proposition that directors can never make a contract by which they bind themselves to the future exercise of their powers in a particular manner, even though the contract taken as a whole is manifestly for the benefit of the company. Such a rule could well prevent companies from entering into contracts which were commercially beneficial to them."

In making this finding, the UK Court of Appeal in *Fulham Football Club Ltd v Cabra Estates Plc* [1992] B.C.C. 863 relied heavily on and drew support from the decision of the Australian High Court in *Thorby v Goldberg* (1964) 112 CLR 597. In this case it was contended that an agreement was illegal or otherwise void because it purported to bind the directors of a company with regard to the exercise of their powers and duties in the future. Kitto J proclaimed that if at the time when a transaction is being entered into the directors are *bona fide* of the opinion that it is in the interests of the company that the transaction should be entered into and carried into effect, there is no reason in law why the directors should not bind themselves to do whatever under the transaction is to be done by the board (at 605-606). It is therefore important to distinguish between agreements entered into by an individual director from agreements entered into by the board of directors as a whole. When the board of directors enters into an agreement for consideration it may be presumed that the company may legitimately fetter its future conduct in return for whatever contractual benefit it is entitled to receive (Courtney "Fettering Directors' Discretion" 228. See further Griffiths "The Best Interests of Fulham F.C.: Directors' Fiduciary Duties in Giving Contractual Undertakings" 576-585). The legal principle laid down in *Fulham Football Club Ltd v Cabra Estates Plc* [1992] B.C.C. 863 is now encapsulated in s 173(2)(a) of the UK Companies Act of 2006 which expressly provides that the duty to exercise an independent judgment is not infringed by a director acting "in accordance with an agreement duly entered into by the company that restricts the future exercise of discretion by its directors."

4. CONSEQUENCES OF A BREACH OF FIDUCIARY DUTY IN REMOVING A DIRECTOR FROM OFFICE

4.1 Reinstatement of the Improperly Removed Director

An important question that arises when directors remove a fellow board member in breach of their fiduciary duties, is whether a court may reinstate the improperly removed director to the board of directors.

In the pivotal UK case of *Lee v Chou Wen Hsien*[51] the court did not reinstate a director who had been wrongly removed by the board of directors in breach of their fiduciary duties. The Privy Council ruled that while each director that concurs in the removal of a director must act in accordance with what he believes to be in the best interests of the company, it does not follow that a director sought to be removed would continue to remain a director simply because one or more of the directors had acted from an ulterior motive in removing that director.[52] Surprisingly, even though the Privy Council found that the board of directors had acted with ulterior motives in removing the appellant from the board of directors, and had not acted to protect the best interests of the company, it nevertheless held that the removal from office of the director was valid. The Privy Council proclaimed as follows:

> "To hold that bad faith on the part of any one director vitiates the notice to resign and leaves in office the director whose resignation is sought, would introduce into the management of the company a source of uncertainty which their Lordships consider is unlikely to have been intended by the signatories to the articles and by others becoming shareholders in the company. In order to give business sense to article 73(d),[53] it is necessary to construe the article strictly in accordance with its terms without any qualification, and to treat the office of director as vacated if the specified event occurs. If this were not the case, and the expelled director challenged the bona fides of all or any of his co-directors, the management of the company's business might be at a standstill pending the resolution of the dispute by one means or another, in consequence of the doubt whether the expelled director ought or ought not properly to be treated as a member of the board."[54]

[51] [1984] 1 WLR 1202.

[52] *Lee v Chou Wen Hsien* [1984] 1 WLR 1202 at 1206.

[53] Article 73(*d*) of the company's articles of association stated that the office of a director shall be vacated if he is requested in writing by all his co-directors to resign.

[54] *Lee v Chou Wen Hsien* [1984] 1 WLR 1202 at 1206-1207.

In essence, the Privy Council reasoned that, in order to avoid uncertainty in the management of the company pending the resolution of the dispute, it was necessary to hold that bad faith on the part of any one director in removing a fellow board member would not vitiate the removal and would not leave in office the director whose removal was sought.

In *Murray v Conseco Inc*[55] Murray, a director who had been removed from office, contended that the board's action in removing him from office was grounded in improper motives. Murray contended that his removal from the board of directors had come about because he had wanted to pursue litigation, contrary to the views of the board of directors, against certain third parties whom he claimed were responsible for the company's well-publicised financial difficulties. The Court of Appeals of Indiana asserted that Murray's argument that he may have been removed from the board for an improper reason was irrelevant for purposes of determining whether he had been properly removed, and did not create a material issue of fact in the case.[56] The Court of Appeals accordingly held that Murray did not have any cause of action to be reinstated on the board of directors.[57] On appeal, the Supreme Court of Indiana, in affirming the decision of the Court of Appeals not to reinstate Murray to the board of directors, found that Murray had not presented any claims that the board of directors had not acted in good faith in removing him from office or that the board had acted other than in the exercise of its judgment as to the corporation's interests.[58] This resulted in rendering as *obiter dictum* the decision of the court *a quo*.

Section 5(2) of the (South African) Companies Act provides that a court interpreting or applying the Companies Act may consider foreign law to the extent that this is appropriate. On the basis of section 5(2) the dicta in *Lee v Chou Wen Hsien*[59] and *Murray v Conseco Inc*[60] may have persuasive authority in South African company law. This implies that a director who has

[55] 766 N.E.2d 38 (Ind. Ct. App. 2002).

[56] *Murray v Conseco Inc* 766 N.E.2d 38 (Ind. Ct. App. 2002) at 46.

[57] *Murray v Conseco Inc* 766 N.E.2d 38 (Ind. Ct. App. 2002) at 46.

[58] *Murray v Conseco Inc*. 795 N.E.2d 454 (Ind. 2003) at 461.

[59] [1984] 1 WLR 1202.

[60] 766 N.E.2d 38 (Ind. Ct. App. 2002).

been removed from office by the board of directors in breach of its fiduciary duties would not necessarily or automatically be reinstated to the board of directors.

It is, however, submitted that the circumstances of the removal of the director in *Lee v Chou Wen Hsien*[61] and *Murray v Conseco Inc*[62] may be distinguished from the circumstances of the removal of directors in terms of section 71(3) of the (South African) Companies Act in two respects. The first is that removal of a director by the board of directors in these cases did not have to be for cause.[63] In *Lee v Chou Wen Hsien*[64] the director was removed from office by the board of directors under article 73*(d)* of the company's articles of association which stated that the office of a director shall be vacated if "he is requested in writing by all his co-directors to resign". It was clear from this article that the board did not have to give any reason for removing a director. A director could simply have been removed from office without cause. Similarly, in *Murray v Conseco Inc*[65] the relevant provision under which Murray had been removed, section 23-1-33-8(a) of the Indiana Business Corporation Law, permitted directors to remove one or more directors without cause, unless the articles of incorporation provided otherwise. In sharp contrast, under section 71(3) of the Companies Act, the board of directors may not remove directors without cause, but may do so only under one of the grounds stipulated in the section. It is submitted that if a director may be removed by the board of directors without cause, the motives for the removal would not be as pertinent compared to the case where a director must be removed for cause. In circumstances where a director must be removed for cause, the motives for his removal become crucial in determining whether the board of directors had complied with its fiduciary duties in removing the director from office.

The second distinction is that under section 71(3) of the Companies Act a challenge by a director to his removal would not result in the management of the company coming to a standstill, which was of significant concern to the Privy Council in *Lee v Chou Wen Hsien*.[66]

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[61] [1984] 1 WLR 1202.

[62] 766 N.E.2d 38 (Ind. Ct. App. 2002).

[63] The concept of "cause" in the context of the removal of a director from office is discussed in chapter 3, para 6.5.

[64] [1984] 1 WLR 1202.

[65] 766 N.E.2d 38 (Ind. Ct. App. 2002).

[66] [1984] 1 WLR 1202.

As discussed, in *Lee v Chou Wen Hsien*[67] the Privy Council reasoned that it was necessary to hold that bad faith on the part of any one director would not vitiate the notice to vacate office and to leave in office the director whose removal was sought, in order to avoid uncertainty in the management of the company pending the resolution of the dispute "in consequence of the doubt whether the expelled director ought or ought not properly to be treated as a member of the board." In contrast, it is submitted that under the (South African) Companies Act this concern is overcome by the provisions of sections 71(5) and 70(2) of the Companies Act, discussed below.

Section 71(5) of the Companies Act provides that if a director has been removed from office by the board of directors he may within twenty business days apply to a court to review the board's determination.[68] The period of twenty business days places a cap on the amount of time given to a director to contend that he had been removed from office by the board of directors in breach of the directors' fiduciary duties. In order to overcome the uncertainty whether the expelled director is to be treated as a board member during the period of twenty business days following his removal or pending the resolution of the dispute by the court, section 70(2) of the Companies Act states that if the board of directors has removed a director under section 71(3) of the Companies Act a vacancy on the board would not arise until the later of the expiry of the time for filing an application for review in terms of section 71(5) (that is, twenty business days) or the granting of an order by the court on such an application, but the director would be suspended from office during this time. If the director were suspended during the applicable twenty business day period and during the time taken by a court to rule on an application for review in terms of section 71(5) of the Companies Act, the director would clearly not be regarded as being a board member pending the resolution of the dispute. Accordingly the management of the company would not be at a standstill pending the resolution of the dispute. There would not be any doubt whether the expelled director is to be treated as a member of the board of directors.

[67] [1984] 1 WLR 1202 at 1207.

[68] Alternatively, in terms of s 71(5) of the Companies Act, a person who appointed that director in terms of s 66(4)(*a*)(i) may apply to a court within twenty business days to review the determination of the board. If the board of directors has removed a director from office in breach of its fiduciary duties, this would be a relevant factor that a court would likely consider under a review in terms of s 71(5) of the Companies Act. The provisions of s 71(5) of the Companies Act are discussed further in chapter 7, para 2.

It is consequently submitted that the concern in *Lee v Chou Wen Hsien*[69] that the management of the company would come to a standstill if the ulterior motives of the board of directors in removing a fellow board member were to be taken into account, is not a concern with regard to the removal of a director under South African law. On this basis and on the basis that the director's removal under section 71(3) of the Companies Act must be for cause, it is submitted that, contrary to the decision of the respective courts in *Lee v Chou Wen Hsien*,[70] and *Murray v Conseco Inc*,[71] a decision to remove a director under section 71(3) of the Companies Act in breach of the fiduciary duties of the directors must be set aside by a court, and the improperly removed director must be reinstated to the board of directors, if it is appropriate to do so in the circumstances.

It must be stressed that in *Minister of Defence and Military Veterans v Motau and Others*[72] the Constitutional Court did not order the reinstatement of the two directors who had been removed by the Minister of Defence and Military Veterans from the board of directors in circumstances where the removal by the Minister had been procedurally defective. However, the circumstances surrounding the removal of the directors in this case are distinguishable from the removal of a director by the board of directors which is in breach of its fiduciary duties. As discussed earlier,[73] the Constitutional Court in this case proclaimed that while the setting aside of the Minister's decision and the reinstatement of the directors or an award of compensation would usually follow from a finding that a dismissal of directors was procedurally defective, the exceptional circumstances of the case meant that it would not be just and equitable for it to award such remedies in this case.[74] The court found that the relationship between the Minister and the two board members in question had disintegrated irreparably, and that there had been substantively good and compelling reasons for the Minister to remove the two directors from office.[75] It is submitted that the vital difference between removing a director without following

[69] [1984] 1 WLR 1202.

[70] [1984] 1 WLR 1202.

[71] 766 N.E.2d 38 (Ind. Ct. App. 2002).

[72] 2014 (5) SA 69 (CC).

[73] See chapter 3, paras 4.3 and 8.6 for a discussion of this case.

[74] *Minister of Defence and Military Veterans v Motau and Others* 2014 (5) SA 69 (CC) para 86.

[75] *Minister of Defence and Military Veterans v Motau and Others* 2014 (5) SA 69 (CC) para 89.

the proper procedures to do so, and removing a director from office in breach of the fiduciary duties of the directors, is that in the former case there may well be valid substantive reasons to remove the director (as was the case in *Minister of Defence and Military Veterans v Motau and Others*)[76] while in the latter case the director may be removed without there being any substantive basis for his removal. As was stated above,[77] section 71(3) of the Companies Act requires a director to be removed from office on the basis of one of the grounds set out in that section. If the board of directors removes a director from office in breach of its fiduciary duties, without one of these grounds being applicable, it would be very difficult to justify not reinstating the improperly removed director.

As discussed above,[78] the duty of directors to comply with their fiduciary obligations when removing a director from office would also apply when the board of directors decides not to remove a director from office. If the board of directors, in breach of its fiduciary duties, voted *not* to remove from office a director who has contravened one of the grounds set out in section 71(3) of the Companies Act, any director who voted in favour of the removal or any holder of voting rights entitled to be exercised in the election of that director, may apply to court to review the board's determination.[79] The court may either confirm the determination of the board not to remove the director from office or it may itself remove the director from office if it is satisfied that the director is ineligible or disqualified, incapacitated, or has been negligent or derelict.[80] Notably, section 71(6) of the Companies Act does not impose a time limit within which a director or a shareholder may apply to court to review the board's determination not to remove a fellow board member. Even though there would be no uncertainty whether the director in question were a board member because the board would simply regard him as being a member since it did not remove him from office, it is submitted that there must nevertheless be a time bar within which a director or a shareholder may apply to court to review the board's determination not to remove the director from office, so as to bring the matter to a finality. For

[76] 2014 (5) SA 69 (CC).

[77] See chapter 3, para 6 for a discussion of the grounds for the removal of a director by the board of directors under s 71(3) of the Companies Act.

[78] See para 3.4 above.

[79] Section 71(6) of the Companies Act.

[80] Section 71(6)(*b*) of the Companies Act. An applicant in terms of s 71(6) must compensate the company and any other party for costs incurred in relation to the application unless the court reverses the decision of the board of directors (s 71(7) of the Companies Act). Sections 71(6) and 71(7) are discussed in chapter 6, para 2.

the sake of consistency with section 71(5) of the Companies Act, it is submitted that a time limit of twenty business days should be imposed in section 71(6) within which a director or a shareholder may apply to court to review the board's determination not to remove a director from office.[81]

4.2 Liability Under Section 77(2) of the Companies Act

A further consequence of removing a director from office (or in not removing a director from office) in breach of the fiduciary duties of directors is that under section 77(2) of the Companies Act a director on the board of directors may be held liable in accordance with the principles of the common law relating to a breach of a fiduciary duty for any loss, damages or costs sustained by the company as a consequence of the breach by the director of a duty contemplated in sections 76(3)(*a*) (the duty to act in good faith and for a proper purpose) or 76(3)(*b*) (the duty to act in the best interests of the company). Notably, section 77(2)(*a*) of the Companies Act explicitly preserves the common law principles with regard to establishing the liability of directors for a breach of their fiduciary duties. Section 77(2) of the Companies Act applies to alternate directors as well.[82]

The duties referred to in section 77(2) are owed to the company, and consequently it is the company that must proceed against the offending directors.[83] It is accordingly important to note that section 77(2) of the Companies Act applies to any loss, damages or costs sustained by the *company* as a consequence of any breach by the director of a duty contemplated in section 76, and not to any loss, damages or costs sustained by the improperly removed director or by a third party.[84]

A director who removes a fellow board member in breach of his fiduciary duties contained in sections 76(3)(*a*) or 76(3)(*b*) would not be able to escape liability under section 77(2) of the

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[81] This is discussed further in chapter 6, para 2.3.

[82] See s 77(1) of the Companies Act. An alternate director is a person elected or appointed to serve, as the occasion requires, as a member of the board of a company in substitution for a particular elected or appointed director of that company (s 1 of the Companies Act).

[83] FHI Cassim "The Duties and the Liability of Directors" in FHI Cassim et al *Contemporary Company Law* 584.

[84] See also *Sanlam Capital Markets (Pty) Ltd v Mettle Manco (Pty) Ltd and Others* [2014] 3 All SA 454 (GJ) para 41 and *Blue Farm Fashion Limited v Rapitrade 6 (Pty) Ltd and Others* [2016] JOL 35613 (WCC) paras 11-12.

Companies Act. This is because section 78(2) of the Companies Act renders void any provision in a company's Memorandum of Incorporation or rules or in any agreement or resolution of a company (whether express or implied) to the extent that it directly or indirectly purports to relieve a director of a duty contemplated in section 76 of the Companies Act or a liability contemplated in section 77 of the Companies Act.

In terms of section 77(9) of the Companies Act, in any proceedings against a director, other than for wilful misconduct or wilful breach of trust, a court may relieve the director, either wholly or partly, from any liability set out in section 77 of the Companies Act, on any terms it considers just if it appears to the court that the director is or may be liable, but acted honestly and reasonably, or, having regard to all the circumstances of the case, it would be fair to excuse the director. A director who has reason to think that a claim may be made alleging that he is liable, other than for wilful misconduct or wilful breach of trust, may apply to a court for relief in terms of section 77(10) of the Companies Act and the court may grant relief to the director on the same grounds as if the matter had come before the court in terms of section 77(9) of the Companies Act.[85]

It is not clear whether section 77(9) applies only to proceedings between the company and directors or whether it also applies to proceedings between a director and a third party. In *Ex parte Lebowa Development Corporation Ltd*[86] the court held that section 248 of the Companies Act 61 of 1973,[87] the predecessor to section 77(9) of the Companies Act, did not empower a

[85] In *AWA Ltd v Daniels t/a Deloitte Haskins & Sells and Others* (1992) 7 ACSR 759 the Supreme Court of New South Wales stated that s 1318 of the Australian Corporations Act of 2001, which is the equivalent provision to s 77(9) of the Companies Act, is designed to protect honest directors and ought not to be construed in a narrow sense (at 855). For this reason, the court held that a court may grant relief from liability for damages for breach of contract under this provision.

[86] 1989 (3) SA 71 (T) at 107.

[87] Section 248 of the Companies Act 61 of 1973 empowered a court to excuse a director being sued for negligence, default, breach of duty or breach of trust from liability where he had acted honestly and reasonably, and having regard to all the circumstances of the case, he ought fairly to be excused for the negligence, default, breach of duty or breach of trust. There are some differences between s 248 of the Companies Act 61 of 1973 and s 77(9) of the Companies Act. One difference is that under s 248 of the Companies Act 61 of 1973 it had to be proved that a director had acted honestly and reasonably, *and* that, having regard to all the circumstances of the case, he ought fairly to be excused, whereas under s 77(9) of the Companies Act only one of these requirements needs to be fulfilled. FHI Cassim contends that s 77(9) of the Companies Act ought preferably to be read in the same way as s 248 of the Companies Act 61 of 1973 so that a court should refuse to grant relief where, even though the director has acted honestly and reasonably, the circumstances are such that he ought not to be excused (see FHI Cassim "The Duties and the Liability of Directors" in FHI Cassim et al *Contemporary Company Law* 579).

court to grant relief to a director against a claim by a third party such as a creditor of the company, and that the provision applied only to proceedings between the company and its directors. This was the approach adopted in the UK case of *Customs and Excise Commissioners v Hedon Alpha Ltd and Others*[88] on which the court relied. On the one hand section 77(9) of the Companies Act does not qualify the word "proceedings" and it applies in "any proceedings" against a director.[89] On the other hand, section 77(9) of the Companies Act enables a court to relieve a director from "any liability set out in this section", namely section 77 of the Companies Act.[90] In this regard, it appears that section 77(9) would apply only to proceedings between the company and its directors.[91] In this event, section 77(9) of the Companies Act would be of no comfort to a director when faced with a claim made against him personally by a third party. The only relief a director may obtain is relief from liability to the company itself.[92]

In order to rely on sections 77(9) or 77(10) of the Companies Act, a director who has removed a fellow board member in breach of his fiduciary duties would first have to overcome the hurdle of showing that his actions did not constitute wilful misconduct or a wilful breach of trust. Removing a fellow board member in breach of the applicable fiduciary duties and with ulterior motives is dishonest, and may negate any reliance on the provisions of sections 77(9) and 77(10) of the Companies Act. Even if the hurdle of proving that his actions did not constitute wilful misconduct or wilful breach of trust were overcome, a director would either have to demonstrate that he had acted honestly and reasonably, or that having regard to all the circumstances of the case, it would be fair to excuse him. In *Australian Securities and Investments Commission v Macdonald (No 12)*[93] with regard to the meaning of the term "honestly" in section 1318 of the Australian Corporations Act of 2001,[94] which is the

[88] [1981] 2 All ER 697 (CA). Section 248 of the Companies Act 61 of 1973 was worded in exactly the same terms as s 448 of the UK Companies Act of 1948, which was the applicable provision in issue in *Customs and Excise Commissioners v Hedon Alpha Ltd and Others* [1981] 2 All ER 697 (CA).

[89] Delport *Henochsberg on the Companies Act 71 of 2008* 308.

[90] FHI Cassim "The Duties and the Liability of Directors" in FHI Cassim et al *Contemporary Company Law* 580.

[91] FHI Cassim "The Duties and the Liability of Directors" in FHI Cassim et al *Contemporary Company Law* 580.

[92] *Ex parte Lebowa Development Corporation Ltd* 1989 (3) SA 71 (T) at 107.

[93] [2009] NSWSC 714.

[94] Section 1318 of the Australian Corporations Act of 2001 provides as follows: "If, in any civil proceeding against a person to whom this section applies for negligence, default, breach of trust or breach of duty in a capacity as such a person, it appears to the court before which the proceedings are taken that the person is or may be liable in respect of the negligence, default or breach but that the person has acted honestly and that, having regard to all

equivalent provision to section 77(9) of the Companies Act, the New South Wales Supreme Court stated as follows:

> "In my view a person acts honestly for the purposes of . . . Section 1318(1), in the ordinary meaning of that term, if that person's conduct is without moral turpitude in the sense that it is without deceit or conscious impropriety, without intent to gain improper benefit or advantage and without carelessness or imprudence at a level that negates the performance of the duty in question. That conclusion may be drawn from evidence of the person's subjective intent. But a lack of such subjective intent will not lead the Court to conclude that a person has acted honestly if a reasonable person in that position would regard the conduct as exhibiting moral turpitude."[95]

In light of the meaning of the term "honestly" as enunciated in *Australian Securities and Investments Commission v Macdonald (No 12)*,[96] it is submitted that if a director were to remove a fellow board member in breach of his fiduciary duties, his conduct would not be "without moral turpitude" and it would be difficult for him to prove that his actions were honest and reasonable, or even that it would be fair for a court to excuse him for a breach of his fiduciary duties. A court nevertheless has a discretion to grant relief to a director, and may relieve him wholly or partly on any terms the court considers just.

The liability under section 77(2) of the Companies Act is joint and several with that of any other person who is also liable for the same act.[97] Proceedings to recover any loss, damages or costs for which a person may be liable under section 77 of the Companies Act may not be commenced more than three years after the act or omission that gave rise to that liability.[98]

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the circumstances of the case, including those connected with the person's appointment, the person ought fairly to be excused for the negligence, default or breach, the court may relieve the person either wholly or partly from liability on such terms as the court thinks fit."

[95] *Australian Securities and Investments Commission v Macdonald (No 12)* [2009] NSWSC 714 para 22.

[96] [2009] NSWSC 714.

[97] Section 77(6) of the Companies Act.

[98] Section 77(7) of the Companies Act. The three-year prescription period under s 77(7) of the Companies Act commences with the act or omission that gave rise to the liability. In contrast, s 12(3) of the Prescription Act 68 of 1969 provides that a three-year prescription period for the extinction of a debt shall begin to run as soon as the debt is due but that a debt shall not be deemed to be due until the creditor has knowledge of the identity of the debtor and of the facts from which the debt arises. The commencement date of the prescription period in s 77(7) of the Companies Act and the Prescription Act 68 of 1969 are quite different, and it is not clear which would prevail in the event of such a conflict (see Jooste "Corporate Finance" in FHI Cassim et al *Contemporary Company Law* 334.) For a further discussion of the Prescription Act 68 of 1969 see chapter 6, notes 498-501 and 507.

4.3 Liability Under Section 218(2) of the Companies Act

Under section 218(2) of the Companies Act, "any person" who contravenes any provision of the Companies Act is liable to any other person for any loss or damage suffered by that person as a result of that contravention. Section 218(2) of the Companies Act imposes strict liability and applies even if the defendant had innocently contravened the Companies Act, as long as the plaintiff suffered damages or loss as a result of the contravention.[99] The reference to "any person" in section 218(2) of the Companies Act would include a director of a company.[100] As affirmed by the respective courts in *Grancy Property Limited v Gihwala*[101] and *Sanlam Capital Markets (Pty) Ltd v Mettle Manco (Pty) Ltd and Others*,[102] a director who does not comply with the standards of directors' conduct as set out in section 76 of the Companies Act would be liable under section 218(2) of the Companies Act to any person who has suffered a loss in consequence thereof.[103]

Consequently, a director who has breached sections 76(3)(*a*) or 76(3)(*b*) of the Companies Act in removing a fellow board member from office may incur liability to that director, or to any other person, under section 218(2) of the Companies Act, for any loss or damage suffered by the director or third person as a result of the contravention. A third person may be a shareholder or even a creditor who has suffered loss as a result of the contravention.[104] As emphasised by the court in *Rabinowitz v Van Graan and Others*[105] a director may only be held liable under section 218(2) of the Companies Act for loss or damage suffered as a result of a contravention of the Companies Act. It follows that section 218(2) of the Companies Act would not be applicable to a breach of a common law fiduciary duty. However, as discussed earlier, the common law fiduciary duty of exercising an unfettered discretion or an independent judgment, which may be breached if a director were removed from office by the board of directors with

[99] MF Cassim "Enforcement and Regulatory Agencies" in FHI Cassim et al *Contemporary Company Law* 832-833; MM Botha "Responsibilities of Companies towards Employees" 26.

[100] *Grancy Property Limited v Gihwala* 2014 JDR 1292 (WCC) para 104.

[101] 2014 JDR 1292 (WCC) para 104.

[102] [2014] 3 All SA 454 (GJ) para 42.

[103] See also *Blue Farm Fashion Limited v Rapitrade 6 (Pty) Ltd and Others* [2016] JOL 35613 (WCC) para 12 and MM Botha "Responsibilities of Companies towards Employees" 26.

[104] Delport *Henochsberg on the Companies Act 71 of 2008* 639.

[105] 2013 (5) SA 315 (GSJ) para 9.

ulterior motives, is regarded as being an aspect of the duty to act in the best interests of the company, as contained in section 76(3)(*b*) of the Companies Act.[106] Accordingly, it is submitted that if the board of directors breached its fiduciary duty of exercising an unfettered discretion or independent judgment in removing a director from office, the improperly removed director may nevertheless rely on section 218(2) of the Companies Act by relying on a breach of the duty to act in the best interests of the company as contained in section 76(3)(*b*) of the Companies Act.

The plaintiff under a section 218(2) claim must specify which contraventions are attributed to the defendant as well as the exact loss or damage sustained as a result of such contravention.[107] Accordingly, a director who has been improperly removed from office by the board of directors in breach of the directors' fiduciary duties under sections 76(3)(*a*) or 76(3)(*b*) of the Companies Act, may have a claim under section 218(2) for any loss or damage suffered by him as a result of this contravention, but he would have to specify the exact loss or damage sustained as a result of his removal in breach of these provisions. In *Burco Civils CC v Stolz and Another*[108] the High Court opined that to succeed on the basis of section 218(2), it must not only be shown that a person contravened any provision(s) of the Companies Act, and that another person suffered damage, but it must also be shown that the damage suffered was as a result of that contravention. In other words, there must be proof of a causal link or connection between the contravention of the Companies Act, and the debts and liabilities for which the person may be held liable.[109] The three-year prescription period referred to in section 77(7) of the Companies Act does not apply to section 218(2) of the Companies Act. Accordingly prescription under section 218(2) of the Companies Act would be governed by the Prescription Act 68 of 1969.[110]

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[106] See FHI Cassim "The Duties and the Liability of Directors" in FHI Cassim et al *Contemporary Company Law* 529 and 532; Keay "The Duty of Directors to Exercise Independent Judgment" 290; Kershaw *Company Law in Context* 356 and Birds et al *Boyle and Birds' Company Law* 610.

[107] *Rabinowitz v Van Graan and Others* 2013 (5) SA 315 (GSJ) para 11.

[108] [2017] JOL 39331 (GP) para 47.

[109] *Burco Civils CC v Stolz and Another* [2017] JOL 39331 (GP) para 47. See also *Motor Industry Bargaining Council v Botha and Another* (34198/2013) [2016] ZAGPPHC 615 (10 June 2016) para 61 where the High Court stated that the element of causation is required in s 218(2) of the Companies Act.

[110] Jooste "Corporate Finance" in FHI Cassim et al *Contemporary Company Law* 349. The prescription period under the Prescription Act 68 of 1969 for the prescription under s 218(2) of the Companies Act is also three years. The three-year prescription period under the Prescription Act 68 of 1969 begins to run as soon as the debt is due, but a debt is not deemed to be due until the creditor has knowledge of the identity of the debtor and of the facts from which the debt arises (s 12(3) of the Prescription Act 68 of 1969). For a further discussion of the Prescription

5. CONCLUSIONS AND RECOMMENDATIONS

When the board of directors exercises the power to remove a director from office it must comply with its fiduciary duties to the company.[111] In particular, in accordance with sections 76(3)(*a*) and (*b*) of the Companies Act, directors have a duty to act in good faith and for a proper purpose, and in the best interests of the company.[112] Directors must exercise their power to remove a fellow board member under section 71(3) of the Companies Act for the proper purpose for which the power was given to them, and not for a collateral or ulterior purpose.[113] In addition, directors must exercise an unfettered discretion and an independent judgment when removing directors from office.[114] They must consider the proposed resolution to remove a fellow board matter in an unbiased and objective manner.[115] The duty of directors to comply with their fiduciary duties when removing a director from office would also apply when the board of directors decides not to remove a director from office.[116]

It was submitted that, contrary to the dicta in *Lee v Chou Wen Hsien*[117] and *Murray v Conseco Inc*,[118] if the directors remove a fellow director from office under section 71(3) of the Companies Act in breach of their fiduciary duties, the decision must be set aside by a court, and the improperly removed director must be reinstated to the board of directors, if it is appropriate to do so in the circumstances.[119] It was argued that the removal of directors under section 71(3) of the Companies Act is distinguishable from the removal of directors in the

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Act 68 of 1969 see chapter 6, notes 498–501 and 507. See further chapter 6, para 3.3.1.2 for a discussion on s 218(2) of the Companies Act.

[111] See para 2 above.

[112] See para 3.1 above.

[113] See para 3.2 above.

[114] See para 3.3 above.

[115] See para 3.3 above.

[116] See para 3.4 above.

[117] [1984] 1 WLR 1202.

[118] 766 N.E.2d 38 (Ind. Ct. App. 2002).

[119] See para 4.1 above.

circumstances that applied in *Lee v Chou Wen Hsien*[120] and *Murray v Conseco Inc*,[121] in two respects.[122] First, the removals of the directors in these cases did not have to be for cause, and were in fact without cause, whereas the removal of a director under section 71(3) of the Companies Act must be for cause.[123] It follows that under section 71(3) of the Companies Act the fiduciary duties and any ulterior motives of the board of directors in removing a fellow board member are of fundamental importance in assessing the propriety of the removal in order to determine if the removal was indeed for cause.[124] Secondly, it was argued that if a removal of a director by the board of directors in breach of their fiduciary duties were to be challenged by a director, this would not bring the management of a company to a standstill, which was the concern of the Privy Council in *Lee v Chou Wen Hsien*.[125] It was contended that sections 71(5) and 70(2) of the Companies Act overcome this concern because section 71(5) places a limit of twenty business days in which the challenge to the improper removal must be raised, while section 70(2) suspends the removed director from office pending the filing of an application for review or the granting of an order by the court on such an application, whichever is the later.[126]

It was submitted that a further consequence of removing a director from office in breach of the fiduciary duties of directors (or in not removing that director from office) is that under section 77(2) of the Companies Act a director may be held liable in accordance with the principles of the common law relating to a breach of a fiduciary duty for any loss, damages or costs sustained by the company as a consequence of the breach by the director of a duty contemplated in sections 76(3)(*a*) (the duty to act in good faith and for a proper purpose) and 76(3)(*b*) (the duty to act in the best interests of the company).[127] Liability under section 77(2) of the Companies Act is joint and several with that of any other person who is also liable for the same act.[128]

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[120] [1984] 1 WLR 1202.

[121] 766 N.E.2d 38 (Ind. Ct. App. 2002).

[122] See para 4.1 above.

[123] See para 4.1 above.

[124] See para 4.1 above.

[125] [1984] 1 WLR 1202. See para 4.1 above.

[126] See para 4.1 above.

[127] See para 4.2 above.

[128] See para 4.2 above.

Finally, it was contended that a director who has contravened sections 76(3)(*a*) or (*b*) of the Companies Act in removing a fellow board member from office would incur liability to that director, or to any other person, under section 218(2) of the Companies Act, for any loss or damage suffered by the improperly removed director or third person as a result of the contravention.[129]

[129] See para 4.3 above.

CHAPTER 5 THE REMOVAL OF DIRECTORS HOLDING MULTIPLE POSITIONS IN A COMPANY

1. INTRODUCTION

When a director is involved with a company in more than one capacity, such as an employee and a shareholder, the relationship between the director and the company becomes complicated.[1] The complexity of this relationship may impose additional considerations regarding the removal of the director from the company. Before a director is removed from office, cognisance must be taken of any other capacities in which the director is involved with the company, so that the consequences of such appointment may be considered prior to removing the director from office.

[1] For example, in *Greaves and Others v Barnard* 2007 (2) SA 593 (C) the question arose whether a director was entitled to a spoliation remedy where the company had prevented him from entering its premises and accessing his office. A spoliation remedy (also known as a *mandament van spolie)* is a common law possessory remedy used by a person who has been dispossessed of goods without due legal procedure having been followed. In order to obtain a spoliation order the onus is on the applicant to prove the required possession, and that he was unlawfully deprived of such possession (see *Yeko v Qana* 1973 (4) SA 735 (A) at 739). In *Greaves and Others v Barnard* 2007 (2) SA 593 (C) para 10 the Cape Provincial Division affirmed that a spoliation order may be granted if the applicant was in possession of property with the intention of securing a benefit for himself. (See further on the spoliation remedy *Mpunga v Malaba* 1959 (1) SA 853 (W); *Yeko v Qana* 1973 (4) SA 735 (A) and *Dlamini and Another v Mavi and Others* 1982 (2) SA 490 (W)). The director in question in *Greaves and Others v Barnard* 2007 (2) SA 593 (C) not only occupied the office of director, but was also an employee of the company and a shareholder. Moreover, the shareholders' agreement stated that the relationship between shareholders was to be regarded as that of quasi-partners. In deciding whether the director was entitled to institute spoliation proceedings, the Cape Provincial Division considered the director's position as a director, as an employee and as a shareholder. The court held that the director was entitled to a spoliation order on the basis that he had been in possession of the premises in his capacity as a director and a shareholder of the company, and therefore his interest in possession of the premises transcended those of a mere employee (para 21). The court remarked that by virtue of his employment, shareholding and directorship in the company, in occupying his office the director was carrying out his functions as employee and director and at the same time, advancing his own interests as a shareholder (para 17). It found that the director had an interest in the company over and above that of a mere employee. He had performed his work and occupied his office with the intention of securing some benefit for himself and not for another (para 21). On this basis the court held that the director was entitled to a spoliation order. This case illustrates the complexity of the relationship between a company and a director who is involved in the company in more than one capacity. For a discussion of this case see Esser "Company Law and the Spoliated Director" 135-145.

This chapter examines two such circumstances. The first is the board removal of a director who is also an employee of the company. The LRA[2] will in this case apply and its effect on the removal of directors must be considered. This chapter also investigates the validity of an automatic termination clause in the service contract of a director. Such a clause typically states that termination of board membership results in the automatic and simultaneous termination of a director's employment by the company. In addition, this chapter examines the validity of a "reverse automatic termination" provision, which typically states that the termination of employment leads to the automatic and simultaneous termination of the directorship in the company.

The second consideration regarding the removal of a director from the company is the removal by shareholders of directors who are also shareholders in the company but who have loaded voting rights. This chapter appraises whether a shareholding-director who holds shares with loaded votes is validly able to prevent his removal from office. In this regard the leading UK case of *Bushell v Faith*[3] is critically evaluated in this chapter.

2. THE REMOVAL OF DIRECTORS WHO ARE EMPLOYEES

Executive directors are full-time employees of the company while non-executive directors occupy the office of director but are not employees of the company.[4] Since executive directors are also employees of the company, it is important to examine the role and relevance of the LRA in the removal of an executive director from office. It is also

[2] The LRA is described in chapter 1, para 2.3.

[3] [1970] AC 1099 (HL).

[4] In *Protect a Partner (Pty) Ltd v Laura Machaba-Abiodun and Others* [2013] JOL 31048 (LC) para 48 the Labour Court remarked that executive directors of a company are also referred to as "inside directors". The court stated that executive directors represent the interest of the entity's stakeholders and often have special knowledge of its inner workings, its financial or market position, and its vision and mission. A non-executive director, the court observed, is not employed by the entity and does not generally represent any of its stakeholders. A typical example of a non-executive director, the court remarked, is a director who is the president of a firm or entity in a different industry. See further chapter 3, paras 6.2.3 and 6.3.1 and para 2.1 below for a further discussion of the distinction between executive and non-executive directors; Annex 2.2 and 2.3 of the King III Report; *In re City Equitable Fire Insurance Co Limited* [1925] 1 Ch 407 at 429; *Fisheries Development Corporation of SA Ltd v Jorgensen; Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd* 1980 (4) SA 156 (W) at 165; *Howard v Herrigel and Another NNO* 1991 (2) SA 660 (A) at 678; *AWA Ltd v Daniels t/a Deloitte Haskins & Sells and Others* (1992) 7 ACSR 759 at 867 and Esser & Havenga "Directors and Other Officers" in Loubser & Mahony *Company Secretarial Practice* 8-7.

necessary to examine whether executive directors may rely on remedies under the LRA if they are unfairly dismissed as employees of the company. The discussion in this chapter is confined to the removal of executive directors from office. It does not extend to the removal of non-executive directors from office as they are not employees.

2.1 The Role and Relevance of the LRA in the Removal from Office of an Executive Director

It is trite that the fact that a person is a director of a company does not mean that he cannot also be an employee of the company.[5] Whether a person is an employee depends on whether or not he falls within the definition of the term "employee" in section 213 of the LRA.[6] In *PG Group (Pty) Ltd v Mbambo NO & Others*[7] the Labour Court found that the definition of an "employee" in section 213 of the LRA is wide enough to include most, if not all, directors. Section 213 of the LRA defines an "employee" as follows:

> "'employee' means –
> (a) any person, excluding an independent contractor who works for another person or for the State and who receives, or is entitled to receive, any remuneration; and
> (b) any other person who in any matter assists in carrying on or conducting the business of an employer,
> and 'employed' and 'employment' have meanings corresponding to that of 'employee'"

[5] *Stevenson v Sterns Jewellers (Pty) Ltd* (1986) 7 ILJ 318 (IC); *Whitcutt v Computer Diagnostics & Engineering (Pty) Ltd* (1987) 8 ILJ 356 (IC) at 362; *Oak Industries (SA) (Pty) Ltd v John NO and Another* 1987 (4) SA 702 (N) at 704; *Long & Another v Chemical Specialities Tvl (Pty) Ltd* (1987) 8 *ILJ* 523 (IC) at 531-532; *PG Group (Pty) Ltd v Mbambo NO & Others* [2005] 1 BLLR 71 (LC) para 31; *Greaves and Others v Barnard* 2007 (2) 593 (C) at 598; *Amazwi Power Products (Pty) Ltd v Shelly Turnbull* 2008 JOL 22089 (LAC) para 15; *Mpofu v South African Broadcasting Corp Limited (SABC) and Others* (2008/18386) [2008] ZAGPHC 413 (16 September 2008) para 23; *Chillibush v Johnston* [2010] 6 BLLR 607 (LC) para 24; *Protect a Partner (Pty) Ltd v Laura Machaba-Abiodun and Others* [2013] JOL 31048 (LC) para 46; *Kaimowitz v Delahunt and Others* 2017 (3) SA 201 (WCC) para 19; Larkin "Distinctions and Differences: A Company Lawyer looks at Executive Dismissals" 248; Cilliers & Benade *Corporate Law* 166; Delport *Henochsberg on the Companies Act 71 of 2008* 274(2)-274(3); Van Eck & Lombard "Dismissal of Executive Directors: Comparing Principles of Company Law and Labour Law" 25-27; Esser "Company Law and the Spoliated Director" 142; Stoop "The Company Director as Employee" 2367-2370; Van Eck "Are Senior Managerial Employees Prescribed Officers in terms of the Companies Act 71 of 2008 and are they treated the same as Executive Directors?" 791-792.

[6] *Denel (Pty) Ltd v Gerber* [2005] 9 BLLR 849 (LAC) para 25; MM Botha "The Different Worlds of Labour and Company Law: Truth or Myth?" 2053-2055.

[7] [2005] 1 BLLR 71 (LC) para 24.

In *Oak Industries (SA) (Pty) Ltd v John NO and Another*[8] the High Court held that a managing director was an employee as he was a person who had assisted in "carrying on or conducting the business" of the employer, as defined in section 213 of the LRA.[9]

The Labour Court in *PG Group (Pty) Ltd v Mbambo NO & Others*[10] stated that the argument that the LRA does not apply to directors is largely premised on the argument that employment is characterised by an imbalance in bargaining power or insubordination, and that this characterisation is not applicable to financial directors, managing directors or ordinary directors. The Labour Court rejected this argument on the basis that this imbalance is not capable of being described in such precise terms as to particularly exclude directors from the definition of "employees" in section 213 of the LRA, and proclaimed that company law too is concerned with the disparity in power between ownership and control.[11]

In *Whitcutt v Computer Diagnostics & Engineering (Pty) Ltd*[12] the former Industrial Court[13] opined that it could not have been the intention of the legislature that the behests

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[8] 1987 (4) SA 702 (N) at 705-706.

[9] This case was decided under the Labour Relations Act 28 of 1956, but the reasoning of the court would still apply to the Labour Relations Act 66 of 1995 because the definition of "employee" and "employer" in both statutes are essentially the same with minor differences. The definition of an "employee" under the Labour Relations Act 28 of 1956 read as follows:

> "'Employee' means any person who is employed by or working for any employer and receiving or entitled to receive any remuneration, and, subject to ss (3), any other person whomsoever who in any manner assists in the carrying on or conducting of the business of an employer; and 'employed' and 'employment' have corresponding meanings."

See further on the dual status of a managing director of a company *Mpofu v South African Broadcasting Corp Limited (SABC) and Others* (2008/18386) [2008] ZAGPHC 413 (16 September 2008) para 23 and *SA Post Office Ltd v Mampeule* [2009] 8 BLLR 792 (LC) para 21.

[10] [2005] 1 BLLR 71 (LC) para 28.

[11] *PG Group (Pty) Ltd v Mbambo NO & Others* [2005] 1 BLLR 71 (LC) para 28. See further Larkin "Distinctions and Differences: A Company Lawyer looks at Executive Dismissals" 252-253 where this argument was canvassed. The disparity in power between ownership and control in companies is discussed in chapter 2, paras 2 and 3.

[12] (1987) 8 *ILJ* 356 (IC) at 362.

[13] The former Industrial Court was established under the now repealed Labour Relations Act 28 of 1956. In an attempt to address the uncertainty of the statutes of the Industrial Court, the Labour Court was established as a superior court with the status and standing of a High Court and as a court of law and equity, in terms of s 151 of the LRA (see Landman "The New Labour Court of South Africa" 29). It replaced the Industrial Court (refer to item 22 of Schedule 7 of the LRA which deals with the transition of matters which

of the Companies Act 61 of 1973 could have curtailed any rights of employees covered by the LRA. In a similar vein, in *PG Group (Pty) Ltd v Mbambo NO & Others*[14] the court remarked that neither the LRA nor the Companies Act 61 of 1973 (which was in force at the time of this decision) specifically preclude a director from the protection of the LRA. The current Companies Act likewise does not preclude a director from the protection of the LRA. Accordingly, when a director holds a dual position as a director and employee, his rights as an employee are not affected by the fact that he also holds the office of a director in the company.[15]

Executive directors generally conclude contracts of employment with the company.[16] The contracts of employment create a range of rights and obligations that do not exist in the case of non-executive directors.[17] If an employment contract is concluded the same rules would apply with regard to the termination of the director's contract of employment that apply to other employees.[18] Where a person accepts the office of an executive director but a contract of employment has not been expressly concluded, a contract of employment between the director and the company will be implied.[19]

Section 15(6)(*c*) of the Companies Act provides that the Memorandum of Incorporation of a company is binding between the company and each director of the company in the exercise of their respective functions within the company. It should be noted that this provision binds directors in the exercise of their functions as directors and not in any

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were pending before the former Industrial Court when the LRA came into force in 1995). Only labour law matters may be referred to the Labour Court.

[14] [2005] 1 BLLR 71 (LC) para 29.

[15] *Chillibush v Johnston* [2010] 6 BLLR 607 (LC) para 28.

[16] *PG Group (Pty) Ltd v Mbambo NO & Others* [2005] 1 BLLR 71 (LC) paras 26-27; *Mpofu v South African Broadcasting Corp Limited (SABC) and Others* (2008/18386) [2008] ZAGPHC 413 (16 September 2008) para 23. For examples of distinguishing features between executive and non-executive directors see Esser & Havenga "Directors and Other Officers" in Loubser & Mahony *Company Secretarial Practice* 8-7. See further para 2 above and chapter 3, paras 6.2.3 and 6.3.1 on executive and non-executive directors.

[17] *Mpofu v South African Broadcasting Corp Limited (SABC) and Others* (2008/18386) [2008] ZAGPHC 413 (16 September 2008) para 23.

[18] Van Eck "Are Senior Managerial Employees Prescribed Officers in terms of the Companies Act 71 of 2008 and are they Treated the same as Executive Directors?" 796.

[19] *Amazwi Power Products (Pty) Ltd v Shelly Turnbull* 2008 JOL 22089 (LAC) para 12.

other capacity. If the Memorandum of Incorporation confers rights or imposes obligations on a director in some other capacity (for instance, in a capacity as an attorney of the company) the director may not enforce those terms against the company on the basis of section 15(6) of the Companies Act.[20] It follows that a director may rely on the Memorandum of Incorporation of the company in respect of his position as a director but not in respect of his position as an employee of the company.

A person simultaneously employed as an executive director and a board member holds two distinct positions.[21] Since executive directors enjoy a dual status as directors and employees of the company they enjoy the protection of both the Companies Act and the LRA.[22] As directors they are governed by the provisions of the Companies Act, and as employees they are governed by the provisions of the LRA.[23] Consequently, when an executive director is removed from office, the provisions of both the Companies Act and the LRA must be considered in the removal process.[24] A distinction must therefore be drawn between the removal of a director from his office as a director of the company, and the removal of a director from his position as an employee of the company. Notably, employees who are also directors of companies would be entitled to rely on the remedies under the LRA if they are unfairly dismissed as employees.[25]

The fact that a chief executive officer of a company is suspended as an employee does not necessarily mean that he is also suspended or removed as a director of a company

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[20] MF Cassim "Formation of Companies and the Company Constitution" in FHI Cassim et al *Contemporary Company Law* 147-148.

[21] *Kaimowitz v Delahunt and Others* 2017 (3) SA 201 (WCC) para 19.

[22] *PG Group (Pty) Ltd v Mbambo NO & Others* [2005] 1 BLLR 71 (LC) para 29; *Amazwi Power Products (Pty) Ltd v Shelly Turnbull* 2008 JOL 22089 (LAC) para 15; *Mpofu v South African Broadcasting Corp Limited (SABC) and Others* (2008/18386) [2008] ZAGPHC 413 (16 September 2008) para 23 and *SA Post Office Ltd v Mampeule* [2010] 10 BLLR 1052 (LAC) para 21.

[23] *Chillibush v Johnston* [2010] 6 BLLR 607 (LC) para 24.

[24] *Amazwi Power Products (Pty) Ltd v Shelly Turnbull* [2008] JOL 22089 (LAC) para 15; *Mpofu v South African Broadcasting Corp Limited (SABC) and Others* (2008/18386) [2008] ZAGPHC 413 (16 September 2008); *Wicks v SA Independent Services (Pty) Ltd and Another* [2010] JOL 25715 (WCC); *Chillibush v Johnston* [2010] 6 BLLR 607 (LC); *SA Post Office Ltd v Mampeule* [2010] 10 BLLR 1052 (LAC); Van Eck & Lombard "Dismissal of Executive Directors: Comparing Principles of Company Law and Labour Law" 20.

[25] See para 2.2 below where these remedies are discussed.

(assuming that he is a director of the company).[26] In *Maqubela v South African Graduates Development Association and Others*[27] the applicant was employed as the chief executive officer of the first respondent. By virtue of this position, he was also an executive director on the board of directors of the first respondent. The applicant was suspended as the chief executive officer of the first respondent on the ground that he had unlawfully authorised certain payments to himself. He challenged his suspension on various grounds, one of them being that by virtue of his position as the chief executive officer of the company, the suspension had also translated into his suspension as the executive director of the first respondent's board. To this end he argued that the board resolution taken to suspend him as the chief executive officer of the company was contrary to the provisions of section 71 of the Companies Act in that he had not been given notice of the meeting or a copy of the proposed resolution, nor had he been afforded an opportunity to make representations to the board of directors. The Labour Court stressed that the suspension of the applicant as the chief executive officer of the company did not mean that he was also removed as a member of the board.[28] The court found that the applicant had incorrectly assumed that by virtue of his suspension as the chief executive officer of the company he was thereby removed as a member of the board of directors.[29] The Labour Court held that since the board of directors had not taken a resolution to remove the applicant from the board of directors, the applicant could not rely on the Companies Act to challenge his suspension as the chief executive officer of the company.[30]

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[26] The chief executive officer of a company is usually a director of the company, but he need not necessarily be appointed as such. He may be a prescribed officer of a company, if he exercises general executive control over and management of the business and activities of the company or regularly participates to a material degree in the exercise of general executive control over and management of the business and activities of the company (see the definition of a "prescribed officer" in s 1 of the Companies Act and regulation 38(1) of the Companies Regulations, 2011). The King IV Report defines the "CEO" as "the chief executive officer or the highest ranking employee in an organisation regardless of naming convention" (King IV Report, Glossary of Terms, at 10).

[27] [2014] 6 BLLR 582 (LC).

[28] *Maqubela v South African Graduates Development Association and Others* [2014] 6 BLLR 582 (LC) para 18.

[29] *Maqubela v South African Graduates Development Association and Others* [2014] 6 BLLR 582 (LC) para 18.

[30] *Maqubela v South African Graduates Development Association and Others* [2014] 6 BLLR 582 (LC) para 18.

Conversely, the fact that an executive director resigns as a director or is removed from office as a director does not mean that he has also resigned or has been removed as an employee of the company. In *Amazwi Power Products (Pty) Ltd v Shelly Turnbull*[31] the respondent was employed by the appellant, a company, as an internal accountant and was, at a later stage, also appointed to the board of directors as its financial director. Approximately a year after her appointment to the board of directors she tendered her resignation as a director, but undertook at the same time to continue her employment as the internal accountant of the appellant. She subsequently received a letter from the appellant accepting her resignation from its employment. She objected to this letter on the ground that she had resigned only as a director and not as an employee of the appellant. The Labour Appeal Court affirmed that the LRA does indeed afford protection to a director who is dismissed by a company.[32] The court observed that while a director is not necessarily an employee of a company, he may be an employee in addition to holding the independent office as a director.[33] It ruled that to be legally effective, a notice of intention to resign from employment and to terminate such employment must be clear and unequivocal.[34] It found that the respondent had made it clear that she did not intend to resign from her employment relationship with the appellant.[35] The Labour Appeal Court consequently held that the appellant's attempt to use the respondent's resignation letter as a director as a basis to terminate her employment as an accountant, was "opportunistic".[36] The court accordingly found that the dismissal of the respondent as an employee of the appellant was substantively unfair.[37]

[31] [2008] JOL 22089 (LAC).

[32] *Amazwi Power Products (Pty) Ltd v Shelly Turnbull* [2008] JOL 22089 (LAC) para 15.

[33] *Amazwi Power Products (Pty) Ltd v Shelly Turnbull* [2008] JOL 22089 (LAC) para 12.

[34] *Amazwi Power Products (Pty) Ltd v Shelly Turnbull* [2008] JOL 22089 (LAC) para 16.

[35] *Amazwi Power Products (Pty) Ltd v Shelly Turnbull* [2008] JOL 22089 (LAC) para 20.

[36] *Amazwi Power Products (Pty) Ltd v Shelly Turnbull* [2008] JOL 22089 (LAC) para 21.

[37] *Amazwi Power Products (Pty) Ltd v Shelly Turnbull* [2008] JOL 22089 (LAC) para 21.

The decisions in *Maqubela v South African Graduates Development Association and Others*[38] and *Amazwi Power Products (Pty) Ltd v Shelly Turnbull*[39] both illustrate that a director's position as a director is independent from his position as an employee.[40] These cases also make it clear that it is possible for an executive director to be suspended from, resign from or to be removed from the one position while still maintaining the other position.[41] As evidenced by these two cases, the removal of a person as a director of a company and the removal of an employee of a company are two separate processes in law and must be treated as such.

In *Chillibush v Johnston*[42] the Labour Court observed that labour law and company law essentially operate in their own spheres but at certain times they impact on one another. The court opined that the most striking example of this is the fact that the rules relating to the dismissal of an employee under the LRA and the removal of a director under the Companies Act are not the same.[43] For instance, the procedures to remove a director under the Companies Act are not as comprehensive as those set out in the LRA with regard to the dismissal of an employee.[44] A further distinction between company law and labour law is that when the shareholders remove a director from office under the

[38] [2014] 6 BLLR 582 (LC).

[39] [2008] JOL 22089 (LAC).

[40] See further Cilliers & Benade *Corporate Law* 166 and Esser "Company Law and the Spoliated Director" 142.

[41] See further Stoop "The Company Director as Employee" 2371.

[42] [2010] 6 BLLR 607 (LC) para 42.

[43] *Chillibush v Johnston* [2010] 6 BLLR 607 (LC) para 42.

[44] *Chillibush v Johnston* [2010] 6 BLLR 607 (LC) para 42. The LRA Code of Good Practice (refer to chapter 3, para 6.2.1 where the LRA Code of Good Practice is described) sets out guidelines on the procedures to be followed when dismissing an employee for reasons related to conduct and capacity. Item 2(1) of the LRA Code of Good Practice states that a dismissal is unfair if it is not effected for a fair reason and in accordance with a fair procedure. Item 4 of the LRA Code of Good Practice sets out general guidelines on what constitutes a fair procedure to dismiss an employee. In terms of item 4, the employer should conduct an investigation to determine whether there are grounds for dismissal, but this does not need to be a formal enquiry. The employer should notify the employee of the allegations using a form and language that the employee can reasonably understand. The employee should be allowed an opportunity to state a case in response to the allegations. In addition, the employee should be entitled to a reasonable time to prepare the response, and to the assistance of a trade union representative or fellow employee. After the enquiry, the employer should communicate the decision taken, and preferably furnish the employee with written notification of that decision. Only in exceptional circumstances, if the employer cannot reasonably be expected to comply with these guidelines, may he dispense with these pre-dismissal procedures.

Companies Act their discretion is unfettered and they require no reason to do so.[45] While a director is entitled to make a presentation to the shareholders before a vote on his proposed removal takes place, the shareholders are not required to take into account the director's submissions, nor are they required to take into account any considerations of fairness when voting on his removal.[46] In contrast, when dismissing an employee in terms of the LRA the discretion in labour law is not as unfettered as it is when the shareholders remove a director from office.[47] Another difference between company law and labour law is that in the field of labour law the overriding principle is fairness, and not lawfulness, which is the overriding principle in company law.[48] In *SA Post Office Ltd v Mampeule*[49] the Labour Appeal Court asserted that in labour law jurisprudence lawfulness cannot be equated with fairness. The fact that an executive director has been *lawfully* removed as a director does not mean that this would also result in a *fair* dismissal as an employee.[50] Whether or not the dismissal of the executive director as an employee is fair, is a matter that is subject to scrutiny in terms of labour law, by either the Commission for Conciliation, Mediation and Arbitration ("CCMA") or the Labour Court.[51] It is submitted that the notion that the overriding principle in labour law is fairness, is buttressed by item 1(3) of the LRA Code of Good Practice, which states as follows:

> "The key principle in this Code is that employers and employees should treat one another with mutual respect. A premium is placed on both employment justice and the efficient operation of business. While employees should be protected from arbitrary action, employers are entitled to satisfactory conduct and work performance from their employees."

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[45] *Chillibush v Johnston* [2010] 6 BLLR 607 (LC) para 42. See chapter 4, para 2 where this is discussed further.

[46] Stoop "The Company Director as Employee" 2373.

[47] *Chillibush v Johnston* [2010] 6 BLLR 607 (LC) para 42.

[48] *Chillibush v Johnston* [2010] 6 BLLR 607 (LC) para 42.

[49] [2010] 10 BLLR 1052 (LAC) para 21.

[50] *Chillibush v Johnston* [2010] 6 BLLR 607 (LC) para 42. See further *SA Post Office Ltd v Mampeule* [2010] 10 BLLR 1052 (LAC) para 21. In *Numsa v Vetsak Co-operative Ltd & Others* [1996] 6 BLLR 697 (AD) at 709 the then Appellate Division stated that there is no sure correspondence between lawfulness and fairness. The court stated further that while an unlawful dismissal would probably always be regarded as unfair, a lawful dismissal will not for that reason alone be fair (at 709).

[51] *Chillibush v Johnston* [2010] 6 BLLR 607 (LC) para 42.

If a conflict arises between the LRA and the Companies Act, the provisions of the LRA will prevail. This is affirmed by section 5(4)(*b*) of the Companies Act which states that if there is an inconsistency between the Companies Act and the LRA, to the extent that it is impossible to apply or comply with one of the inconsistent provisions without contravening the second, the applicable provisions of the LRA will prevail. Section 210 of the LRA similarly provides that if there is a conflict relating to the matters dealt with in the LRA and the provisions of any other law save for the Constitution or an Act expressly amending the LRA, the provisions of the LRA will prevail.[52]

2.2 Automatic Termination Clauses

An automatic termination clause is a provision which provides for the automatic termination of employment of an employee upon the occurrence of an event. It is intended to operate as a mechanism by which an employment relationship may be terminated. For example, in *SA Post Office Ltd v Mampeule*[53] the respondent was appointed for five years as the chief executive officer of the applicant as well as a member of its board of directors. His employment contract stated that membership of the board of directors was a prerequisite for appointment as the chief executive officer, and that termination of board membership would lead to the termination of the appointment as the chief executive officer. This amounts to an automatic termination clause since it provides that the occurrence of a certain event (the termination of board membership) leads to the automatic termination of employment (as the chief executive officer) with the company. The Labour Court in *SA Post Office Ltd v Mampeule*[54] was required to determine whether the above automatic termination clause was valid. The respondent's employment contract had provided further that the appointment of the chief executive officer could be terminated on the grounds of incapacity, misconduct or operational requirements. Prior to the expiry of the respondent's five-year contract term, the board of directors of the appellant, the South African Post Office SOC Limited, had approved a motion by the Minister of Communications (who represented the State as the sole shareholder of the

[52] See further *Chillibush v Johnston* [2010] 6 BLLR 607 (LC) (para 29) where the Labour Court affirmed that if there is a conflict between company law and labour law, labour law will prevail.

[53] [2009] 8 BLLR 792 (LC).

[54] [2009] 8 BLLR 792 (LC).

appellant) that the respondent be removed from office as a director of the appellant. The respondent was then informed that his employment as the chief executive officer of the appellant had ceased. He instituted legal proceedings in the Labour Court for breach of contract and for unfair dismissal.

The Labour Court found that the automatic termination clause on which the appellant had relied to dismiss the respondent as the chief executive officer was not valid on the ground that it was in conflict with the respondent's right under the LRA not to be unfairly dismissed.[55] This was upheld by the Labour Appeal Court on appeal.[56] The Labour Appeal Court held that by acknowledging that the chief executive officer could be dismissed for incapacity, misconduct or operational requirements, the appellant had recognised that the chief executive officer had enjoyed the full range of employee rights, including the right not to be unfairly dismissed from office.[57] The court found that the appellant's conduct had been designed to avoid its obligations under the LRA.[58] It held further that parties to an employment contract may not contract out of the protection against unfair dismissal afforded to an employee whether through the mechanism of automatic termination provisions, or otherwise, because the LRA had been promulgated not only to cater for an individual's interest but for the public's interest as well.[59] Even if an employee might be deemed to have waived his rights under the LRA, such a waiver is not valid or enforceable.

In *Mahlamu v CCMA & Others*[60] the Labour Court had to decide whether it is permissible for an employee to contract out of the right not to be unfairly dismissed as enshrined in the LRA. The Labour Court held that this depends on whether the subject of the right is

[55] *SA Post Office Ltd v Mampeule* [2009] 8 BLLR 792 (LC) para 45. The right not to be unfairly dismissed is enshrined in s 185 of the LRA.

[56] *SA Post Office Ltd v Mampeule* [2010] 10 BLLR 1052 (LAC) paras 22-23. See further Du Toit et al *Labour Relations Law: A Comprehensive Guide* at 86 and 223 and Van Niekerk et al *Law@work* 223 for a discussion of this case.

[57] *SA Post Office Ltd v Mampeule* [2010] 10 BLLR 1052 (LAC) para 21.

[58] *SA Post Office Ltd v Mampeule* [2010] 10 BLLR 1052 (LAC) para 24.

[59] *SA Post Office Ltd v Mampeule* [2010] 10 BLLR 1052 (LAC) para 23.

[60] [2011] 4 BLLR 381 (LC).

intended to be its sole beneficiary.[61] If other persons have an interest in the existence of the right or if the interests of the public were served by the conferment of the right, the right could not legally be waived.[62]

It is a well-established legal principle that a statutory provision that is enacted for the special benefit of any individual or body may be waived by that individual or body provided that no public interests are involved.[63] In *Bafana Finance Mabopane v Makwakwa & Another*[64] the Supreme Court of Appeal proclaimed that an agreement whereby a party purports to waive the benefits conferred upon him by statute will be *contra bonos mores* and is accordingly unenforceable if it can be shown that such an agreement would deprive the party of protection that the legislature considered should, as a matter of policy, be afforded by law. In *Sasfin (Pty) Ltd v Beukes*[65] the then Appellate Division held that an agreement is contrary to public policy if it is opposed to the interests of the State, or of justice or of the public.

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[61] *Mahlamu v CCMA & Others* [2011] 4 BLLR 381 (LC) para 19.

[62] *Mahlamu v CCMA & Others* [2011] 4 BLLR 381 (LC) para 19. The applicant was employed as a security guard. His employment contract stipulated that it would expire automatically on termination of the contract between the employer and its client or if the client no longer required the applicant's service for any reason. When the client cancelled the security contact, the employer informed the applicant that his services were no longer required. The CCMA found that the employment contract had terminated automatically since the client no longer required the applicant's services, and that the applicant had failed to prove that he had been dismissed. The Labour Court held that the commissioner had committed a material error of law and set aside his award (para 25). It held that employers and employees may not contract out of the protection against unfair dismissal, and that contracting out of the right not to be unfairly dismissed is not permitted by the LRA (para 22). Since the applicant's dismissal was patently for the employer's operational requirements the applicant was granted leave to refer the matter to the Labour Court (para 25).

[63] *Ritch and Bhyat v Union Government (Minister of Justice)* 1912 AD 719 at 734-735; *Bezuidenhout v AA Mutual Insurance Association Ltd* 1978 (1) SA 703 (A) at 710; *Govender v Sona Development Co (Pty) Ltd* 1980 (1) SA 602 (D) at 604-605; *SA Eagle Insurance Co Ltd v Bavuma* 1985 (3) SA 42 (A) at 49; *Ryland v Edros* 1997 (2) SA 690 (C) at 711-712; *South African Co-operative Citrus Exchange Ltd v Director-General Trade and Industry and Another* 1997 (3) SA 236 (SCA) at 242-243; *Bafana Finance Mabopane v Makwakwa & Another* 2006 (4) S 581 (SCA) para 9; Du Bois et al *Wille's Principles of South African Law* 763; Van der Merwe et al *Contract: General Principles* 166-168; Bradfield *Christie's Law of Contract in South Africa* 392 and 518.

[64] 2006 (4) S 581 (SCA) para 10.

[65] 1989 (1) SA 1 (A) at 8. See further Du Bois et al *Wille's Principles of South African Law* 763; Van der Merwe et al *Contract: General Principles* 167 and Bradfield *Christie's Law of Contract in South Africa* 401-407.

In *Chillibush v Johnston*[66] the Labour Court affirmed that an employer and an employee may not contractually agree in a contract of employment or in the Memorandum of Incorporation of a company of which the employee is also a director, that the employment relationship will automatically terminate if the employee's directorship is terminated. A shareholders' agreement may also not limit the statutory rights against unfair dismissal which an employee enjoys in terms of the LRA because a shareholders' agreement does not generally supersede a contract of employment.[67] The court held that an automatic termination clause falls foul of the constitutional right of every employee to fair labour practices, enshrined in section 23(1) of the Constitution.[68]

A further reason given by the Labour Court in *Chillibush v Johnston*[69] for not condoning automatic termination provisions is that such clauses contravene sections 5(2)(*b*)[70] and 5(4)[71] of the LRA. These provisions prohibit an employer and an employee from agreeing

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[66] [2010] 6 BLLR 607 (LC).

[67] *Chillibush v Johnston* [2010] 6 BLLR 607 (LC) para 38.

[68] *Chillibush v Johnston* [2010] 6 BLLR 607 (LC) paras 38 and 39. Section 23(1) of the Constitution states that "[e]veryone has the right to fair labour practices." The LRA gives effect to s 23(1) of the Constitution by recognising the right not to be unfairly dismissed in s 185 of the LRA. See *Nehawu v University of Cape Town & Others* (2003) 24 *ILJ* 95 (CC) para 42 where the Constitutional Court affirmed that s 185 of the LRA is an extension of the constitutional right to fair labour practices. Section 185 of the LRA states as follows:

> "Every employee has the right not to be-
> *(a)* unfairly dismissed; and
> *(b)* subjected to unfair labour practice."

Section 1(a) of the LRA gives further effect to s 23(1) of the Constitution by stating that the one of the primary objects of the LRA is to give effect to and regulate the fundamental rights conferred by s 23 of the Constitution (see further Van Niekerk et al *Law@work* 43-44 and 51-52 for a discussion of the fairness component of s 23(1) of the Constitution).

[69] [2010] 6 BLLR 607 (LC) para 38.

[70] Section 5(2)(*b*) of the LRA states as follows:

> "5 Protection of employees and persons seeking employment
> (1) No person may discriminate against an employee for exercising any right conferred by this Act.
> (2) Without limiting the general protection conferred by subsection (1), no person may do, or threaten to do, any of the following-
> (a) . . .
> (b) prevent an employee or a person seeking employment from exercising any right conferred by this Act or from participating in any proceedings in terms of this Act;"

[71] Section 5(4) of the LRA states as follows:

to limit an employee's statutory rights. In *Mahlamu v CCMA & Others*[72] the Labour Court stressed that the LRA must be purposively construed in order to give effect to the Constitution.[73] It follows that section 5 of the LRA must be interpreted in favour of protecting employees against unfair dismissal, since this is one of the objects of the Constitution.[74] The Labour Court in *Mahlamu v CCMA & Others*[75] consequently affirmed that an automatic termination provision falls foul of section 5(2)(*b*) of the LRA, because an employee is denied the right to challenge the fairness of the dismissal in terms of section 188 of the LRA.

Section 5(4) of the LRA contains an exception that provides that a provision in a contract that directly or indirectly contradicts or limits section 5 is invalid "unless the contractual provision is permitted" by the LRA. In order to fall within the scope of the exception in section 5(4) of the LRA the employer must prove that the automatic termination clause which contradicts or limits section 5 of the LRA is permitted by the LRA.[76] In *Mahlamu v CCMA & Others*[77] the Labour Court stated that what this boils down to in the labour law context is whether it is permissible to contract out of the right not to be unfairly dismissed in the LRA. The court held that an automatic termination clause does not fall within the exception in section 5(4) of the LRA because contracting out of the right not to be unfairly dismissed is not permitted by the LRA.[78] The Labour Court accordingly affirmed that parties to an employment contract may not contract out of the protection

> "A provision in any contract, whether entered into before or after the commencement of this Act, that directly or indirectly contradicts or limits any provision of section 4, [Employees' right to freedom of association] or this section, is invalid, unless the contractual provision is permitted by this Act."

[72] [2011] 4 BLLR 381 (LC) para 12.

[73] Section 3(*b*) of the LRA states that the LRA must be interpreted in compliance with the Constitution.

[74] *Mahlamu v CCMA & Others* [2011] 4 BLLR 381 (LC) para 12.

[75] [2011] 4 BLLR 381 (LC) paras 19 and 22.

[76] *Mahlamu v CCMA & Others* [2011] 4 BLLR 381 (LC) para 19.

[77] [2011] 4 BLLR 381 (LC) para 19.

[78] *Mahlamu v CCMA & Others* [2011] 4 BLLR 381 (LC) para 22.

against unfair dismissal afforded to an employee, whether through the mechanism of automatic termination provisions or otherwise.[79]

In *Mwelase and Others v Enforce Security Group and Others*[80] the Labour Court was again faced with the question whether it is permissible to contract out of the right not to be unfairly dismissed. The employer was a private security service provider. It had entered into contracts with various clients and had employed security officers to work for its clients on a temporary basis. A clause in the employment contract of each security officer required each employee to agree that the termination of the contract between the employer and its client would automatically terminate the employee's employment contract, and further that such termination would not be construed as a retrenchment but as a completion of the contract. When the client subsequently terminated its contract with the employer, the employer enforced this clause. In legal proceedings by the employee's trade union, the Labour Court had to decide whether the automatic termination clause was valid and whether it was permissible to contract out of the right not to be unfairly dismissed. The employees had been employed as security officers. The Labour Court found that as security officers they were lay persons and were unacquainted with the interpretation of legislation.[81] They were therefore regarded as incapable of defending themselves without legal representation.[82] For this reason the court held that the public had an interest in ensuring that the applicants were not exploited and as such, their right not to be unfairly dismissed could not be contracted out of.[83] The court found that the automatic termination clause was not valid; it had the effect of denying the employees the right to challenge the fairness of the employer's conduct, and of enforcing their rights

[79] *Mahlamu v CCMA & Others* [2011] 4 BLLR 381 (LC) para 21.

[80] (D358/12) [2015] ZALCD 46 (21 May 2016) para 6.

[81] *Mwelase and Others v Enforce Security Group and Others* (D358/12) [2015] ZALCD 46 (21 May 2016) para 9.

[82] *Mwelase and Others v Enforce Security Group and Others* (D358/12) [2015] ZALCD 46 (21 May 2016) para 9.

[83] *Mwelase and Others v Enforce Security Group and Others* (D358/12) [2015] ZALCD 46 (21 May 2016) para 9.

in terms of section 189 of the LRA, dealing with dismissals based on operational requirements and the payment of severance pay.[84]

In *Pecton Outsourcing Solutions CC v Pillemer* and *Others*[85] the Labour Court again found that an automatic termination clause in a fixed term employment contract was an attempt to contract out of the mandatory provisions of section 189 of the LRA.[86] The Labour Court held that the automatic termination clause left the employee's security of employment entirely dependent on the will and the whim of the client.[87] The court, however, acknowledged that automatic termination clauses in fixed term contracts based on an event such as a permanent employee returning to work after an absence, are legitimate.[88] This is because there is no mischief by a client exercising its will against the employee whose fixed term contract is terminated.[89] This means that automatic termination clauses in fixed terms contracts that rely on happenings other than the unilateral exercise of a party's will are generally enforceable.[90] However, where an automatic termination clause is used in order to circumvent an employee's right to challenge the fairness of his dismissal, it will not be enforceable.

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[84] Under s 189(2) of the LRA (Dismissals based on operational requirements) an employer is required to engage in a meaningful joint consensus-seeking process with the relevant trade union or the affected employees. The parties must attempt to reach consensus on appropriate measures to avoid the dismissal, to minimise the number of dismissals, to change the timing of the dismissals, to mitigate the adverse effect of the dismissals, the method of selecting the employees to be dismissed, and the severance pay for dismissed employees. Section 189A of the LRA deals with dismissals based on operational requirements by employers with more than fifty employees. For a further discussion on dismissals for operational requirements see Grogan *Workplace Law* 317-345; Van Niekerk et al *Law@work* 313-333; Du Toit et al *Labour Relations Law: A Comprehensive Guide* 472-498; Bendix *Labour Relations: A Southern African Perspective* 317-347 and B Jordaan & Stander *Effective Workplace Solutions: Employment Law from a Business Perspective* 194-204.

[85] [2016] 2 BLLR 186 (LC).

[86] The Labour Court in *Pecton Outsourcing Solutions CC v Pillemer* and *Others* [2016] 2 BLLR 186 (LC) held that Pecton, a labour broker, could not rely on a clause in a fixed-term agreement which stated that the employment contract would automatically terminate if its client terminated its service contract with Pecton. See further on automatic termination clauses in fixed-term contracts Grogan *Workplace Law* 170-171 and Van Niekerk et al *Law@work* 71-72.

[87] *Pecton Outsourcing Solutions CC v Pillemer* and *Others* [2016] 2 BLLR 186 (LC) para 33.

[88] *Pecton Outsourcing Solutions CC v Pillemer* and *Others* [2016] 2 BLLR 186 (LC) para 46.

[89] *Pecton Outsourcing Solutions CC v Pillemer* and *Others* [2016] 2 BLLR 186 (LC) para 46.

[90] See further *South African Transport and Allied Workers Union obo Dube and Others v Fidelity Supercare Cleaning Services Group (Pty) Ltd* [2015] JOL 33144 (LC) paras 29-30 where the Labour Court also remarked that to the extent that the termination of employment is triggered by an event and is not based on the employer's own decision, there is no dismissal.

It is clear from the cases discussed above that reliance on an automatic termination provision to automatically bring an employment relationship to end when an individual is removed from office as a director is not permissible.[91] If an executive director is removed from office by the board of directors or by the shareholders, the proper procedures under the LRA must be followed to dismiss the director as an employee. The company may not contract out of complying with these procedures by the mechanism of automatic termination clauses. A waiver by an executive director of his right to be fairly dismissed as an employee is against public policy and unenforceable. In light of the fact that automatic termination clauses may not be used to terminate the employment of an executive director, before a company terminates a director's services in his capacity as an employee, it must have a valid substantive ground to do so.

The grounds for a fair dismissal of an employee recognised by section 188(1)(*a*) of the LRA read with item 2(1) of the LRA Code of Good Practice are misconduct, poor work performance, ill health, injury and operational requirements.[92] When the board of directors purports to remove a director from office under section 71(3) of the Companies Act it may do so if the director has become ineligible or disqualified to be a director, incapacitated, neglectful, derelict and negligent.[93] There is some overlap between the grounds listed in section 188(1)(*a*) of the LRA and section 71(3) of the LRA. For example, the grounds of ill health and injury in section 188(1)(*a*) of the LRA may overlap

[91] See further *National Union of Mineworkers obo Milisa and Others v WBHO Construction (Pty) Ltd* [2016] 6 BLLR 642 (LC) where the Labour Court assessed the validity of an automatic termination clause which stated that an employment contract would endure for the duration of "the skills requirements of the project". The Labour Court held that the automatic termination clause was not valid because it granted the employer an unfettered and subjective discretion to decide when the employee's skills were no longer required (para 7). It therefore violated the provisions of the LRA which protect employees against unfair dismissals (para 8). The court found further that the employees had in fact been dismissed for operational requirements but the employee had failed to comply with the provisions of s 189 of the LRA to dismiss them (para 8).

[92] Section 188(2) of the LRA provides that in considering whether or not the reason for the dismissal is a fair reason or whether the dismissal was effected in accordance with a fair procedure any relevant code of good practice issued in terms of the LRA must be taken into account. See further on the grounds for a fair dismissal Grogan *Workplace Law* 189-190; Du Toit et al *Labour Relations Law: A Comprehensive Guide* 439-536; Van Niekerk et al *Law@work* 271-333; Bendix *Labour Relations: A Southern African Perspective* 252 and B Jordaan & Stander *Effective Workplace Solutions: Employment Law from a Business Perspective* 72-75.

[93] Section 71(3) of the Companies Act. These provisions are discussed in chapter 3, para 6.

with that of incapacity in section 71(3) of the LRA. Likewise, the ground of misconduct[94] in section 188(1)(*a*) of the LRA may overlap with that of being neglectful, derelict or negligent in section 71(3) of the Companies Act. It follows that if there is a valid ground to remove a director from office under section 71(3) of the Companies Act the company may well have a valid substantive ground to fairly dismiss the director as an employee under the LRA.

If the company does not have a valid substantive ground on which to dismiss a director in his capacity as an employee, it would have to accommodate the former executive director as an employee in the company. If such an employment position is not feasible, the company would have to accommodate the former executive director in a new employee capacity.[95] If an appropriate vacancy does not exist in the company, the company would then have to comply with the procedures for dismissal based on operational requirements, as contained in section 189 of the LRA, and retrench the former-director employee.[96] Smaller companies in particular may be faced with having to comply with the procedures to retrench the former director as an employee if they do not have the capacity or the resources to accommodate the former executive director in a new employee capacity in the company.[97]

If the company dismisses a former executive director as an employee and his dismissal is found to be unfair under the LRA, he would be entitled to rely on the remedies provided for by the LRA. He would be entitled to claim reinstatement, re-employment or compensation for the unfair dismissal.[98] The LRA does not explain the difference between reinstatement and re-employment. A reinstatement order restores the contractual

[94] Misconduct in s 188(a) of the LRA means behaviour for which the employee may be held accountable or blameworthy, and which the employee could have avoided (see Grogan *Workplace Law* 190). For a discussion on the specific acts of misconduct justifying dismissal see Van Niekerk et al *Law@work* 274-281.

[95] Stoop "The Company Director as Employee" 2371.

[96] Stoop "The Company Director as Employee" 2371; FHI Cassim "The Division and Balance of Power" 168. Refer to note 84 above for the procedures to retrench an employee under s 189 of the LRA.

[97] Stoop "The Company Director as Employee" 2377.

[98] Section 193(1) of the LRA. See further on these remedies Van Eck & Lombard "Dismissal of Executive Directors: Comparing Principles of Company Law and Labour Law" 33; Grogan *Workplace Law* 198-206 and Van Niekerk et al *Law@work* 243-248.

position between the employer and the employee as if it was never broken, and it implies a continuity of the employment relationship as if it had not ended.[99] If employees are reinstated they resume their employment on the same terms and conditions that had prevailed at the time of their dismissal.[100] A court or an arbitrator may order the employer to re-instate the employee from any date not earlier than the date of dismissal.[101] In *Equity Aviation Services (Pty) Ltd v Commission for Conciliation, Mediation and Arbitration and Others*[102] the Constitutional Court explained the meaning of "reinstatement" as follows:

> "The ordinary meaning of the word 'reinstate' is to put the employee back into the same job or position he or she occupied before the dismissal, on the same terms and conditions. Reinstatement is the primary statutory remedy in unfair dismissal disputes. It is aimed at placing an employee in the position he or she would have been but for the unfair dismissal. It safeguards workers' employment by restoring the employment contract. Differently put, if employees are reinstated they resume employment on the same terms and conditions that prevailed at the time of their dismissal."[103]

Re-employment on the other hand means that the employment contract ended at the date of dismissal and resumed on the re-employment.[104] The new employment contract which is created may be created on different terms.[105] A court or an arbitrator may order the employer to re-employ the employee either in the work in which the employee had been

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[99] Grogan *Workplace Law* 199; Van Niekerk et al *Law@work* 245; Du Toit et al *Labour Relations Law: A Comprehensive Guide* 525.

[100] *Consolidated Frame Cotton Corporation Ltd v President of the Industrial Court and Others; Consolidated Woolwashing and Processing Mills Ltd v President of the Industrial Court and Others* 1986 (3) SA 786 (A) at 798; Grogan *Workplace Law* 199; Van Niekerk et al *Law@work* 245.

[101] Section 193(1)(*a*) of the LRA. A court or an arbitrator has a discretion to decide on the date from which the reinstatement will run, provided the reinstatement is not ordered from a date earlier than the date of the dismissal (*Numsa and Others v Fibre Flair CC t/a Kango Canopies* [2006] 6 BLLR 631 (LAC) at 633; *Equity Aviation Services (Pty) Ltd v Commission for Conciliation, Mediation and Arbitration and Others* 2009 (1) SA 390 (CC) para 36).

[102] 2009 (1) SA 390 (CC) para 36.

[103] See further *Nel v Oudtshoorn Municipality* (247/2012) [2013] ZASCA 37 (28 March 2013) para 10 where the Supreme Court of Appeal explained that by reinstating a dismissed employee the employer does not purport to conclude a fresh contract of employment, but merely restores the position to what it was before the dismissal.

[104] Grogan *Workplace Law* 199; Van Niekerk et al *Law@work* 245; Du Toit et al *Labour Relations Law: A Comprehensive Guide* 525. Re-employment is generally ordered where the employee's former post no longer exists, or where the employment is of a seasonal nature (Grogan *Workplace Law* 202).

[105] Du Toit et al *Labour Relations Law: A Comprehensive Guide* 525.

employed before the dismissal or in other reasonably suitable work on any terms and from any date not earlier than the date of dismissal.[106]

Section 193(2) of the LRA obliges the court or arbitrator to reinstate or re-employ an unfairly dismissed employee, unless the following applies: (i) the employee does not wish to be reinstated or re-employed; (ii) the circumstances surrounding the dismissal are such that a continued employment relationship would be intolerable; (iii) it is not reasonably practicable for the employer to reinstate or re-employ the employee; or (iv) the dismissal is unfair only because the employer did not follow a fair procedure. In *PG Group (Pty) Ltd v Mbambo NO & Others*[107] the Labour Court cast doubt on whether an executive director is entitled to reinstatement because of the dual capacities in which he holds office. While reinstatement may be more difficult with regard to executive directors, this does not mean that a court would not in appropriate circumstances order the reinstatement of an unfairly dismissed director in his capacity as an employee.

For instance, in *Whitcutt v Computer Diagnostics & Engineering (Pty) Ltd*[108] the former Industrial Court reinstated as an employee a financial director of a company on the ground that his dismissal as an employee had been substantively and procedurally unfair.[109] The court found that the financial director's position in his capacity as an employee could be distinguished from his capacity as a director.[110] It consequently reinstated the employee, retrospectively, on terms and conditions not less favourable to him than those which had governed his employment prior to his termination.[111] In *Oak Industries (SA) (Pty) Ltd v John NO and Another*[112] in an application for a review of a decision of the Industrial Court, the High Court found that a managing director of the company was an employee

[106] Section 193(1)(*b*) of the LRA.

[107] [2005] 1 BLLR 71 (LC) para 29.

[108] (1987) 8 ILJ 356 (IC).

[109] The financial director was dismissed on the basis of misconduct and incompetence. The Industrial Court found that these allegations were unfounded and his dismissal was therefore substantively unfair. He had also not been given an opportunity to present his side of the case at a hearing, and for this reason the dismissal was also found to be procedurally unfair.

[110] *Whitcutt v Computer Diagnostics & Engineering (Pty) Ltd* (1987) 8 ILJ 356 (IC) at 362.

[111] *Whitcutt v Computer Diagnostics & Engineering (Pty) Ltd* (1987) 8 ILJ 356 (IC) at 365.

[112] 1987 (4) SA 702 (N) at 704.

of the company who had been unfairly dismissed. The court upheld the reinstatement of the unfairly dismissed managing director to his employment position with the company. The former managing director was reinstated only to his position of employment but not to his position as a director of the company.[113] Even though it may be complicated to reinstate executive directors in the company because of the dual capacities in which they hold office, as demonstrated by the above cases, the courts may nevertheless reinstate executive directors as employees if they have been unfairly dismissed as employees. Their capacities as employees must be capable of being separated from their capacities as directors.

If an employee is not re-instated or re-employed he may claim compensation from the employer for unfair dismissal under section 193 of the LRA. The compensation must be just and equitable but it may not be more than the equivalent of twelve months' remuneration calculated at the employee's rate of remuneration on the date of dismissal.[114] In *Fedlife Insurance Ltd v Wolfaardt*[115] the Supreme Court of Appeal held that section 195 of the LRA confers an additional remedy of compensation on employees over and above full performance of an employer's contractual obligations.[116] Therefore the right to claim compensation in terms of section 193 of the LRA does not deprive an employee from claiming common-law damages over and above the compensation.[117] The court based its finding on section 195 of the LRA which states that an award for compensation under the LRA is "in addition to, and not a substitute for, any other amount to which the employee is entitled in terms of any law, collective agreement or contract of employment."[118]

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[113] *Oak Industries (SA) (Pty) Ltd v John NO and Another* 1987 (4) SA 702 (N) at 703.

[114] Section 194(1) of the LRA. There is no definition in the LRA of what would constitute "just and equitable" compensation. Commissioners and judges have a discretion as to the amount of compensation which is to be awarded and their discretion must be exercised judicially (see further Van Niekerk et al *Law@work* 245-248 and Du Toit et al *Labour Relations Law: A Comprehensive Guide* 528-530 for a discussion on the compensation payable to employees whose dismissal is found to be unfair).

[115] 2002 (1) SA 49 (SCA).

[116] *Fedlife Insurance Ltd v Wolfaardt* 2002 (1) SA 49 (SCA) paras 22 and 24.

[117] *Fedlife Insurance Ltd v Wolfaardt* 2002 (1) SA 49 (SCA) paras 19 and 22.

[118] *Fedlife Insurance Ltd v Wolfaardt* 2002 (1) SA 49 (SCA) para 19. The Supreme Court of Appeal held that the LRA does not expressly abrogate an employee's common law entitlement to enforce contractual rights, and that there are clear indications in the LRA that the legislature had no intention of doing so (para 17). See further on this judgment Van Eck & Lombard "Dismissal of Executive Directors: Comparing

It is evident from the above discussion that the consequences of failing to terminate the employment of an executive director in a substantially and procedurally fair manner are severe for a company. The onus rests on the employer to prove that the dismissal was fair.[119] In sum, if the dismissal is found to be unfair, the company may be ordered to re-instate or re-employ the unfairly dismissed employee, or to pay just and equitable compensation to the executive director, which may be up to the equivalent of twelve months' remuneration. In addition, the former executive director may, in his capacity as an employee, claim common-law damages for a breach of contract over and above the compensation claimable under the LRA. It consequently is imperative that a company takes cognisance of the applicable labour law principles and that it adheres to such principles when removing an executive director from office.

It is not always practical to strictly separate the two positions held by an executive director, or to consistently apply a strict separation of such positions.[120] It may be that the positions of director and employee are so interlinked that the person's capacity as a director cannot logically be separated from his capacity as an employee.[121] For instance, in a large company with a number of non-executive directors who do not occupy offices on the company's premises but which company has a smaller number of executive directors who are employed by the company and have offices on the company's premises, one can generally separate the position of a director from that of an employee.[122] In contrast, in a company where all the directors are actively involved in managing the company's affairs on a daily basis, it is more difficult to separate their employee status from their official capacity as directors.[123]

Principles of Company Law and Labour Law" 33; Van Niekerk et al *Law@work* 97 and Du Toit et al *Labour Relations Law: A Comprehensive Guide* 533.

[119] Section 192(2) of the LRA.

[120] Stoop "The Company Director as Employee" 2371; FHI Cassim "The Division and Balance of Power" 168.

[121] Van Eck & Lombard "Dismissal of Executive Directors: Comparing Principles of Company Law and Labour Law" 35.

[122] Esser "Company Law and the Spoliated Director" 142.

[123] Esser "Company Law and the Spoliated Director" 142.

Prior to removing an executive director from the board of directors, the board must take heed of the role which the director plays in the company as an employee, whether his position as an employee and as a director may strictly be separated and the consequences for the company if the director is removed from office as a director but not as an employee. The board must also bear in mind whether it will be practical to retain the former director as an employee, particularly if there has been a breakdown in the relationship between the director and the company. The board must further take into account the fact that the processes under the LRA to dismiss an executive director as an employee may be complicated and lengthy.[124]

2.3 Reverse Automatic Termination Provisions

A provision which provides for the automatic termination of a *directorship* (as opposed to employment) upon the occurrence of an event, hereby termed a "reverse automatic termination" provision (or a self-executing rule),[125] may be valid in certain instances. An automatic termination clause (as discussed in paragraph 2.2 above) generally provides that if a person ceases to be a director of a company, he automatically ceases to be an employee. A reverse automatic termination provision states that if a director ceases to be an employee of a company, he automatically ceases to be a director of the company. Two examples of valid reverse automatic termination provisions are discussed below.

2.3.1 Additional Ground of Ineligibility or Disqualification to be a Director

In *Pretorius v PB Meat (Pty) Ltd*[126] two directors had resigned as employees. A clause in their service agreements had provided that in the event of termination of their employment, they would be required also to resign as directors on request by the company. It is submitted that this was a reverse automatic termination provision because it in effect provided that if the directors ceased to be employees of the company they would automatically cease to be directors of the company. Despite repeated requests by

[124] Esser & Delport "Shareholder Protection Philosophy in terms of the Companies Act 71 of 2008" 14.

[125] Removal provisions drafted in this way may also be termed "self-executing rules" because they make it clear that when specific criteria are met removal follows without any act of the board being required (see Knight "Breaking Up is Hard to Do – Dealing with the Removal of Directors from the Board" 486).

[126] [2013] ZAWCHC 89.

the company, the applicants refused to resign as directors notwithstanding this provision in their service agreements. The applicants alleged that this provision had been included in their service agreements as a result of a common mistake, which the company denied.[127] The Cape Provincial Division did not address the question whether the reverse automatic termination provision was valid.

It is submitted that the above reverse automatic termination provision is valid under the Companies Act on the basis that section 69(6)(*a*) of the Companies Act states that the Memorandum of Incorporation of a company may impose additional grounds of ineligibility or disqualification of directors.[128] Section 71(3) states that if a shareholder or a director alleges that a director "has become ineligible or disqualified in terms of section 69", the board must determine the matter by resolution. Accordingly, in instances where the Memorandum of Incorporation of a company provides that if a director ceases to be an employee of the company he automatically ceases to be a director of the company, the requirement to be an employee may be construed to be an additional ground of ineligibility or disqualification to be a director. It follows that if the director were to resign as an employee or were to be validly dismissed as an employee, he would be ineligible or disqualified to be a director,[129] and would automatically cease to be a director of the company.

The requirement that one must be an employee in order to be appointed a director of a company, may be inserted in the Memorandum of an Incorporation of a company either as an additional ground of ineligibility, or as an additional ground of disqualification. If it is inserted as an additional ground of ineligibility, then a person may not be appointed as a director unless he is first appointed as an employee of the company. If it is inserted in the Memorandum of Incorporation as an additional ground of disqualification, then a

[127] *Pretorius v PB Meat (Pty) Ltd* [2013] ZAWCHC 89 para 3. As a consequence of the refusal of the applicants to resign as directors of the company, a director of the company had caused letters to be served upon the applicants to attend a meeting of the board of directors. The meeting was convened to consider a proposed resolution to remove the applicants as directors in terms of s 71(3) of the Companies Act on the basis that they had been derelict in the performance of the functions of directors. The facts and decision of *Pretorius v PB Meat (Pty) Ltd* [2013] ZAWCHC 89 are discussed in chapter 3, paras 8.3 and 8.4.

[128] See chapter 3, para 6.5 where the additional grounds for removal of a director are discussed.

[129] R Cassim "Contesting the Removal of a Director by the Board of Directors under the Companies Act" 157.

person who is appointed as a director would be disqualified from continuing to act as director if he ceases to be an employee. Section 69(7)(*c*) of the Companies Act is a useful provision under which to incorporate the requirement that a person must be an employee in order to be a director of a company. The provision states that a person is ineligible to be a director of a company if he does not satisfy any qualification set out in the company's Memorandum of Incorporation. It would be feasible to regard the requirement that a person be an employee in order to be a director of a company, as an additional qualification to be appointed a director, under section 69(7)(*c*) of the Companies Act.

It is submitted that a reverse automatic termination provision would not empower the board of directors to bypass the procedures set out in section 71(4) of the Companies Act to remove the director from office. In terms of section 71(3) of the Companies Act, if a shareholder or a director alleges that a director of the company has become ineligible or disqualified in terms of section 69 of the Companies Act, the board of directors must determine the matter by resolution. Section 71(4) of the Companies Act sets out the procedures to be followed before the board of directors may consider a resolution contemplated in section 71(3) of the Companies Act. Therefore, even if a director ceases to be an employee, and automatically ceases to be a director by virtue of a reverse automatic termination provision disqualifying him from being a director, if he does not voluntarily step down as a director of the company, the board of directors would have to follow the procedures in section 71(4) of the Companies Act to remove him from office.[130] The (former) director would also not be deprived of his statutory right under the Companies Act to be provided with a notice of the meeting, a statement setting out the reasons for the proposed resolution to remove him from office, and a reasonable opportunity to make a presentation to the meeting before the resolution is put to a vote.[131]

Despite the validity of a reverse automatic termination provision which disqualifies a person from being a director of the company if he ceases to be an employee of the company, it is not advisable for companies to insert such a provision in their Memorandums of Incorporation. If every director of a company were required to be an

[130] See chapter 3, para 6.1 where the necessity of formal removal proceedings in instances of the ineligibility and disqualification of a director are discussed further.

[131] See s 71(3) of the Companies Act and chapter 3, para 8 where these procedures are discussed.

employee of the company in order to be a director in the company, this would mean that all the directors in the company would have to be executive directors. This is contrary to the recommendation of the King IV Report that the board of directors should comprise a majority of non-executive directors, most of whom should be independent.[132] If a company were to incorporate such a reverse automatic termination provision in its Memorandum of Incorporation, this provision should not be applicable to all its directors on the board of directors.

2.3.2 The Removal of *Ex Officio* Directors

An "*ex officio* director" is defined in section 1 of the Companies Act as a person who holds office as a director of a particular company solely as a consequence of that person holding some other office, title, designation or similar status specified in the company's Memorandum of Incorporation. He serves on the board for this reason and not as a result of an election or appointment to the board of directors. Section 66(4)(*a*)(ii) of the Companies Act states that a company's Memorandum of Incorporation may provide for a person to be an *ex officio* director of the company as a consequence of the person holding some other office, title, designation or similar status. For example, the Memorandum of Incorporation may provide that the chief executive officer of the company will serve on the board *ex officio*. In this event the position of the director is tied to the office of the chief executive officer and not to the individual.[133]

The appointment of an *ex officio* director is subject to section 66(5)(*a*) of the Companies Act which provides that an *ex officio* director may not serve or continue to serve as such if that person is or becomes ineligible or disqualified to be a director in terms of section 69 of the Companies Act. In other words, even if a person holds a particular office, title, designation or similar status, if he is ineligible or disqualified to be a director, he may not serve as an *ex officio* director.

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[132] King IV Report, principle 7, recommended practice 8. See chapter 3, note 314 for a description of an independent non-executive director under the King IV Report.

[133] A person does not necessarily have to be an employee of the company in order to be an *ex officio* director. This is indicated by the words "title, designation or similar status" used in the definition of an *ex officio* director in s 1 of the Companies Act. For instance, the secretary of a trade union or the chairperson of a certain society may be an *ex officio* director of a company. An *ex officio* director must deliver to the company a written consent to serve as its director (s 66(7)(*b*) of the Companies Act).

As discussed in paragraphs 2.1 and 2.2 above, a dismissal in the capacity as an employee of a company does not translate into an automatic dismissal as a director of the company. However this is not the legal position with respect to *ex officio* directors. In terms of section 70(1)(*b*)(ii) of the Companies Act if an *ex officio* director ceases to hold the office, title, designation or similar status that entitles him to be an *ex officio* director, a vacancy will arise on the board of a company. It is submitted that this has the same effect as a reverse automatic termination provision because if the director ceases to hold a particular office, title, designation or similar status, he automatically ceases to hold the office of director in the company.

It appears from section 70(1)(*b*)(ii) of the Companies Act that the vacancy on the board of directors will arise automatically, without the company or the board of directors having to take any further steps. To use the example of a chief executive officer who serves a board *ex officio*, if such person resigns as the chief executive officer of the company or is removed as the chief executive officer of the company in his capacity as an employee, his position as a director on the board of director automatically and simultaneously terminates, and the new chief executive officer of the company automatically assumes his (former) position on the board of directors. The chief executive officer must have been dismissed in accordance with the proper procedures under the LRA before he will automatically cease to be a director of the company.[134] This provides some protection to *ex officio* directors from arbitrary removal as employees and as directors of the company.[135]

3. THE REMOVAL OF SHAREHOLDING-DIRECTORS HOLDING LOADED VOTING RIGHTS

Not only may a director be involved in a company in the capacity as a director and an employee, but he may also be involved in a company in the capacity as a shareholder. Directors can and do wear different hats. In his capacity as a shareholder, a director may hold voting rights in the company. A director who is also a shareholder with voting rights, is in his capacity as a shareholder, entitled to vote on the resolution proposed for this own

[134] Stoop "The Company Director as Employee" at 2376.

[135] Stoop "The Company Director as Employee" at 2377.

removal as a director.[136] The threshold for passing a shareholders' resolution to remove a director is more than fifty per cent of the voting rights exercised on the resolution.[137] This threshold may not be increased in a company's Memorandum of Incorporation.[138] It follows that a director who holds more than fifty per cent of the voting rights in a company would always be empowered to prevent his own removal from office by voting against the ordinary resolution in his capacity as a shareholder.

If a director is not a majority shareholder in a company, a shareholders' resolution may be successfully passed to remove him from office. Before this is done, however, consideration must be given to whether the director, in his capacity as a shareholder, holds loaded voting rights in the company.

The expression "loaded voting rights" or "weighted votes" is used to describe the device whereby certain shares are given additional voting strength above that enjoyed by other shares which, in every other respect, are identical to their participation in the company.[139] In essence, loaded voting rights or weighted votes are voting rights that are disproportionate to shareholdings.[140] Loaded voting rights may apply generally to all resolutions or they may be confined to resolutions on specific matters.[141] Loaded votes would be exercisable when voting takes place on a poll, and not where voting takes place

[136] R Cassim "Governance and the Board of Directors" in FHI Cassim et al *Contemporary Company Law* 445.

[137] In terms of s 71(1) of the Companies Act 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. Section 1 of the Companies Act defines an "ordinary resolution" as meaning a resolution adopted with the support of more than fifty per cent of the voting rights exercised on the resolution, or a higher percentage as contemplated in s 65(8).

[138] Section 65(8) of the Companies Act prohibits the Memorandum of Incorporation of a company from increasing the threshold to pass an ordinary resolution for the removal of a director under s 71 of the Companies Act.

[139] Anon "'Weighted' or 'Loaded' Votes in Private Companies" D5.

[140] FHI Cassim "The Division and Balance of Power" 164. See further on loaded voting rights Kershaw *Company Law in Context* 713; French, Mayson & Ryan *Mayson, French & Ryan on Company Law* 95-96; Davies & Worthington *Gower Principles of Modern Company Law* 380 and Hannigan *Company Law* 96-97.

[141] Anon "'Weighted' or 'Loaded' Votes in Private Companies" D5.

on a show of hands.[142] The removal of shareholding-directors who hold loaded voting rights in a company is examined below.

3.1 The Conferral of Loaded Voting Rights on Directors in their Capacity as Directors

Unless the Memorandum of Incorporation of a company provides otherwise, each director has one vote on a matter before the board.[143] It follows that a director may have more than one vote on a matter before the board of directors if this is specifically stated in the Memorandum of Incorporation of a company. For instance, the Memorandum of Incorporation may provide that the chairman of the board of directors will have two votes on any resolution to remove a fellow board member from office.

It is important to note that loaded voting rights which are conferred on a director in his capacity as a director do not confer on him any power to influence a proposed resolution to remove himself from office. Section 71(3) of the Companies Act explicitly states that the board "other than the director concerned" must determine the matter of the director's removal by resolution. Thus a director who is the subject of a removal resolution may not, in his capacity as a director, vote on his own removal from office. This is logical because a director who is the subject of a removal resolution would naturally be inclined to vote against his own removal. It follows that a provision in a company's Memorandum of Incorporation which confers loaded votes on a director in his capacity as a director with regard to a proposed resolution to remove himself from office would be void,[144] and that such loaded votes would not be exercisable by the director.

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[142] Under s 63(5) of the Companies Act if voting is by a show of hands a shareholder or proxy for a shareholder has one vote, irrespective of the number of voting rights that person would otherwise be entitled to exercise. If voting on a particular matter is by polling, a shareholder or proxy for a shareholder has the number of votes determined in accordance with the voting rights associated with the securities held by that shareholder (see s 63(6) of the Companies Act). In terms of s 63(7) of the Companies Act a polled vote must be held on a particular matter if a demand for such a vote is made by at least five persons having the right to vote on that matter, or by a person or persons who together are entitled to exercise at least ten per cent of the voting rights entitled to be voted on that matter.

[143] Section 73(5)(*c*) of the Companies Act.

[144] See ss 15(1)(*a*) and (*b*) of the Companies Act which essentially provide that each provision in a company's Memorandum of Incorporation must be consistent with the Companies Act and is void to the extent that it contravenes, or is inconsistent with the Companies Act, subject to s 6(15). Section 6(15) of the Companies Act provides that to the extent that the specific content or particular effect of any provision

It is important to be aware of the capacity in which a director is voting on a proposed removal resolution. Even though the issue of a director holding loaded voting rights in his capacity as a shareholder would arise only when the shareholders purport to remove such director from office and not when the board of directors purports to remove the director from office, the board of directors must take cognisance of whether a shareholding-director holds loaded voting rights in his capacity as a shareholder since this may present an obstacle to the removal of the director by the shareholders (as discussed below). In such event, the board of directors would have to take the necessary steps to remove the shareholding-director from office, provided there are valid grounds to do so.

In small private companies where the directors may also be shareholders it is particularly important to be aware of the capacity in which a director is voting on a proposed removal resolution. Errors in the voting capacity of the directors may easily be made in such companies. Such an error occurred in the USA decision of *Iwasaki v Iwasaki Bros Inc*[145] where a director in a small private family-owned company was removed from the board of directors by a three-to-two vote of the board, rather than by a vote of the shareholders. All of the directors were also shareholders. Two of the directors voting for the removal held two-thirds of the company's shares. The director in question had the right to vote on his own removal in his capacity as a shareholder, but had abstained from voting. Although it was improper for the board of directors to vote on the removal resolution since it was contrary to the applicable statute, the Oregon Court of Appeals nevertheless did not invalidate the removal of the director from office on the ground that the outcome of the vote would have been the same if the vote had been exercised at a shareholders' meeting.[146] Under the (South African) Companies Act it would be improper and invalid for a director to vote on a board resolution to remove himself from office since this is expressly prohibited by section 71(3) of the Companies Act. For this reason it is important

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of a company's Memorandum of Incorporation is required of the company in terms of any applicable public regulation or by the listings requirements of an exchange which has the effect of negating, restricting, limiting, qualifying, extending or otherwise altering the substance or effect of an unalterable provision of the Companies Act, that provision must not be construed as being contrary to s 15(1)(*a*) of the Companies Act.

[145] Or. App. 649 P.2d 598.

[146] *Iwasaki v Iwasaki Bros Inc* Or. App. 649 P.2d 598 at 601.

to be mindful of the capacity in which directors who are also shareholders vote on removal resolutions.

3.2 The Conferral of Loaded Voting Rights on Shareholders

Loaded votes are often used to protect minority shareholders.[147] Through the use of loaded voting rights persons with relatively small financial contributions to a company may have a relatively large voting power conferred on them.[148]

According to section 37(2) of the Companies Act, each issued share of a company, regardless of its class, has one general voting right associated with it,[149] except to the extent provided otherwise by (i) the Companies Act; or (ii) the preferences, rights, limitations and other terms determined by the company's Memorandum of Incorporation in accordance with section 36 of the Companies Act. It follows that the Memorandum of Incorporation of a company may depart from the default rule of each share having one general voting right.

In terms of section 36(1)(*b*) of the Companies Act a company's Memorandum of Incorporation must set out with respect to each class of shares, the preferences, rights, limitations and other terms associated with that class, subject to section 36(1)(*d*) of the Companies Act. Under section 36(1)(*d*) of the Companies Act a company's Memorandum of Incorporation may set out a class of shares (i) without specifying the associated preferences, rights, limitations or other terms of that class; (ii) for which the board of directors must determine the associated preferences, rights, limitations or other terms; and (iii) which must not be issued until the board of the company has determined the associated preferences, rights, limitations or other terms. Sections 36(1)(*b*) and 36(1)(*d*) authorise the board of directors to determine the preferences, rights, limitations

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[147] Anon "'Weighted' or 'Loaded' Votes in Private Companies" D5.

[148] *Model Business Corporation Act with Official Comments and Reporter's Annotations* 7-115.

[149] A "voting right" is defined in s 1 of the Companies Act as meaning, with respect to any matter to be decided by a company, the rights of any holder of the company's securities to vote in connection with that matter (in the case of a profit-company) or the rights of a member to vote in connection with the matter (in the case of a non-profit company). "Voting power" is the voting rights that may be exercised by a particular person in connection with a matter to be decided by a company, as a percentage of all such voting rights (s 1 of the Companies Act).

and other terms of a particular class of shares. A further notable provision of the Companies Act is section 37(5)(*a*) which permits a company's Memorandum of Incorporation, subject to any other law, to establish for any particular class of shares, preferences, rights, limitations or other terms that confer special, conditional or limited voting rights. Sections 36(1), 37(2) and 37(5)(*a*) of the Companies Act authorise a company's Memorandum of Incorporation to confer more than one voting right on some classes of shares.

The approach adopted to loaded voting rights under the Companies Act is consistent with the approach adopted in the USA under the MBCA. Section 7.21(a) of the MBCA states that each share is entitled to one vote unless otherwise provided in the articles of incorporation. Thus companies may depart from the default rule of giving each share one vote by appropriate provisions in their articles of incorporation. Under section 250E(1) of the Australian Corporations Act of 2001 loaded voting rights are also permissible.[150] In *Amalgamated Pest Control Pty Ltd and Another v McCarron and Others*[151] the Supreme Court of Queensland held that it is permissible for a company's constitution to confer a voting right or voting privilege which is disproportionate to the size of the shareholding of the member. Section 284 of the UK Companies Act of 2006 confers on a shareholder one vote on a resolution on a show of hands and one vote in respect of each share where voting takes place on a poll, but it permits the articles of association of a

[150] Section 250E(1) of the Australian Corporations Act of 2001 provides that, subject to any rights or restrictions attached to any class of shares, at a meeting of members of a company with a share capital, on a show of hands each member has one vote, and on a poll each member has one vote for each share they hold. It follows that a particular class of shares may have attached to it any specific rights, such as loaded voting rights. Section 231 of the Australian Corporations Act of 2001 defines a "member" as meaning a member of the company on its registration; or a person who agrees to become a member of the company after its registration and their name is entered on the register of members; or a person who becomes a member of the company under s 167 of the Australian Corporations Act of 2001 (membership arising from the conversion of a company from one limited by guarantee to one limited by shares).

[151] (1994) 13 ACSR 42 at 45-46. This case concerned the validity of a provision in the plaintiff's articles of association. Article 27D provided that the permanent governing director was entitled to a weighted vote at any general meeting which was equivalent to twenty six per cent of the total votes available, whether or not he was a member of the company. The Supreme Court of Queensland held that Article 27D was valid save for the part which permitted a weighted vote "whether or not" the governing director was a member (at 45). The court severed this part of the Article 27D and held that, provided that it is associated with membership, a voting privilege unrelated to the size of the shareholding of the member was valid (at 45-46). The court thus recognised the freedom given to shareholders to contract with each other, in terms of the constitution of the company, to determine their respective rights and responsibilities (Armstrong "Australia: Company Law: Weighted Voting Rights" 96-97.) The only limit expressed by the court on this right is that the articles of association must provide that the individual in question is a shareholder of the company (see further Armstrong "Australia: Company Law: Weighted Voting Rights" 96-97).

company to alter the voting rights of shareholders.[152] Accordingly, in the UK loaded voting rights are also permissible if the articles of association so provide.

Under the (South African) Companies Act loaded voting rights are permissible with regard to both public and private companies. In contrast, under section 195(1) of the Companies Act 61 of 1973 public companies were not permitted to issue shares with loaded voting rights - only private companies were permitted to do so.[153] The Companies Act does not make any distinction between the types of company which may make provision for loaded voting rights in its Memorandum of Incorporation. While public companies are entitled to issue shares with loaded voting rights, public companies listed on the Johannesburg Stock Exchange are prohibited from doing so.[154] Listed companies in Australia are also prevented from issuing shares with loaded voting rights.[155] The same approach has been adopted in the UK, which recently tightened up its listing principles and requirements to prevent listed companies from issuing shares with loaded voting rights.[156]

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[152] See s 284(4) of the UK Companies Act of 2006, which provides that the provisions of s 284 are subject to any provision of the company's articles of association.

[153] Section 195(1) of the Companies Act 61 of 1973 stated as follows: "(1) A member of a public company having a share capital shall–(a) if the share capital is divided into shares of par value, be entitled to that proportion of the total votes in the company which the aggregate amount of the nominal value of the shares held by him bears to the aggregate amount of the nominal value of all the shares issued by the company; (b) if the share capital is divided into shares of no par value, be entitled to one vote in respect of each share he holds."

[154] Paragraph 3.29 of the JSE Listings Requirements provides that securities in each class for which listing is applied must rank *pari passu* in respect of all rights. According to para 3.29(c) of the JSE Listings Requirements this means that the securities must carry the same rights as to unrestricted transfer, attendance and voting at general and annual general meetings and in all other respects. Paragraph 4.18 of the JSE Listings Requirements states that the Johannesburg Stock Exchange will not grant a listing to a company with low or high voting securities or allow an existing listed company to issue low or high voting securities. A low voting security is one that confers on its holder reduced voting rights in comparison with the voting rights conferred on the holders of equity securities of the issuer already listed (para 4.19 of the JSE Listings Requirements). A high voting security is one that confers on its holder enhanced voting rights in comparison with the voting rights conferred on the holders of equity securities of the issuer already listed (para 4.20 of the JSE Listings Requirements).

[155] ASX Listing Rule 6.8 provides that on a resolution to be decided on a show of hands each holder of an ordinary security and a preference security who has a right to vote must be entitled to one vote. ASX Listing Rule 6.9 provides that on a resolution to be decided on a poll each holder of an ordinary security and a preference security who has a right to vote must be entitled to one vote for each fully paid security and a fraction of a vote for each partly paid security. The ASX Listing Rules are enforceable against listed entities under the Australian Corporations Act of 2001 (see ss 793C and 1101B).

[156] Premium Listing Principle 3 of Listing Rule 7.2.1A contained in Chapter 7 of the UK Listing Rules requires equity shares admitted to a premium listing to carry an equal number of votes on any shareholder vote. This rule came into force on 16 May 2014. See chapter 2, note 224 where premium listings are

3.3 The Removal of Shareholding-Directors with Loaded Voting Rights

An important question which arises is whether a director who holds loaded voting shares in a company would validly be able to use his loaded voting rights to defeat a shareholders' resolution to remove him as a director from office. This question was the crux of the controversial landmark UK case of *Bushell v Faith*,[157] which is discussed below.

3.3.1 *Bushell v Faith*

In *Bushell v Faith*[158] the company had an issued share capital of three hundred shares. The shares were divided equally between the appellant Mrs Bushell, her sister Dr Bayne and their brother, the respondent, Mr Faith. Each shareholder held one hundred shares. Mrs Bushell and Mr Faith were the company's sole directors. Article 9 of the articles of the company, which was a small private company, stated as follows:

> "In the event of a resolution being proposed at any general meeting of the company for the removal from office of any director, *any shares held by that director shall on a poll* in respect of such resolution *carry the right to three votes per share* and regulation 62 of Part 1 of Table A shall be construed accordingly."[159] [Emphasis added]

The two sisters were unhappy with their brother's conduct as a director and purported to remove him from office. On a show of hands the resolution was successfully passed because the two sisters voted in favour of the resolution. Faith demanded that voting take place on a poll. On a poll, both sisters voted in favour of the removal of Faith, while Faith voted, in his capacity as a shareholder, against the purported resolution to remove him from office. A dispute arose regarding whether the resolution had been passed or not.

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discussed. The UK Listing Rules are a set of regulations which apply to a company listed on a UK stock exchange and are subject to the oversight of the UK Listing Authority.

[157] [1970] AC 1099 (HL).

[158] [1970] AC 1099 (HL).

[159] Regulation 62 of Part 1 of Table A provided as follows: "Subject to any rights or restrictions for the time being attached to any class or classes of shares, on a show of hands every member present in person shall have one vote, and on a poll every member shall have one vote for each share of which he is the holder."

Bushell contended that the resolution had been passed by two hundred votes to one hundred. Faith argued that, in accordance with article 9 of the articles of association of the company, his one hundred shares carried three hundred votes, and that therefore the resolution had been defeated by three hundred votes to two hundred. The question before the court was whether article 9 was valid and applicable, or whether it was to be treated as overridden by section 184 of the UK Companies Act of 1948 (which was the equivalent of section 168 of the UK Companies Act of 2006),[160] and therefore void. Section 184 of the UK Companies Act of 1948 enabled a company to remove a director, by ordinary resolution, before the expiration of his period of office "notwithstanding anything in the articles."

The court *a quo* found in favour of Bushell, on the basis that article 9 of the articles of association of the company was invalid because it infringed section 184(1) of the UK Companies Act of 1948. Ungoed-Thomas J expressed the view that it would "make a mockery of the law" to uphold article 9 of the constitution of the company.[161] Faith appealed and the UK Court of Appeal unanimously reversed the decision of the court *a quo*. In finding in favour of Faith, the UK Court of Appeal was of the view that the object of section 184 of the UK Companies Act of 1948 was to increase the powers of the shareholders in general meeting by providing that "nothing higher than a simple majority of votes was required"[162] to remove a director from office. The UK Court of Appeal remarked further that section 184 of the UK Companies Act of 1948 did "nothing to restrict a company's ability to allocate voting rights to shares in varying degrees and circumstances".[163] On a further appeal, by Bushell, the House of Lords, by a majority of four to one, upheld the decision of the UK Court of Appeal and found in favour of Faith.

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[160] See chapter 3, para 2.3 where s 168 of the UK Companies Act of 2006 is discussed.

[161] This decision of Ungoed-Thomas J, dated 3 December 1968, does not appear to have been reported. This quote is taken from the judgment of Harman LJ in the judgment of the UK Court of Appeal in *Bushell v Faith and Another* [1969] 1 All ER 1002 at 1004 and from the judgment of Lord Upjohn in the House of Lords in *Bushell v Faith* [1970] AC 1099 (HL) at 1107-1108.

[162] *Bushell v Faith and Another* [1969] 1 All ER 1002 at 1003, per Harman LJ.

[163] *Bushell v Faith and Another* [1969] 1 All ER 1002 at 1006, per Russell LJ.

The House of Lords held that article 9 was valid and enforceable, and that it was not in conflict with section 184(1) of the UK Companies Act of 1948 since that Act did not prevent special voting rights being attached to special circumstances and particular types of resolutions.[164] The court found that the practice of loaded voting rights was valid and recognised and that Parliament had not sought to fetter the right of the company to issue shares with such loaded voting rights[165] but had, instead, left to companies the "liberty to allocate voting rights as they pleased."[166] Lord Upjohn described the distinction between voting rights attached to shares and the policy of the UK Companies Act of 1948 as follows:

> "Parliament has never sought to fetter the right of the company to issue a share with such rights or restrictions as it may think fit. There is no fetter which compels the company to make the voting rights or restrictions of general application and it seems to me clear that such rights or restrictions can be attached to special circumstances and to particular types of resolution. This makes no mockery of section 184; all that Parliament was seeking to do thereby was to make an ordinary resolution sufficient to remove a director. Had Parliament desired to go further and enact that every share entitled to vote should be deprived of its special rights under the articles it should have said so in plain terms by making the vote on a poll one vote one share."[167]

With regard to the words "notwithstanding anything in its articles" contained in section 184(1) of the UK Companies Act of 1948, Lord Upjohn of the House of Lords remarked that the reason why Parliament had included these words in section 184(1) was to ensure that a director would be removable by virtue of an ordinary resolution instead of an extraordinary resolution[168] (that is, by a seventy five per cent majority). The UK Court of Appeal in *Bushell v Faith and Another*[169] also found that the words "notwithstanding anything in its articles" in section 184(1) of the UK Companies Act of 1948 simply ensured that a requirement that a greater majority than a simple majority for passing the removal resolution, would be of no effect.

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[164] *Bushell v Faith* [1970] AC 1099 (HL) at 1109, per Lord Upjohn.

[165] *Bushell v Faith* [1970] AC 1099 (HL) at 1109, per Lord Upjohn.

[166] *Bushell v Faith* [1970] AC 1099 (HL) at 1110, per Lord Donovan.

[167] *Bushell v Faith* [1970] AC 1099 (HL) at 1109, per Lord Upjohn.

[168] *Bushell v Faith* [1970] AC 1099 (HL) at 1108.

[169] [1969] 1 All ER 1002 at 1004, per Russell LJ.

Lord Reid of the House of Lords accepted that the extra voting power conferred by article 9 of the articles of association on a director whose removal is proposed would make it impossible for any resolution for the removal to be passed if that director voted against the resolution.[170] The learned judge admitted that article 9 of the articles of association was "obviously designed"[171] to evade section 184(1) of the UK Companies Act of 1948. Despite the admission that article 9 of the articles of association of the company was designed to make the director irremovable, Lord Reid agreed with the majority decision of the House of Lords that article 9 was valid. It appears though that he had difficulty with his decision because he commented that his agreement with the majority decision was "with some reluctance."[172]

The minority judgment in *Bushell v Faith*,[173] per Lord Morris of Borth-y-Gest, the sole dissentient, accepted that some shares may carry a greater voting power than others, but proclaimed that this does not warrant a "device"[174] such as that introduced by article 9 of the articles of association. The learned judge held that the "unconcealed effect" of article 9 was "to make a director irremovable."[175] He stated further as follows:

> "If the question is posed whether the shares of the respondent possess any added voting weight the answer must be that they possess none whatsoever beyond, if valid, an ad hoc weight for the special purpose of circumventing section 184. If article 9 were writ large it would set out that a director is not to be removed against his will and that in order to achieve this and to thwart the express provision of section 184 the voting power of any director threatened with removal is to be deemed to be greater than it actually is. The learned judge[176] thought that to sanction this would be to make a mockery of the law. I think so also."[177]

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[170] *Bushell v Faith* [1970] AC 1099 (HL) at 1105, per Lord Reid.

[171] *Bushell v Faith* [1970] AC 1099 (HL) at 1105.

[172] *Bushell v Faith* [1970] AC 1099 (HL) at 1105, per Lord Reid.

[173] [1970] AC 1099 (HL).

[174] *Bushell v Faith* [1970] AC 1099 (HL) at 1106.

[175] *Bushell v Faith* [1970] AC 1099 (HL) at 1106.

[176] Lord Morris of Borth-y-Gest was here referring to the judgment of the court *a quo*, per Ungoed-Thomas J, which had found in favour of Bushell.

[177] *Bushell v Faith* [1970] AC 1099 (HL) at 1106.

3.3.2 Evaluation of *Bushell v Faith*

The majority judgment in *Bushell v Faith*[178] adopted a literal and narrow approach to interpreting article 9 and section 184(1) of the UK Companies Act of 1948,[179] and not a purposive approach. The House of Lords interpreted section 184(1) of the UK Companies Act of 1948 strictly according to the words of the section as enacted by Parliament. *Bushell v Faith*[180] is a controversial decision, and commentators have been divided on the merit and validity of the judgment, with some commentators expounding the correctness of the decision, while others strongly criticising it.

In defence of the majority judgment in *Bushell v Faith*[181] Cartoon contends that if the shareholders of the company had specifically, deliberately and intentionally, included in the constitution of the company a provision which had the effect of excluding the benefits of section 184 of the UK Companies Act of 1948, they had only themselves to blame when Faith exercised his three votes against the removal resolution, and so defeated it.[182] Beuthin supports the UK Court of Appeal decision in *Bushell v Faith*[183] and remarks that it may be highly desirable for directors to be safeguarded in directorships by means of special voting rights.[184] Hahlo assumes that the UK Court of Appeal decision in *Bushell v Faith*[185] is good law and accepts that it is possible to give a shareholder or group of shareholders multiple voting rights on a resolution for the removal of a director with the consequence that the removal of a director may be prevented.[186]

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[178] [1970] AC 1099 (HL).

[179] See *Muir v Lampl and Another* [2005] 1 HKLRD 338 at 345; Boros "Virtual Shareholder Meetings: Who Decides how Companies make Decisions?" 283 and Dignam *Hicks & Goo's Cases and Materials on Company Law* 334.

[180] [1970] AC 1099 (HL).

[181] [1970] AC 1099 (HL).

[182] Cartoon "The Removal of Company Directors" 19-20.

[183] [1969] 1 All ER 1002.

[184] Beuthin "A Director Firmly in the Saddle" 489.

[185] [1969] 1 All ER 1002.

[186] Hahlo "Restrictions on the Alteration of Articles" 351.

In *Muir v Lampl and Another*[187] the High Court of Hong Kong accepted the majority judgment in *Bushell v Faith*[188] as being correct. The court distinguished between an unqualified provision that prohibits the shareholders from removing a particular person as a director, and one that confers weighted voting rights on a shareholder. The court asserted that the first type of agreement constitutes an unlawful fetter on the statutory power conferred by section 157B of the Companies Ordinance (Cap. 32) (the equivalent provision to section 71(1) of the Companies Act).[189] The court commented that, bearing in mind the background leading to the enactment of section 157B of the Companies Ordinance and its equivalent provision in the UK, these statutory provisions are intended to be strong provisions safeguarding shareholders' residual indirect control in the management of the company.[190] They provide an important underpinning for the checks and balances in the distribution of power between the shareholders and directors.[191] For these reasons the court questioned whether absolute immunity from removal could ever be justified.[192] It was, however, asserted by the court that there is a conceptual difference between weighted voting rights and an absolute agreement prohibiting the removal of a director.[193] In the former case, the court stated, the result of the vote is dictated by the vote cast by the shareholder with weighted votes, whereas in the latter, the result is dictated by the terms of the shareholders' agreement prohibiting the removal of a director and is more acute and direct.[194] Based on this reasoning, the court accepted that the

[187] [2005] 1 HKLRD 338.

[188] [1970] AC 1099 (HL).

[189] *Muir v Lampl and Another* [2005] 1 HKLRD 338 at 346, per Lam J. Section 157B of the Companies Ordinance (Cap. 32) provided as follows: "A company may by ordinary resolution remove a director before the expiration of his period of office, notwithstanding anything in its memorandum or articles or in any agreement between it and him: Provided that this subsection shall not, in the case of a private company, authorize the removal of a director holding office for life on the commencement of the Companies (Amendment) Ordinance 1984 (6 of 1984)."

[190] *Muir v Lampl and Another* [2005] 1 HKLRD 338 at 346.

[191] *Muir v Lampl and Another* [2005] 1 HKLRD 338 at 347.

[192] *Muir v Lampl and Another* [2005] 1 HKLRD 338 at 347.

[193] *Muir v Lampl and Another* [2005] 1 HKLRD 338 at 347.

[194] *Muir v Lampl and Another* [2005] 1 HKLRD 338 at 347.

weighted voting rights could be exercised in a manner which would result in the defeat of a shareholders' resolution to remove a director.[195]

Lord Donovan of the House of Lords justified the decision of the majority judgment in *Bushell v Faith*[196] by stating that article 9 was needed to protect shareholders who were directors in small companies. He reasoned that provisions such as article 9 were a safeguard against family quarrels in small family companies running a family business having their repercussions in the boardroom.[197] In light of this rationalisation of the majority judgment, Davies and Worthington suggest that the decision of the majority judgment may be justified in small private companies, which are in effect an incorporated partnership or a quasi-partnership, where it is not unreasonable for each "partner" to be entitled (as under partnership law) to participate in the management of the firm in the absence of his agreement to the contrary and to protect himself against removal by his fellow partners.[198] Rutabanzibwa argues that weighted voting rights are in fact useful in protecting the interests in small private companies which are established on the basis of mutual confidence and trust.[199] Birds et al[200] also express the view that the ratio of *Bushell v Faith*[201] may be legitimate in the context of small private companies. On the basis of the above reasoning and justification it is arguable that the ratio of *Bushell v Faith*[202] must be confined to private companies only, and that it does not apply to public companies.[203]

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[195] *Muir v Lampl and Another* [2005] 1 HKLRD 338 at 344 and 347.

[196] [1970] AC 1099 (HL).

[197] *Bushell v Faith* [1970] AC 1099 (HL) at 1110-1111, per Lord Donovan.

[198] Davies & Worthington *Gower Principles of Modern Company Law* 380. See chapter 7, note 132 for a description of a quasi-partnership.

[199] Rutabanzibwa "What is Golden in the Golden Share? Company Law Implications of Privatisation" 43.

[200] Birds et al *Boyle and Birds' Company Law* 563.

[201] [1970] AC 1099 (HL).

[202] [1970] AC 1099 (HL).

[203] See further D Botha "Some Aspects Concerning the Removal of Directors" 467; Beuthin & Luiz *Beuthin's Basic Company Law* 210-211; Keay "Company Directors Behaving Poorly: Disciplinary Options for Shareholders" 672-673; Kershaw *Company Law in Context* 227 and French, Mayson & Ryan *Mayson, French & Ryan on Company Law* 446.

On the other hand, other commentators have argued that the decision in *Bushell v Faith*[204] runs contrary to the spirit of section 184(1) of the UK Companies Act of 1948. Article 9 of the articles of the company in effect enabled a director of the company to prevent a resolution being passed for his removal from office since he could out-vote the other two shareholders.[205] This meant that directors of the company were irremovable and were effectively entrenched in office.[206] Collier remarks that the minority judgment of Lord Morris of Borth-y-Gest is more in consonance with the spirit and intendment of the law.[207] Schmitthoff also opines that the decision of the House of Lord "contravenes the spirit, if not the letter, of section 184,"[208] and remarks further that the decision of the House of Lords will go down in legal history as one of the most remarkable instances of judicial interpretation defeating the clear intention of the legislator.[209] Prentice expresses the view that the decision of the UK Court of Appeal, which was affirmed by the House of Lords, "reduced section 184 to an empty rhetorical gesture."[210] Kaye remarks that the majority judgment of the House of Lords in *Bushell v Faith*[211] sanctioned a scheme which succeeds in making "a mockery of the law".[212] Griffin agrees with the minority judgment that the acceptance of a weighted voting clause made a mockery of the law because it nullifies the existence of the statutory power to remove a director.[213]

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[204] [1970] AC 1099 (HL).

[205] FHI Cassim "The Division and Balance of Power" 164.

[206] FHI Cassim "The Division and Balance of Power" 164.

[207] Collier "Company - Power to Remove Director by Ordinary Resolution - Weighted Voting - Whether Ordinary Resolution" 42.

[208] Schmitthoff "House of Lords Sanctions Evasion of Companies Act" 2.

[209] Schmitthoff "House of Lords Sanctions Evasion of Companies Act" 1.

[210] Prentice "Removal of Directors from Office" 696.

[211] [1970] AC 1099 (HL).

[212] Kaye "A Mockery of the Law?" 66.

[213] Griffin *Company Law Fundamental Principles* 288. For a further discussion of *Bushell v Faith* [1970] AC 1099 (HL) see Baker "Editorial Notes" 155-157; D Botha "Some Aspects Concerning the Removal of Directors" 467; Anon "'Weighted' or 'Loaded' Votes in Private Companies" D5-D-16; Anon "'Weighted' Votes Again" D17-D20; Rutabanzibwa "What is Golden in the Golden Share? Company Law Implications of Privatisation" 42-43; Beuthin & Luiz *Beuthin's Basic Company Law* 210-211; Boros "Virtual Shareholder Meetings: Who Decides how Companies make Decisions?" 282-284; Griffin *Company Law Fundamental Principles* 54; Delport *Henochsberg on the Companies Act 71 of 2008* 274; R Cassim "Governance and the Board of Directors" in FHI Cassim et al *Contemporary Company Law* 447-448; Kershaw *Company Law in Context* 223-228; FHI Cassim "The Division and Balance of Power" 164-165;

In *Swerdlow v Cohen and Others*[214] Botha J expressed the view that the majority decision in *Bushell v Faith*[215] was incorrect. He agreed with the minority judgment written by Lord Morris of Borth-y-Gest which he stated was "unanswerable".[216] This view is however only an *obiter dictum* because the facts in *Swerdlow v Cohen and Others*[217] are distinguishable from those in *Bushell v Faith*.[218] In *Swerdlow v Cohen and Others*[219] the directors had a right to veto a resolution.[220] While in a sense the power to veto a resolution may be regarded as a special voting right, it is not a species of a loaded or weighted voting right that must be taken into account in counting the votes in order to determine whether an ordinary resolution has been passed.[221] Botha J held that the power of veto was invalid when invoked to defeat a resolution to remove certain directors under section 220 of the Companies Act 61 of 1973.[222] On appeal, Margo J confirmed the dictum of Botha J in the court *a quo*, but found that it was unnecessary to examine the validity of the decision in *Bushell v Faith*[223] or to express an opinion on the main issue in *Bushell v Faith*[224] on

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Birds et al *Boyle and Birds' Company Law* 562-563; French, Mayson & Ryan *Mayson, French & Ryan on Company Law* 95-96 and 446; Davies & Worthington *Gower Principles of Modern Company Law* 380 and Hannigan *Company Law* 174.

[214] 1977 (1) SA 178 (W) at 184-185.

[215] [1970] AC 1099 (HL).

[216] *Swerdlow v Cohen and Others* 1977 (1) SA 178 (W) at 184-185.

[217] 1977 (1) SA 178 (W).

[218] [1970] AC 1099 (HL).

[219] 1977 (1) SA 178 (W).

[220] In *Swerdlow v Cohen and Others* 1977 (1) SA 178 (W) article 42(3) of the then articles of association of the company had stated as follows: "Subject always to the provisions of sec. 64 of the Companies Act, 1926, as amended, questions arising at any meeting of members shall be decided by a majority of votes, provided that if and for so long as Arnold Swerdlow, Ernest Cohen and Karl Bähr or any of them shall be members no resolution shall be of any force or effect unless they or those of them who are members of the company are in favour of the resolution, provided further, however, that if only one of them is against the resolution the other or others may require the resolution to be submitted to arbitration in terms of the Arbitration Act, 1965, and the decision in the arbitration shall then be deemed to be the decision of the members and shall be entered as such in the minute book of the company."

[221] *Swerdlow v Cohen and Others* 1977 (1) SA 178 (W) at 188.

[222] *Swerdlow v Cohen and Others* 1977 (1) SA 178 (W) at 188-189.

[223] [1970] AC 1099 (HL).

[224] [1970] AC 1099 (HL).

the basis that the facts in the case before him were distinguishable from those in *Bushell v Faith*.[225]

3.3.3 The Application of *Bushell v Faith* in South African Law

It is an open question whether the majority judgment of *Bushell v Faith*[226] would be followed by a South African court. There is no difference in general principle between the UK law which applied in *Bushell v Faith*[227] with regard to loaded voting rights and section 37(2) of the (South African) Companies Act, which permits loaded voting rights to be conferred on shareholders. Section 5(2) of the Companies Act permits a court whenever appropriate to consider foreign law. On this basis the dictum of the majority judgment of *Bushell v Faith*[228] would have persuasive authority in South African law.[229]

A further reason why *Bushell v Faith*[230] would have persuasive authority in South African law is that section 71(1) of the Companies Act contains similar wording to that used in section 184(1) of the UK Companies Act of 1948. Section 71(1) of the Companies Act states that a director may be removed from office "[d]espite anything to the contrary in a company's Memorandum of Incorporation or rules, or any agreement between a company and a director, or between any shareholders and a director". As discussed above, with regard to the words "notwithstanding anything in its articles" contained in section 184(1) of the UK Companies Act of 1948, the House of Lords asserted that the reason why Parliament had included these words in section 184(1) was to ensure that a director would be removable by virtue of an ordinary resolution instead of an extraordinary resolution.[231]

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[225] [1970] AC 1099 (HL). *Swerdlow v Cohen* 1977 (3) SA 1050 (T) at 1056. See further MJ Oosthuizen "Swerdlow v Cohen and Others 1977 1 SA 178 (W)" 165-169 and Anon "'Weighted' or 'Loaded' Votes in Private Companies" D-5-D-7 for a discussion of *Swerdlow v Cohen and Others* 1977 (1) SA 178 (W) and Anon "'Weighted' Votes Again" D17-D20 for a discussion of the appeal decision reported in *Swerdlow v Cohen* 1977 (3) SA 1050 (T).

[226] [1970] AC 1099 (HL).

[227] [1970] AC 1099 (HL).

[228] [1970] AC 1099 (HL).

[229] FHI Cassim "The Division and Balance of Power" 165.

[230] [1970] AC 1099 (HL).

[231] *Bushell v Faith* [1970] AC 1099 (HL) at 1108, per Lord Upjohn. See para 3.3.1 above where this is discussed.

The UK Court of Appeal in *Bushell v Faith and Another*[232] also found that the words "notwithstanding anything in its articles" in section 184(1) of the UK Companies Act of 1948 simply acted to ensure that a requirement that a greater majority than a simple majority for passing the removal resolution would be of no effect.

The UK Companies Act of 2006 did not undo the effect of *Bushell v Faith*.[233] The majority judgment is still applicable in the UK, save for listed companies.[234] This means that loaded voting rights remain a valid method of entrenchment for directors in the UK, and a court will enforce loaded voting rights conferred on a shareholding-director even if the loaded voting rights are exercised in a manner which thwarts a shareholders' resolution to remove a director. Griffin asserts that the continued acceptance and validity of weighted voting clauses in the UK is indicative of the view that statutory powers, whilst workable in theory, can in specified circumstances be manipulated to such an extent whereby they are of little practical worth.[235] Section 168 of the UK Companies Act of 2006 states that a company may by ordinary resolution at a meeting remove a director before the expiration of his period of office "notwithstanding anything in any agreement between it and him", deviating from the wording of its predecessor, section 184(1) of the UK Companies Act of 1948, "notwithstanding anything in its articles". In light of this change in wording Dignam remarks that *Bushell v Faith*[236] is no longer of direct authority in the UK in this area of the law.[237] It is submitted, however, that since the House of Lords in *Bushell v Faith*[238] found that the words "notwithstanding anything in its articles" in section 184(1) of the UK Companies Act of 1948 did no more than

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[232] [1969] 1 All ER 1002 at 1004, per Russell LJ.

[233] [1970] AC 1099 (HL). See Griffin *Company Law Fundamental Principles* 288; Keay "Company Directors Behaving Poorly: Disciplinary Options for Shareholders" 672-673; Birds et al *Boyle and Birds' Company Law* 563 and Hannigan *Company Law* 174.

[234] As discussed in para 3.2 above, listed companies in the UK may not issue shares with loaded voting rights. See Premium Listing Principle 3 of Listing Rule 7.2.1A contained in Chapter 7 of the UK Listing Rules, which requires equity shares admitted to a premium listing to carry an equal number of votes on any shareholder vote.

[235] Griffin *Company Law Fundamental Principles* 288.

[236] [1970] AC 1099 (HL).

[237] Dignam *Hicks & Goo's Cases and Materials on Company Law* 334.

[238] [1970] AC 1099 (HL).

ensure that a director is removable by an ordinary resolution instead of by a special resolution and that these words did not prevent loaded voting rights being used to prevent the removal of a shareholding-director, the omission of these words from section 168(1) of the UK Companies Act of 2006 would not alter the effect of *Bushell v Faith*[239] on the removal of directors by loaded voting rights. Section 303 of the UK Companies Act of 1985, the predecessor to section 168 of the UK Companies Act of 2006, stated that a company may by ordinary resolution remove a director before the expiration of his period in office "notwithstanding anything in its articles or in any agreement between it and him." The Government remarked that the reason for the reference to the "articles" in section 168 of the UK Companies Act of 2006 being deleted was that it was not necessary to include a reference to the articles since the articles may not in any case override the requirements set out in the UK Companies Act of 2006.[240]

While *Bushell v Faith*[241] may have persuasive authority in South African law, it is submitted that the House of Lords adopted a limited interpretation of the words "notwithstanding anything in its articles" in section 184(1) of the UK Companies Act of 1948. The wide wording of section 184(1) of the UK Companies Act of 1948 indicates that the section was aimed at preventing *any* form of entrenchment of directors by whatever means possible.[242] In a similar vein it is arguable that giving the words "despite anything to the contrary" in section 71(1) of the (South African) Companies Act their ordinary meaning indicates that the legislature intended to override *any* methods, whether direct or indirect, designed to ensure that a director is not removed from office,[243] and not just to ensure that a director is removed from office by an ordinary resolution. Accordingly if an article in the Memorandum of Incorporation of a company confers loaded voting rights on a particular class of shares which has the effect of defeating an

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[239] [1970] AC 1099 (HL).

[240] Hansard, May 2006, Volume No. 681, Part No. 142 at column 826, per Lord Sainsbury of Turville. See further Kershaw *Company Law in Context* 223; Worthington *Sealy & Worthington's Text, Cases and Materials in Company Law* 300 and chapter 3, note 24 where the deletion of the reference to the words "notwithstanding anything its articles" in s 168(1) of the UK Companies Act of 2006 is discussed further.

[241] *Bushell v Faith* [1970] AC 1099 (HL).

[242] Kaye "A Mockery of the Law?" 65.

[243] See Delport *Henochsberg on the Companies Act 71 of 2008* 274 and R Cassim "Governance and the Board of Directors" in FHI Cassim et al *Contemporary Company Law* 448.

ordinary resolution to remove a director, it is submitted that such an article would be an indirect method of entrenching a director in office and that it would be in breach of section 71(1) of the Companies Act.

A critical provision of the (South African) Companies Act is the anti-avoidance provision contained in section 6(1). This provision must be considered in evaluating the weight of the majority judgment in *Bushell v Faith*[244] in South African law. This provision empowers a court, on application by the CIPC, the Takeover Regulation Panel or an exchange in respect of a company listed on an exchange, to 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."

A court would have to examine the substance of a provision to ascertain whether it is primarily or substantially intended to circumvent an unalterable provision in the Companies Act.[245] The test for "primarily" is a subjective test and requires that one's state of mind be directed at defeating or reducing the effect of a prohibition or requirement established by or in terms of an unalterable provision of the Companies Act.[246] "Substantially" is aimed at the effect of the provision rather than the intention.[247] Accordingly if the primary intention of a provision is not to defeat the effect of a prohibition or a requirement in the Companies Act but objectively it has the effect that it has been defeated, then that provision would fall foul of section 6(1) of the Companies Act.[248]

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[244] [1970] AC 1099 (HL).

[245] FHI Cassim "Introduction to the New Companies Act" in FHI Cassim et al *Contemporary Company Law* 7.

[246] Delport *Henochsberg on the Companies Act 71 of 2008* 40.

[247] Delport *Henochsberg on the Companies Act 71 of 2008* 40.

[248] Delport *Henochsberg on the Companies Act 71 of 2008* 40.

Section 71(1) of the Companies Act is an unalterable provision of the Companies Act as it does not expressly contemplate that its effect may be negated, restricted, limited, qualified, extended or otherwise altered in substance or effect by a company's Memorandum of Incorporation.[249] It follows that no Memorandum of Incorporation of a company may negate, restrict, limit, qualify, extend or alter the substance or effect of the power conferred by section 71(1) of the Companies Act on the shareholders to remove directors. It is arguable that if the Memorandum of Incorporation of a company contains a provision conferring loaded voting rights on certain shares with the intention of defeating a resolution to remove a director from office, such a provision may be declared void under section 6(1) of the Companies Act on the basis that it is primarily intended to defeat section 71(1) of the Companies Act.[250] It is submitted that if a provision in the Memorandum of Incorporation were to confer loaded voting rights on shareholders with regard to voting generally on ordinary resolutions, and not specifically with regard to voting on an ordinary resolution to remove a director, but the substantial effect of the exercise of the loaded voting rights on a removal resolution is that the effect of section 71(1) of the Companies Act is defeated, such a provision would also fall foul of section 6(1) of the Companies Act. A loaded voting rights clause which has the practical effect of thwarting the removal of a director would clearly defeat the intention behind section 71(1) of the Companies Act and render the statutory provision of little practical worth. It is accordingly submitted that under the Companies Act a provision in the Memorandum of Incorporation conferring loaded voting rights may be declared void under section 6(1) of the Companies Act to the extent that it defeats section 71(1) of the Companies Act.

It is noteworthy that the legislature stated in section 65(8) of the Companies Act that while the threshold for the passing of an ordinary resolution may be increased, this may not be done with regard to an ordinary resolution for the removal of a director.[251]

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[249] Refer to chapter 3, para 2.1 for a discussion on alterable and unalterable provisions of the Companies Act.

[250] See further FHI Cassim "The Division and Balance of Power" 165.

[251] Section 65(8) of the Companies Act states as follows:

> "Except for any ordinary resolution for the removal of a director under s 71, a company's Memorandum of Incorporation may require –
> (a) a higher percentage of voting rights to approve an ordinary resolution; or

Presumably the legislature enacted this restriction in order to prevent a company, in its Memorandum of Incorporation, from increasing the threshold to pass an ordinary resolution with the intention of making it difficult or impossible to remove a director from office. It is submitted that since loaded voting rights may have the effect of making it difficult or impossible to remove a shareholding-director from office, in light of section 6(1) of the Companies Act, a similar exception should be carved out in section 37(2) of the Companies Act to the effect that a company may not permit shares to have more than one vote per share where this will have the effect of defeating section 71(1) of the Companies Act. It is accordingly submitted that section 37(2) must be tightened up by the legislature in order to prevent an evasion of section 71(1) of the Companies Act by the device of loading of voting rights. The following amendment to section 37(2) of the Companies Act is proposed:

> "(2) Each issued share of a company, regardless of its class, has associated with it one general voting right, except to the extent provided otherwise by-
>
> *(a)* this Act; or
>
> *(b)* the preferences, rights, limitations and other terms determined by or in terms of the company's Memorandum of Incorporation in accordance with section 36~~,~~;
>
> provided that the Memorandum of Incorporation may not make provision for an issued share of a company to have associated with it more than one general voting right in circumstances where this will have the effect of primarily or substantially defeating section 71(1) of this Act."[252]

(b) one or more higher percentages of voting rights to approve ordinary resolutions concerning one or more particular matters, respectively,

provided that there must at all times be a margin of at least 10 percentage points between the highest established requirement for approval of an ordinary resolution on any matter, and the lowest established requirement for approval of a special resolution on any matter."

See chapter 5, para 3 where s 65(8) of the Companies Act is discussed.

[252] The recommended insertions to s 37(2) of the Companies Act are underlined, while the recommended deletion is "struck out."

Until a South African court authoritatively decides on the impact of *Bushell v Faith*[253] on our law or the legislature clarifies the legal position in this regard, it remains an open question whether *Bushell v Faith*[254] would be followed in our law, and whether loaded voting rights attaching to a director's shares may be used as a device to defeat a shareholders' resolution for his removal. The exercise of loaded voting rights are a consideration which must be taken into account with regard to the removal of a shareholding-director from office. For this reason it is imperative that, where a director is also a shareholder, before initiating proceedings to remove a director from office, cognisance is taken whether the Memorandum of Incorporation of the company permits loaded voting rights to be exercised by the shareholding-director, and whether a director would validly be able to use his loaded voting rights to block his removal from office.

4. CONCLUSIONS AND RECOMMENDATIONS

This chapter discussed two considerations regarding the removal of a director by the board of directors in circumstances where the director holds multiple positions or capacities in relation to the company. The first consideration is where a director is both a director and an employee of the company.[255] In this event the executive director enjoys the protection of both the Companies Act and the LRA.[256] Accordingly when an executive director is removed from office, the provisions of both the Companies Act and the LRA must be considered.[257] A distinction must be drawn between the removal of a director from his office as a director of the company, and the removal of a director from his position as an employee of the company.[258]

Reliance on an automatic termination provision to automatically bring an employment relationship to an end once an individual is removed from office as a director is not

[253] [1970] AC 1099 (HL).

[254] [1970] AC 1099 (HL).

[255] See paras 2 and 2.1 above.

[256] See para 2.1 above.

[257] See para 2.1 above.

[258] See para 2.1 above.

permissible.[259] If an executive director is removed from office by the board of directors or by the shareholders the proper procedures under the LRA must be followed to also dismiss the former director as an employee.[260] A company may not contract out of complying with these procedures by the mechanism of automatic termination clauses.[261] Even if an executive director purported to waive his right to be fairly dismissed as an employee, the waiver would be against public policy and unenforceable.[262] If a company does not have a valid ground to fairly dismiss the director as an employee, it may have to accommodate the former director in another capacity.[263] If an appropriate vacancy does not exist in the company the company would have to follow the procedures for dismissal based on operational requirements under section 189 of the LRA and retrench the former-director employee.[264]

While automatic termination clauses are not valid, this chapter discussed two instances when reverse automatic termination provisions may be valid.[265] The first instance is where the Memorandum of Incorporation imposes an additional ground of ineligibility or disqualification of directors under section 69(6) of the Companies Act to the effect that a director will be ineligible or disqualified to be a director if he is not an employee of the company.[266] The second instance when reverse automatic termination provisions may be valid is where an *ex officio* director ceases to hold the office, title, designation or similar status that entitled him to be an *ex officio* director.[267] In this event he will automatically cease to be a director of the company.[268]

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[259] See para 2.2 above.

[260] See para 2.2 above.

[261] See para 2.2 above.

[262] See para 2.2 above.

[263] See para 2.2 above.

[264] See para 2.2 above.

[265] See para 2.3 above.

[266] See para 2.3.1 above.

[267] See para 2.3.2 above.

[268] See para 2.3.2 above.

If the dismissal of the executive director as an employee is found to be unfair, the unfairly dismissed director-employee will be entitled to use the remedies for unfair dismissal provided for by the LRA and to claim reinstatement, re-employment or compensation for the unfair dismissal.[269] The consequences of not terminating the employment of an executive director in a substantially and procedurally fair manner are severe for a company.[270] A company must consider whether it will be feasible to retain the former director as an employee, particularly if there has been a breakdown in the relationship between the director and the company.[271] It is not always practical to strictly separate the two positions held by an executive director, or to consistently apply a strict separation of such positions.[272] These are some limitations which the board of directors must take into account prior to taking steps under the Companies Act and the LRA to remove an executive director from office.

The second consideration which must be taken into account before removing a director from office is whether the director is a shareholder of the company and holds loaded voting rights in the company.[273] This chapter discussed and evaluated the leading UK case of *Bushell v Faith*,[274] in which a shareholding-director prevented his removal from office by the exercise of his loaded voting rights.[275] This decision is a controversial one.[276] The extent of the persuasive force in South African law of the majority and minority judgment in this case was considered.[277] It is not clear whether the majority judgment of

[269] See para 2.2 above.

[270] See para 2.2 above.

[271] See para 2.2 above.

[272] See para 2.2 above.

[273] See paras 3 and 3.2 above.

[274] [1970] AC 1099 (HL).

[275] See paras 3.3.1 and 3.3.2 above.

[276] See para 3.3.2 above.

[277] See para 3.3.3 above.

Bushell v Faith[278] would be followed by a South African court.[279] While the majority decision may have persuasive authority in South African law, at the same time a provision in the Memorandum of Incorporation of a company that confers loaded voting rights on a particular class of shares and has the effect of defeating an ordinary resolution to remove a director, would be an indirect method of entrenching a director in office.[280] Such a provision may contravene section 71(1) of the Companies Act, and may also fall foul of the anti-avoidance provision contained in section 6(1) of the Companies Act.[281]

It was suggested that section 37(2) of the Companies Act, which permits loaded voting rights to be issued, must be tightened up by the legislature in order to prevent an evasion of section 71(1) of the Companies Act by the loading of voting rights.[282] An amendment to section 37(2) of the Companies Act was proposed.[283]

Until the courts authoritatively decide on the impact of the ratio of *Bushell v Faith*[284] on South African law or the legislature clarifies the legal position in this regard, it remains an open question whether *Bushell v Faith*[285] would be followed in our law, and whether loaded voting rights attaching to a director's shares may be used as a device to defeat a shareholders' resolution for his removal.[286] Both public and private companies (but not listed companies) must carefully consider whether their Memorandum of Incorporation permits loaded voting rights to be exercised by a shareholding-director, and whether the shareholding-director would be able to effectively use his loaded voting rights to block his removal from office.[287]

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[278] [1970] AC 1099 (HL).

[279] See para 3.3.3 above.

[280] See para 3.3.3 above.

[281] See para 3.3.3 above.

[282] See para 3.3.3 above.

[283] See para 3.3.3 above.

[284] [1970] AC 1099 (HL).

[285] [1970] AC 1099 (HL).

[286] See para 3.3.3 above.

[287] See para 3.3.3 above.

CHAPTER 6 THE JUDICIAL REMOVAL OF DIRECTORS FROM OFFICE

1. INTRODUCTION

Sections 71(6) and 162 of the Companies Act enable an appropriate court to remove a director from office. This chapter examines the removal of directors under these sections. It also examines the judicial removal of directors under the UK Company Directors Disqualification Act 1986, the Australian Corporations Act of 2001, the MBCA, the DGCL and the relevant legislation of various USA States with a view to comparing sections 71(6) and 162 with the equivalent legislation in these jurisdictions. Based on the comparative research some recommendations are proposed to improve and enhance the provisions of sections 71(6) and 162 of the Companies Act.

In terms of section 71(5) of the Companies Act a director who has been removed by the board of directors, or any person who appointed that director as contemplated in section 66(4)(*a*)(i) of the Companies Act,[1] may apply to court to review the determination of the board within twenty business days.[2] Under section 71(5) of the Companies Act a court does not itself remove a director from office. Instead, a court is empowered to confirm the board's decision to remove a director from office, or, alternatively, to overturn the board's decision to remove a director from office. While section 71(5) empowers the courts to assess and evaluate the board's decision to remove a director, and to confirm or overturn that decision, the provision would be invoked by a director who has already been removed from office by the board of directors. Strictly speaking therefore, section 71(5) of the Companies Act does not constitute a judicial power to remove a director from office since the director would already have been removed from office by the board of directors. Section 71(5) of the Companies Act is discussed in

[1] Section 66(4)(*a*)(i) of the Companies Act makes provision for a company's Memorandum of Incorporation to provide for the direct appointment and removal of one or more directors by any person who is named in or determined in terms of the Memorandum of Incorporation.

[2] Section 71(5) is discussed further in chapter 4, para 4.1 and chapter 7, para 2.

chapter 7 as one of the remedies which are available to a director who has been removed from office by the board of directors.

2. SECTION 71(6) OF THE COMPANIES ACT

In terms of section 71(6) of the Companies Act, if the board of directors has determined that a director is *not* ineligible, disqualified or incapacitated or has *not* been negligent or derelict (as the case may be), any director who voted otherwise on the resolution or any holder of voting rights entitled to be exercised in the election of that director, may apply to court to review the board's determination.[3] For instance, if the applicant is of the view that the board of directors favoured the impugned director or breached its fiduciary duty in failing to remove the impugned director from office, the applicant may apply to court to review the board's decision *not* to remove the director from office.

A court may either confirm the decision of the board of directors not to remove the director in question from office or it may itself "remove the director from office, if the court is satisfied that the director is ineligible or disqualified, incapacitated, or has been negligent or derelict."[4] Section 71(6) of the Companies Act thus confers on a court a direct power to remove a director from office.[5] In terms of section 70(1)(*b*)(vi)(*cc*), if a director is removed from office by an order of the court in terms of section 71(6) of the Companies Act, the person removed from office ceases to be a director and a vacancy arises on the board of the company.

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[3] Section 71(6)(*a)* of the Companies Act.

[4] Section 71(6)(*b*) of the Companies Act.

[5] A court also has a direct power to remove a director from office under s 137(5) of the Companies Act (see chapter 1, para 1). In terms of this provision a business rescue practitioner may, at any time during the business rescue proceedings, apply to court for an order removing a director from office. The grounds under which such an application may be instituted are that the director in question has failed to comply with a requirement of Chapter 6 (Business rescue and compromise with creditors) of the Companies Act, or by an act or omission has impeded or is impeding the business rescue practitioner in the performance of his powers and functions, the management of the company by the practitioner, or the development or the implementation of a business rescue plan. The removal of a director from office by a business rescue practitioner is beyond the scope of this thesis and is not addressed in this study. For a discussion on the removal of a director by a court on the application of a business rescue practitioner see Loubser *Some Comparative Aspects of Corporate Rescue in South African Company Law* (Unpublished LLD Thesis) 112-113; Delport *Henochsberg on the Companies Act 71 of 2008* 482(56)-482(57); FHI Cassim "Business Rescue and Compromises" in FHI Cassim et al *Contemporary Company Law* 887 and FHI Cassim "Business Rescue and Compromises" in Loubser & Mahony *Company Secretarial Practice* 26-27.

Section 71(6) of the Companies Act also applies to decisions of the Companies Tribunal not to remove a director from office.[6] Therefore a decision of the Companies Tribunal not to remove a director from office is also subject to a review in terms of section 71(6) of the Companies Act. The application of section 71(6) to the removal of a director by the Companies Tribunal is discussed in chapter 3.[7]

2.1 *Locus Standi* to Apply to Court to Review the Board's Decision

Section 71(6)(*a*) of the Companies Act confers *locus standi* on only two persons to apply to court for a review of the board's decision not to remove a director from office. These two persons are a director who voted in favour of the removal resolution, and a holder of voting rights entitled to be exercised in the election of that director. It should be noted that section 71(3) of the Companies Act empowers a "shareholder" to allege that a director has become ineligible, disqualified, incapacitated, neglectful or negligent, while section 71(6)(*a*) empowers "any holder of voting rights entitled to be exercised in the election of that director" to apply to court to review the board's decision.

A "shareholder" may not necessarily be a "holder of voting rights entitled to be exercised in the election of that director." A shareholder is defined in section 1 of the Companies Act as meaning, subject to section 57(1) of the Companies Act, the holder of a share issued by the company and whose name is entered as such in the securities register. In terms of section 57(1) of the Companies Act, for the purposes of Part F (Governance of companies) "shareholder" has the meaning set out in section 1 of the Companies Act but also includes a person who is entitled to exercise any voting rights in relation to a company, irrespective of the form, title or nature of the securities to which those voting rights are attached.[8] A particular shareholder may not necessarily have voting rights to elect to office the director who is the subject of a removal

[6] See s 71(8)(*c*) of the Companies Act which provides that s 71(6), read with the changes required by the context, applies to the determination of the matter by the Companies Tribunal. As discussed in chapter 3, para 9 if a company has fewer than three directors s 71(3) of the Companies Act does not apply to the removal of a director but a director or a shareholder may apply to the Companies Tribunal to determine the matter of the director's removal from office.

[7] See chapter 3, para 9 for a discussion on the removal of a director by the Companies Tribunal.

[8] In respect of a profit company "voting rights" are the rights of any holder of the company's securities to vote in connection with a matter to be decided by a company. In respect of a non-profit company voting rights are the rights of a member to vote in connection with the matter (see s 1 of the Companies Act).

resolution. In this event the shareholder would not be empowered under section 71(6) of the Companies Act to apply to court to review the board's decision not to remove the director from office. This means that a shareholder who does not have voting rights to elect a particular director to office, may make an allegation against a director under section 71(3), but, if the board does not remove the particular director from office, that shareholder will not have a remedy under section 71(6) of the Companies Act to apply to court to review the board's decision.

It seems anomalous to provide a shareholder with the right to make an allegation against a director under section 71(3) but not to provide him with a remedy to apply to court to review the board's decision not to remove the director from office. Notably under section 71(6) "any" holder of voting rights entitled to be exercised in the election of that director may apply to court to review the board's determination not to remove the director from office, regardless of whether or not such person made an allegation against the director under section 71(3) of the Companies Act.

2.2 The Powers Conferred on a Court under a Section 71(6) Review Application

Section 71(6)(*a*) of the Companies Act states that the decision of the board of directors not to remove a director from office may be taken on "review." A distinction is drawn in South African law between an appeal and a review.[9] In the strict traditional sense a review involves an enquiry into the procedural aspects of a decision.[10] In contrast, an appeal is a reconsideration

[9] The distinction between an appeal and a review stems from the doctrine of separation of powers. This doctrine holds that it would not be acceptable for judges to pronounce on the merits of administrative decisions because the judiciary would be usurping the functions entrusted by the Constitution and by Parliament to the executive branch of government. The administration forms part of the executive branch of government. The court's role in administrative law is therefore restricted to ensuring that the administration keeps within its mandate and exercises its function in a manner that complies with all law. See *Carephone (Pty) Ltd v Marcus NO and Others* 1999 (3) SA 304 (LAC) para 34; *Pharmaceutical Manufacturers Association of South Africa and Another; In Re: Ex Parte Application of the President of the Republic of South Africa and Others* 2000 (2) SA 674 (CC) para 45; *Bato Star Fishing (Pty) Ltd v Minister of Environmental Affairs and Tourism and Others* 2004 (4) SA 490 (CC) para 46; Hoexter "The Future of Judicial Review in South African Administrative Law" 490; Hoexter, Lyster & Currie *The New Constitutional and Administrative Law* 65; Hoexter *Administrative Law in South Africa* 111; Corder "The Development of Administrative Law in South Africa" in Quinot et al *Administrative Justice in South Africa: An Introduction* 13-14 and Quinot "Regulating Administrative Action" in Quinot et al *Administrative Justice in South Africa: An Introduction* 107. For a general discussion on the separation of powers doctrine see Maree "Administrative Authorities in Legal Context" in Quinot et al *Administrative Justice in South Africa: An Introduction* 34-40.

[10] See *Tikly and Others v Johannes NO and Others* 1963 (2) SA 588 (T) at 590-591 where the difference between an appeal and a review is discussed. See further on the distinction between an appeal and a review *Minister of*

of, and a fresh determination on the merits of the matter, but it is limited to the evidence or information on which the original decision was given.[11] Since an appeal is concerned with the merits of the matter, the question in an appeal is whether the decision was right or wrong.[12] The question in a review is not whether the decision was wrong or right, but whether the manner in which the decision was reached is acceptable.[13] As expressed by the Supreme Court of Appeal in *Rustenburg Platinum Mines Ltd (Rustenburg Section) v Commission for Conciliation, Mediation and Arbitration*[14] in a review the "focus is on the process and on the way in which the decision-maker came to the challenged conclusion". Therefore in a review a court is not entitled to consider the merits of the decision.[15] Instead, the focus in a review is whether the procedure adopted was formally correct or whether there were irregularities in the proceedings which may show that there has been "a failure of justice".[16]

In practice, however, the distinction between questions of procedure and merits is not always clear.[17] It may be that the term "appeal" or "review" is used in legislation when the intention of the legislature is in substance to confer a narrower or a wider power on the courts.[18] In some instances it may be impossible to separate the merits of the decision from the decision-making

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Environmental Affairs and Tourism and Others v Phambili Fisheries (Pty) Ltd; Minister of Environmental Affairs and Tourism and Others v Bato Star Fishing (Pty) Ltd 2003 (6) SA 407 (SCA) para 52.

[11] There is a distinction between an appeal in the ordinary strict sense and an appeal in the wide sense. An appeal in the ordinary strict sense is a re-hearing on the merits but is limited to the evidence or information on which the decision under appeal was given, and in which the only determination is whether that decision was right or wrong. An appeal in the wide sense is a complete re-hearing of and a fresh determination on the merits of the matter with or without additional evidence or information. See *Tikly and Others v Johannes NO and Others* 1963 (2) SA 588 (T) at 590–591; *Health Professions Council of SA v De Bruin* [2004] 4 All SA 392 (SCA) para 23; *Samancor Group Pension Fund v Samancor Chrome* 2010 (4) SA 540 (SCA) para 15 and Hoexter *Administrative Law in South Africa* 68.

[12] *Tikly v Johannes NO* 1963 (2) SA 588 (T) at 590; *Thuketana v Health Professions Council of South Africa* 2003 (2) SA 628 (T) at 634–635; *Rustenburg Platinum Mines Ltd (Rustenburg Section) v Commission for Conciliation, Mediation and Arbitration* 2007 (1) SA 576 (SCA) para 30; L Baxter *Administrative Law* 256; Hoexter, Lyster & Currie *The New Constitutional and Administrative Law* 64; Hoexter *Administrative Law in South Africa* 108.

[13] Hoexter, Lyster & Currie *The New Constitutional and Administrative Law* at 64; Hoexter *Administrative Law in South Africa* 65.

[14] 2007 (1) SA 576 (SCA) para 31.

[15] Hoexter, Lyster & Currie *The New Constitutional and Administrative Law* 64 and 110.

[16] *Davies v Chairman, Committee of the Johannesburg Stock Exchange* 1991 (4) SA 43 (W) at 48.

[17] L Baxter *Administrative Law* 255; Hoexter, Lyster & Currie *The New Constitutional and Administrative Law* 65.

[18] L Baxter *Administrative Law* 255; Hoexter *Administrative Law in South Africa* 65 and 68-69.

process since a court is not able to effectively assess the legality of the decision without considering its merits as well.[19] Accordingly, the focus of a review may in some instances fall on the merits of the decision, instead of the decision-making process.[20] In *Rustenburg Platinum Mines Ltd (Rustenburg Section) v Commission for Conciliation, Mediation and Arbitration*[21] the Supreme Court of Appeal acknowledged that the line between review and appeal may be "notoriously difficult to draw." The Supreme Court of Appeal explained that this is "partly because process-related scrutiny can never blind itself to the substantive merits of the outcome."[22] Nevertheless, the distinction between appeal and review is steadfastly upheld in our courts.[23]

Section 71(6)(*b*) of the Companies Act provides that a court may either (i) confirm the determination of the board of directors not to remove the director from office, or (ii) it may itself remove the director from office, if it is "satisfied" that the director is ineligible, disqualified, incapacitated, or has been negligent or derelict. The word "satisfied" indicates that, in reviewing the board's decision not to remove a director, a court is empowered to

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[19] Hoexter *Administrative Law in South Africa* 110; Quinot "Regulating Administrative Action" in Quinot et al *Administrative Justice in South Africa: An Introduction* 108. For instance, review on the ground of reasonableness applies to the process followed in taking the action but also necessitates some degree of consideration of the merits since the reasonableness of the consequences of the action taken also falls to be reviewed (Corder "The Development of Administrative Law in South Africa" in Quinot et al *Administrative Justice in South Africa: An Introduction* 14). Corder describes review on the ground of reasonableness, which contains a merits-based substantive element, as not an appeal nor a mere procedural review, but as a "substantive" or "wide" review (Corder "Without Deference, With Respect: A Response to Justice O'Regan" 443-444).

[20] Hoexter, Lyster & Currie *The New Constitutional and Administrative Law* 65.

[21] 2007 (1) SA 576 (SCA) para 31.

[22] *Rustenburg Platinum Mines Ltd (Rustenburg Section) v Commission for Conciliation, Mediation and Arbitration* 2007 (1) SA 576 (SCA) para 31. The remarks of the Supreme Court of Appeal were made in the specific context of review for rationality, which is an element of reasonableness. In *Bato Star Fishing (Pty) Ltd v Minister of Environmental Affairs* 2004 (4) SA 490 (CC) para 45, the Constitutional Court, per O'Regan J, also noted that review on the ground of reasonableness gives administrative law review a substantive element. See further Corder "Without Deference, With Respect: A Response to Justice O'Regan". Hoexter opines that it is difficult to draw the line clearly between review and appeal with regard to any ground of review (and not only that of rationality) that gives some scope for judicial choice, and that courts can avoid scrutiny of the merits only in cases decided on the narrowest or most technical grounds (Hoexter *Administrative Law in South Africa* 110 and 351-352; Hoexter "The Future of Judicial Review in South African Administrative Law" 491).

[23] See for instance *Bato Star Fishing (Pty) Ltd v Minister of Environmental Affairs and Others* 2004 (4) SA 490 (CC) para 45 where the Constitutional Court, per O'Regan J, emphasised that the distinction between appeals and reviews continues to be significant. Likewise, in *Shoprite Checkers (Pty) Ltd v Commission for Conciliation, Mediation and Arbitration* 2009 (3) SA 493 (SCA) para 28 the Supreme Court of Appeal remarked that "whilst at times it may be difficult to draw the line [between appeal and review], the distinction must not be blurred." See further Quinot "Regulating Administrative Action" in Quinot et al *Administrative Justice in South Africa: An Introduction* 108.

consider the substance of the decision or the merits of the matter, and not merely the procedural aspects of the decision.[24] It appears that the court's review powers under section 71(6) of the Companies Act are not confined to reviewing the manner in which the decision was reached but extend to considering the merits of the decision. Accordingly the term "review" is not used in section 71(6) of the Companies Act in the traditional sense because the focus of the review may fall on the decision itself instead of the decision-making process. Section 71(6) is therefore an example of the lines between an appeal and a review being blurred. It is submitted that the "review" in section 71(6) of the Companies Act may be described as a "substantive" or a "wide review."[25]

It is submitted that the review power conferred on courts in section 71(6) of the Companies Act may also be construed to be a special statutory power of review. In *Johannesburg Consolidated Investment Co v Johannesburg Town Council*[26] Innes CJ distinguished three types of judicial review in the South African system: a review of the decisions of the inferior courts, a common-law (inherent) review of decisions of administrative authorities, and a wider form of statutory review.[27] The special statutory review is one where the legislature confers on the courts a statutory power of review.[28] With reference to this type of review, Innes CJ stated that a court could:

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[24] Ncube "You're Fired! The Removal of Directors under the Companies Act 71 of 2008" 47.

[25] See note 19 above and Corder "Without Deference, With Respect: A Response to Justice O'Regan" at 443-444 where he describes review on the ground of reasonableness, which contains a merits-based substantive element, as not an appeal nor a mere procedural review, but as a "substantive" or a "wide" review.

[26] 1903 TS 111 at 115-117.

[27] These three forms of review still exist today but other forms of review have since developed. For instance, another type of review is judicial review in the constitutional sense where courts have the power to declare unconstitutional any type of legislation that infringes on rights in the Bill of Rights or which offends against provisions of the Constitution. A further type of review is automatic review. Certain statutes make provision for the decisions of magistrates or other judicial officers to be reviewed automatically by judges, without an application for review being initiated. What used to be common-law review in administrative law has now predominantly been constitutionalised by s 33 of the Constitution and by the Promotion of Administrative Justice Act 3 of 2008 (see *Pharmaceutical Manufacturers Association of South Africa and Another; In Re: Ex Parte Application of the President of the Republic of South Africa and Others* 2000 (2) SA 674 (CC) paras 44-45 and *Bato Star Fishing (Pty) Ltd v Minister of Environmental Affairs and Tourism and Others* 2004 (4) SA 490 (CC) para 22). Section 33 of the Constitution provides that everyone has the right to administrative action that is lawful, reasonable and procedurally fair. It states further that national legislation must be enacted to give effect to these rights. This national legislation is the Promotion of Administrative Justice 3 of 2008. On the various forms of review see L Baxter *Administrative Law* 707; Hoexter, Lyster & Currie *The New Constitutional and Administrative Law* 66-67; Hoexter *Administrative Law in South Africa* at 112-113 and Quinot "Regulating Administrative Action" in Quinot et al *Administrative Justice in South Africa: An Introduction* 107-111.

[28] *Nel and Another NNO v The Master (Absa Bank and Others Intervening)* 2005 (1) SA 276 (SCA) para 22; *Twala v MEC for Education, Eastern Cape and Others* 2016 (2) SA 425 (ECB) para 11.

> ". . . enter upon and decide the matter *de novo*. It possesses not only the powers of a court of review in the legal sense, but it has the functions of a court of appeal with the additional privileges of being able, after setting aside the decision arrived at . . . to deal with the whole matter upon fresh evidence as a court of first instance."[29]

In *Nel and Another NNO v The Master (Absa Bank Ltd and Others Intervening)*[30] the Supreme Court of Appeal, per Van Heerden AJA, approved the above dictum of Innes CJ. The Supreme Court of Appeal affirmed that a statutory power of review confers on the court powers of both appeal and review with the additional power, if required, of receiving new evidence and of entering into and deciding the whole matter afresh.[31] The court's powers under a statutory power of review are not however unlimited or unrestricted.[32] The extent of any statutory review type power depends on the particular statutory provision concerned and on the nature and extent of the functions entrusted to the person or body making the decision under review.[33] A statutory power of review may be wider than a judicial review of administrative action since it combines aspects of both a review and an appeal, but it may also be narrower if the court is confined to particular grounds of review or particular remedies.[34]

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[29] *Johannesburg Consolidated Investment Co v Johannesburg Town Council* 1903 TS 111 at 117.

[30] 2005 (1) SA 276 (SCA) para 22.

[31] *Nel and Another NNO v The Master (Absa Bank Ltd and Others Intervening)* 2005 (1) SA 276 (SCA) para 23. See further *Simelane v Minister of Justice and Constitutional Development* 2009 (5) SA 485 (C) para 10; *Al-Kharafi & Sons v Pema and Others NNO* 2010 (2) SA 360 (W) paras 22-23; *Tongaat Paper Co (Pty) Ltd v The Master and Others* 2011 (2) SA 17 (KZP) para 27 and *Van Zyl and Others NNO v The Master, Western Cape High Court and Another* 2013 (5) SA 71 (WCC) para 19.

[32] *Nel and Another NNO v The Master (Absa Bank Ltd and Others Intervening)* 2005 (1) SA 276 (SCA) para 23.

[33] *Nel and Another NNO v The Master (Absa Bank Ltd and Others Intervening)* 2005 (1) SA 276 (SCA) para 23. See further *Twala v MEC for Education, Eastern Cape and Others* 2016 (2) SA 425 (ECB) para 11 and L Baxter *Administrative Law* 707.

[34] *Nel and Another NNO v The Master (Absa Bank Ltd and Others Intervening)* 2005 (1) SA 276 (SCA) para 23. See further on the special statutory review *Simelane v Minister of Justice and Constitutional Development* 2009 (5) SA 485 (C) para 10; *Al-Kharafi & Sons v Pema and Others NNO* 2010 (2) SA 360 (W) paras 22-23; *Tongaat Paper Co (Pty) Ltd v The Master and Others* 2011 (2) SA 17 (KZP) para 27; *Van Zyl and Others NNO v The Master, Western Cape High Court and Another* 2013 (5) SA 71 (WCC) para 19; *Twala v MEC for Education, Eastern Cape and Others* 2016 (2) SA 425 (ECB) para 11; L Baxter *Administrative Law* 707; Hoexter, Lyster & Currie *The New Constitutional and Administrative Law* 67 and Hoexter *Administrative Law in South Africa* 112-114. Examples of a statutory power of review are the review of a decision, ruling, order or taxation of the Master of the High Court in terms of s 151 of the Insolvency Act 24 of 1936; a review to the Labour Court of arbitration awards made by the CCMA (see s 145 of the LRA); a review of decisions made in terms of the Promotion of Access to Information Act 2 of 2000 which takes place on grounds to be gleaned from this Act (see ss 74-82) and a review of private arbitration in terms of s 33(1) of the Arbitration Act 42 of 1965.

It is submitted that the power given to the courts under a section 71(6) review is wider than a mere review. It combines aspects of both a review and an appeal since the court is empowered to consider the substance of the decision of the board of directors not to remove the director from office, and not merely the procedural aspects of the decision. For this reason it is submitted that the power conferred on courts in section 71(6) of the Companies Act may be construed as a special statutory power of review. The court's remedies are, however, limited by section 71(6)(*b*) of the Companies Act to confirming the determination of the board of directors not to remove the director from office, or removing the director from office. It does not appear from the wording of section 71(6)(*b*) of the Companies Act that the court is empowered to grant any other remedy under its statutory review power (save for making a costs order).[35]

If a court is satisfied that the director concerned is ineligible, disqualified, incapacitated, or has been negligent or derelict it may itself remove the director from office - it is not required to remit the matter to the board of directors so that the board may reconsider the matter and make a new decision. In other words, a court may substitute its own decision for that of the board of directors. The courts' respect for the distinction between appeal and review has traditionally made them reluctant to usurp the decision-making powers that the legislature has delegated to the administration.[36] For this reason, substitution is regarded as an extraordinary remedy in judicial review.[37] In *Gauteng Gambling Board v Silverstar Development Ltd and Others*[38] the Supreme Court of Appeal reasoned that remittance is most always the prudent and proper course since the administrator is generally best equipped by the variety of its composition, experience and access to sources of relevant information and expertise to make the right decision. The Supreme Court of Appeal held that the remedy of substitution is to be exercised in exceptional circumstances, and only when a court is persuaded that a decision to exercise a

[35] The court may make a costs order requiring the applicant to compensate the company and any other party for costs incurred in relation to the application, unless the court reverses the board's decision and removes the director from office. This is discussed further below in para 2.4.

[36] Hoexter *Administrative Law in South Africa* 552; Bleazard & Budlender "Remedies in Judicial Review Proceedings" in Quinot et al *Administrative Justice in South Africa: An Introduction* 253.

[37] Hoexter, Lyster & Currie *The New Constitutional and Administrative Law* 292. See further *Erf One Six Seven Orchards CC v Greater Johannesburg Metropolitan Council (Johannesburg Administration)* 1999 (1) SA 104 (SCA) at 109; *Minister of Home Affairs v Watchenuka and Another* 2004 (4) SA 326 (SCA) para 37 and *Littlewood v Minister of Home Affairs and Another* 2006 (3) SA 474 (SCA) para 18.

[38] 2005 (4) SA 67 (SCA) para 29.

power should not be left to the designated functionary.[39] In *Trencon Construction (Pty) Ltd v Industrial Development Corporation of South Africa Limited and Another*[40] the Constitutional Court further emphasised that even where there are exceptional circumstances, a court must be satisfied that it would be just and equitable and fair to the implicated parties, to grant an order of substitution. It is submitted that permitting the court to substitute the board's decision with its own decision, instead of requiring the court to remit the matter to the board of directors for a new decision to be taken, is indicative of the wide powers given to a court under section 71(6)(*b*) of the Companies Act.

2.3 No Time Limit within which a Section 71(6) Review Application must be Instituted

As pointed out earlier,[41] section 71(6) of the Companies Act does not impose a time limit within which a director or a holder of voting rights entitled to be exercised in the election of the director may apply to court to review the board's determination not to remove a fellow board member. It is important that such a time limit be imposed. Not imposing a time limit results in the director's position on the board of directors being uncertain because of the possibility that another director or a holder of voting rights may apply to court at any time to review the board's decision not to remove him from office.

It is submitted that an applicant under section 71(6) of the Companies Act ought to be given twenty business days to apply to court to review the board's decision not to remove the director from office. The period of twenty business days should commence from the date of the board's decision not to remove the director from office. The time period of twenty business days would result in section 71(6) of the Companies Act being in harmony with section 71(5) of the Companies Act, which gives a director who has been removed from office by the board of directors a time period of twenty business days to apply to court to review the board's decision.[42]

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[39] *Gauteng Gambling Board v Silverstar Development Ltd and Others* 2005 (4) SA 67 (SCA) para 28.

[40] [2015] ZACC 22 paras 35, 47 and 53.

[41] See chapter 4, para 4.1.

[42] See chapter 4, para 4.1 where this matter is discussed further.

2.4 Costs of a Section 71(6) Review Application

In terms of section 71(7) of the Companies Act, if a director or a holder of voting rights entitled to be exercised in the election of the director, applies to court under section 71(6) of the Companies Act to review the board's decision not to remove a director from office, he would be required to compensate "the company, and any other party" for any costs incurred in relation to the application, unless the court reverses the decision of the board. In other words, if the court confirms the decision of the board of directors not to remove the director from office, the applicant under section 71(6) would be required to compensate the company and any other party for the costs incurred in relation to the application.

The fact that the applicant is statutorily required to compensate the "company" implies that the review application must be brought against the company itself. However the fact that the applicant may be required to compensate "any other party" for costs incurred in relation to the application suggests that the review application may also be instituted against the members of the board of directors personally, who will be entitled to compensation for any costs incurred in the application.

The provisions of section 71(7) embody the general principle in South African civil procedure that costs follow the event, that is, that costs are generally awarded against the unsuccessful party and that the successful party should be awarded his costs.[43] While the general principle regarding costs is well-settled in the common law, the courts in their discretion may depart from this principle because each case must be decided on its own facts and each case is in

[43] See for instance *Union Government v Gass* 1959 (4) SA 401 (A) at 413; *Kunene v South African Mutual Fire And General Insurance Co Ltd* 1977 (4) SA 508 (D) at 511; *Nxumalo and Another v Mavundla and Another* 2000 (4) SA 349 (D) at 354; *Mancisco & Sons CC (in liquidation) v Stone* 2001 (1) SA 168 (W) at 181; *Gauteng Provincial Legislature v Kilian and Others* 2001 (2) SA 68 (SCA) para 24 and *Nzimande v Nzimande and Another* 2005 (1) SA 83 (W) para 75.

essence a question of fairness to both sides.[44] In *Intercontinental Exports (Pty) Ltd v Fowles*[45] the Supreme Court of Appeal asserted that a court's discretion with regard to costs is a wide, unfettered and equitable one, which must be exercised judicially with due regard to all relevant considerations. For instance, as the Supreme Court of Appeal indicated, a court may wish in certain circumstances to deprive a party of costs, or a portion thereof, or to order less costs than it might otherwise have done as a mark of displeasure at such party's conduct in relation to the litigation.[46] In *Wanderers Club v Boyes-Moffat and Another*[47] the court enunciated the general rule regarding the award of costs as follows:

> "The general principle regarding the award of costs is well settled. It is entirely a matter for the discretion of the court, which is to be exercised judicially upon a consideration of the facts of each case, and in essence it is a matter of fairness to both sides (cf *Gelb v Hawkins* 1960 (3) SA 687 (A) at 694A; *Graham v Odendaal* 1972 (2) SA 611 (A) at 616A; Cilliers *Law of Costs* at 2.03 – 2.05). A general rule of thumb as stated by Van Wyk J, in my view, detracts from the wide discretion which exists with regard to costs. Or, as it has been succinctly stated by Lloyd LJ in *Bolton Metropolitan District Council and Others v Secretary of State for the Environment; Bolton Metropolitan District Council and Others v Manchester Ship Canal Co; Bolton Metropolitan District Council and Others v Trafford Park Development Corp* [1996] 1 All ER 184 (CA) at 186 (*Cilliers* op cit at 1.04):
>
> > 'As in all questions to do with costs, the fundamental rule is that there are no rules. Costs are always in the discretion of the court. . . .'"

Notably, under section 71(6) of the Companies Act, the legislature has excluded the common law discretion conferred on courts with regard to the making of a costs order. It appears from a

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[44] *Gelb v Hawkins* 1960 (3) SA 687 (A) at 694; *Transvaal and Orange Free State Chamber of Mines v General Electric Co* 1967 (2) SA 32 (T) at 72; *Ward v Sulzer* 1973 (3) SA 701 (A) at 706; *Nieuwoudt v Joubert* 1988 (3) SA 84 (SE) at 88; *Joubert T/A Wilcon v Beacham and Another* 1996 (1) SA 500 (C) at 502; *Malangu v De Jager* 1996 (3) SA 235 (LCC) at 246-247*; McDonald t/a Sport Helicopter v Huey Extreme Club* 2008 (4) SA 20 (C) at 22; *Antoy Investments v Rand Water Board* (159/2007) [2008] ZASCA10 (20 March 2008) para 9. In *Gelb v Hawkins* 1960 (3) SA 687 (A) at 694 the Appellate Division stated as follows, with regard to the general principle on the awarding of costs:

> "In seeking a basic principle to apply, I do not think it is necessary or desirable to say more than that the Court has a discretion, to be exercised judicially upon a consideration of the facts of each case, and that in essence it is a matter of fairness to both sides."

According to s 48(d) of the Magistrates' Courts Act 32 of 1944 a magistrate's court judgment for costs must be "just". In an appeal from a judgment or order for costs made by a magistrate's court, a high court may make such order of costs as "justice may require" (see s 87(e) of the Magistrates' Courts Act 32 of 1944).

[45] 1999 (2) SA 1045 (SCA) para 25.

[46] *Intercontinental Exports (Pty) Ltd v Fowles* 1999 (2) SA 1045 (SCA) para 25.

[47] 2012 (3) SA 641 (GSJ) at 643-644.

literal interpretation of section 71(7) that even if, in the circumstances, it would be fair not to award costs against an unsuccessful applicant in a section 71(6) review application, a court "must" nevertheless order an unsuccessful applicant to pay the costs of the company and any other party. Section 71(7) is a mandatory provision. It is debatable whether the exclusion of this discretion is advisable. On the one hand, the threat of a potential costs order would discourage frivolous and vexatious applications to court to review the board's decision not to remove a director from office.[48] On the other hand, the threat of a potential costs order would also deter *bona fide* applicants from instituting a review application, even when the application is justified. Individual directors and holders of voting rights generally do not have the funds and resources necessary to institute litigation proceedings. Therefore the risk of being burdened with the costs of the company and any other party if the review action fails is a formidable deterrent to instituting a review application. This has the effect that a decision of the board of directors not to remove a fellow board member from office, in circumstances where there are valid grounds to do so, may frequently go unchallenged.

In contrast, the legislature did not exclude the discretion of the court to make a costs order with regard to an application for leave to bring derivative proceedings under section 165 of the Companies Act. In terms of section 165(10) of the Companies Act a court "may make any order it considers appropriate about the costs". The costs order may relate to the costs of the application for leave to bring a derivative action or to the actual derivative action itself.[49] It may concern the costs of the person who applied for leave or who was granted leave to bring a derivative action, or of the company, or any other party to the proceedings, or of the application

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[48] See *Beinash and Another v Ernst & Young and Others* 1999 (2) SA 116 (CC) para 30 where the Constitutional Court stated as follows, with regard to making a costs order in instances of vexatious litigation:

> "Often parties to litigation on a constitutional issue are required to bear their own costs in relation to the proceedings before this Court. The rationale for this has been expressed already in several judgments of this Court. In this case, however, by litigating as persistently and vexatiously as they did, the applicants placed respondents in the untenable position where they had to respond to such unmeritorious litigation, resulting in unnecessary costs. I am therefore in respectful agreement with Fevrier AJ that it would be unfair for the harassed respondents to bear the costs. In the circumstances, costs should follow the result."

[49] See MF Cassim "Shareholder Remedies and Minority Protection" in FHI Cassim et al *Contemporary Company Law* at 792-793 for a detailed discussion of the costs orders under s 165(10) of the Companies Act and the two step process involved in instituting a derivative action. The first process is that a successful application must be made to the court for leave to bring proceedings in the name and on behalf of the company, and the second step is the derivative action itself.

for leave to bring a derivative action.[50] Also noteworthy is that if a shareholder applies to court to determine the fair value of his shares with regard to the exercise of the appraisal remedy in terms of section 164 of the Companies Act,[51] the legislature has not excluded the court's discretion in making a costs order, but has conferred on the court the discretion to make an "appropriate order of costs".[52]

It is submitted that it would be preferable for the general discretion of courts that apply in the ordinary course in deciding costs applications to be preserved under section 71(7) of the Companies Act. This should be done so that courts may make an award of costs which they consider to be fair and equitable in the circumstances of the case. In accordance with this submission section 71(7) of the Companies Act should be deleted altogether and replaced with a provision conferring on a court the discretion to make any order it considers appropriate on the costs of the application in terms of section 71(6).

In *Lynmar Investments (Pty) Ltd v South African Railways and Harbours*[53] the High Court held that it was not fettered by a statutory injunction (being the provisions of the now repealed Railway Expropriation Act 37 of 1955) as to costs and that it was at liberty to make such order as appeared to it to be proper in the circumstances of the case. If section 71(7) of the Companies Act is not deleted and replaced with a provision conferring on a court a discretion to make an appropriate order of costs, it is submitted that the approach adopted by the High Court in *Lynmar Investments (Pty) Ltd v South African Railways and Harbours*[54] ought to be adopted to

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[50] See MF Cassim *The New Derivative Action under the Companies Act: Guidelines for Judicial Discretion* 148-151 for a further discussion of the discretion given to courts to make a costs order under s 165(10) of the Companies Act and para 3.3.1.2 below for a discussion on s 165(10) of the Companies Act.

[51] The appraisal remedy is the right of dissenting shareholders who do not approve of certain triggering events (such as an amalgamation or merger) to have their shares bought out by the company in cash at the fair value of the shares. In certain instances the fair value of the shares may be determined judicially. See further Delport *Henochsberg on the Companies Act 71 of 2008* 577-582(2) and MF Cassim "Shareholder Remedies and Minority Protection" in FHI Cassim et al *Contemporary Company Law* at 796-817 on the appraisal remedy.

[52] See s 164(15)(*c*)(iv) of the Companies Act. In making an appropriate order of costs s 164(15)(*c*)(iv) requires a court to have regard to any offer made by the company for the shareholder's shares and the final determination of the fair value of the shares made by the court.

[53] 1975 (3) SA 905 (D) at 911. This case concerned an expropriation of a block of flats under the now repealed Railway Expropriation Act 37 of 1955. Regarding the award of costs, s 9(1)(c) of this Act set out certain rules regarding the award of a costs order by the court. Miller J held that the purpose of the legislature when enacting s 9(1) of the Railway Expropriation Act 37 of 1955 was to induce both parties to a dispute in respect of compensation for expropriation to act reasonably (at 910).

[54] 1975 (3) SA 905 (D) at 911.

the award of a costs order under section 71(7) of the Companies Act. The courts should still have a residual discretion, if valid reasons and justice so require, to depart from the rule in section 71(7) of the Companies Act.

For instance, where an applicant under a section 71(6) review application is unsuccessful but had meritorious grounds to institute the review application, if a court had a discretion with regard to a costs order it would be able to order the applicant to compensate the company for its costs, but not to compensate the directors whose conduct was the subject of the complaint. It is submitted that conferring on a court a discretion to make a costs order which is fair to both parties would strike the right balance in ensuring that on the one hand directors and holders of voting rights are not discouraged from instituting *bona fide* and genuine review applications in terms of section 71(6) of the Companies Act, and that on the other hand, they do not institute vexatious and frivolous review applications.

Section 71(6) of the Companies Act does not explicitly provide that a successful applicant in terms of a section 71(6) review application is entitled to be compensated by the company, or by any other party, for the costs incurred by him in such application. In accordance with the common law rule that a successful party should be awarded his costs, it is submitted that a successful applicant in a section 71(6) review application must be compensated for the costs incurred by him in instituting the application.

2.5 Interference by the Judiciary with the Internal Affairs of a Company

The distinct advantage of the provisions of section 71(6) of the Companies Act is that these provisions are a deterrent and a safeguard against the board of directors favouring a director who ought to be removed from office on the ground that he is ineligible, disqualified, incapacitated, neglectful, negligent or derelict. If the board of directors votes against the removal of a director who ought properly to be removed from office, it runs the risk of a court application under section 71(6) of the Companies Act being instituted. In the event that the application is successful, the directors incur the risk of having to pay the costs of the application. Access to court is an important safety mechanism in instances where the board of directors is unable or is unwilling to remove a director from office.

Nevertheless, as discussed in chapter 2,[55] section 71(6) offends the principle of non-interference by courts in the internal affairs of the company. As a general principle, courts are disinclined to interfere with the internal operations of a company involving management decisions.[56] Courts adopt the policy that they should not get involved in situations where the parties are capable of resolving their disputes internally.[57] The election, retention, dismissal or removal of officers, directors and employees are examples of such internal corporate operations, which essentially involve management decisions.[58] If under a section 71(6) review application a court is satisfied that the director in question is ineligible, disqualified, incapacitated, neglectful or has been negligent or derelict, it may remove the director from office even if the board of directors had voted against removing the director from office. This results in a clear infringement of the principle of non-interference in the internal company affairs of a company.

If under section 71(3) of the Companies Act the board of directors were to vote against the removal of an ineligible of disqualified director, its failure to remove such a director would contravene section 69(2) of the Companies Act which prohibits a person who is ineligible or disqualified to act as a director of a company. In this event, the removal of the director by the court and the interference by the court in the internal company affairs of the company under section 71(6)(*b*) of the Companies Act would clearly be justified. Other instances where the removal of a director by the court and the interference in the internal affairs of the company by the court would be justified is where there has been some illegality, oppressive conduct or fraudulent conduct by the board of directors in failing to remove the director from office.[59] The

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[55] Refer to chapter 2, para 6 where the principle of non-interference by courts in the internal affairs of the company is discussed.

[56] *Maynard v Office Appliances (SA) (Pty) Ltd* 1927 WLD 290 at 293; *Irvin & Johnson Ltd v Gelcer & Co (Pty) Ltd* 1958 (2) SA 59 (C); *Yende v Orlando Coal Distributors (Pty) Ltd and Others* 1961 (3) SA 314 (W); *Breetveldt and Others v Van Zyl and Others* 1972 (1) SA 304 (T); *Makhuva v Lukoto Bus Service (Pty) Ltd and Others* 1987 (3) SA 376 (V) at 393-395; *Mbethe v United Manganese of Kalahari (Pty) Ltd* 2016 (5) SA 414 (GJ) para 59; *CDH Invest NV v Petrotank South Africa (Pty) Ltd and Another* [2018] 1 All SA 450 (GJ) paras 44 and 82.

[57] See *Cluver and Another v Robertson Portland Cement and Lime Co Ltd* 1925 CPD 45 at 52.

[58] *Wilkes v Springside Nursing Home, Inc.* Mass. 353 N.E.2d 657 (1976) at 662; *Connolly v Bain* 484 N.W.2d 207 (Iowa App. 1992) at 211; *Demoulas v Demoulas* 1996 WL 511519 (Mass. Super. Ct. Pct 1, 1996) para 32.

[59] See *Maynard v Office Appliances (S.A.) (Pty) Ltd* 1927 WLD 290 at 294 and chapter 2, para 6 where these grounds are discussed. The dictum of this case was followed in numerous cases, such as *Reich v Hathorn Syndicate* 1930 NPD 233; *Silverman v Doornhoek Mines* 1935 TPD 349; *In Re Mulvihal's Mineral Waterworks (Pty) Ltd* 1936 CPD 135; *Repp v Ondundu Goldfields Ltd* 1937 CPD 375 and *Irvin & Johnson Ltd v Gelcer & Co (Pty) Ltd* 1958 (2) SA 59 (C). See further *Kronenberg v Sullivan County Steam Laundry Co.* 91 N.Y.S. 2d 144 (1949) para 8 and *Demoulas v Demoulas* 1996 WL 511519 (Mass. Super. Ct. Pct 1, 1996) para 32.

board of directors has some discretion, under section 71(3) of the Companies Act, whether or not to remove from office a director whom it has found to be incapacitated, or who has neglected or has been derelict in the performance of his functions, or who has been negligent.[60] If a court were to remove from office an incapacitated, neglectful, negligent or derelict director whom the board of directors has, in its discretion, decided not to remove from office, the interference by the court in the internal affairs of the company would be more difficult to justify.[61]

2.6 Discretion of the Court in a Section 71(6) Review Application

Section 71(6)(*b*) gives a court a discretion whether or not to remove a director from office even if the court is satisfied that the director is ineligible, disqualified, incapacitated, neglectful or has been negligent or derelict. This is made clear by the use of the word "may" in section 71(6)(*b*) of the Companies Act.

It follows that even if a court is satisfied that a director whom the board of directors has failed to remove from office is ineligible, disqualified, incapacitated, neglectful or has been negligent or derelict, it is not obliged to remove the director from office. As proposed in chapter 2,[62] it is submitted that before exercising its discretion to remove a director from office under section 71(6)(*b*)(ii) of the Companies Act, a court must give due consideration to the reasons why the board of directors in the first place failed to remove the director concerned from office. A court should also consider whether the board of directors complied with its fiduciary duties in not removing the director from office, whether it has acted with ulterior motives, and whether it has acted openly and transparently and in the best interests of the company in not removing the director from office.[63] It is submitted that if these factors are deliberated upon by courts in a section 71(6) review application, due consideration would have been given by the courts to the principle of non-interference in the internal affairs of the company, and the interference of the court may in that event be justifiable.

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[60] See chapter 3, para 7 where the discretion of the board of directors in removing a director from office is discussed.

[61] See chapter 2, para 6 where the interference by the judiciary in the internal affairs of a company is discussed further.

[62] See chapter 2, para 7.

[63] See chapter 2, para 7 where these factors are discussed further.

3. SECTION 162 OF THE COMPANIES ACT

Section 162 of the Companies Act also confers on a court the power to remove a director from office. Under this provision various stakeholders have *locus standi* to apply to court for an order declaring a director delinquent or under probation. The concept of a court declaring a director delinquent or under probation is a significant innovation of the Companies Act. There is no equivalent provision in the Companies Act 61 of 1973. The term "delinquent" has not been defined in the Companies Act. It seems that courts will not shy away from placing directors under delinquency or probation should the circumstances warrant this.[64]

Section 71 of the Companies Act provides an additional remedy to the right of a person to apply under section 162 of the Companies Act to court for an order declaring a director delinquent or placing him under probation.[65] Accordingly a director or a shareholder may make an allegation under section 71(3) of the Companies Act, and, at the same time may apply to court for an order declaring a director delinquent or placing him under probation. A company may also apply in terms of section 162 of the Companies Act to declare a director delinquent.[66] In *Lewis Group Limited v Woollam*[67] the court stated that the right given to a company to apply to declare a director delinquent in terms of section 162 of the Companies Act is not to act in its own legal interests (which it is able to address in terms of section 71 of the Companies Act), but to empower the company to act in the public interest. This is demonstrated by the fact that a company may remove a director from office in terms of section 71 of the Companies Act and may thereafter apply for a declaration of delinquency against the person concerned notwithstanding that he would by then no longer be involved in the administration of the company.[68]

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[64] See R Cassim "Delinquent Directors under the Companies Act 71 of 2008" 26 and *Demetriades and Another v Tollie and Others* 2015 ZANCHC 17 para 51 where the court agreed with this observation.

[65] Section 162(10) of the Companies Act.

[66] Section 162(2) of the Companies Act.

[67] 2017 (2) SA 547 (WCC) para 42.

[68] *Lewis Group Limited v Woollam* 2017 (2) SA 547 (WCC) para 42.

Under section 163 of the Companies Act a shareholder or a director of a company may apply to court for relief from oppressive or prejudicial conduct.[69] On considering such an application a court may make any interim or final order it considers fit, including an order declaring a person delinquent or placing him under probation, as contemplated in section 162 of the Companies Act.[70] Section 163 of the Companies Act therefore gives a court the power, *mero motu*, in the context of adjudicating an application for relief from oppressive or prejudicial conduct, to declare a director delinquent or to place him under probation. The making of an order declaring a director delinquent or placing him under probation in the particular context of the oppression remedy is not discussed further in this chapter.[71]

An applicant may apply to have a director declared delinquent even if his motive is to have the director removed from office by a court. This was affirmed in *Msimang NO and Another v Katuliiba and Others*.[72] In this case the applicants, trustees of a family trust, had instituted an application in terms of section 162 of the Companies Act to declare two directors of a company delinquent. The trust was a thirty nine per cent shareholder of the company. The directors contended that the applicants had invoked the section 162 application for an ulterior purpose. It was argued that the ulterior purpose was that the applicants had wanted the court to declare the directors delinquent with the effect that the directors would be removed from office so that any opposition from them to a takeover of the shareholding of the company would be eliminated.[73] The court held that although the applicants may have had a commercial objective in wanting to remove the directors of the company, this did not make it impermissible for the applicants, as shareholders of the company, to invoke a statutory remedy in circumstances

[69] In terms of s 163(1) of the Companies Act a shareholder or a director of a company may apply to court for relief if (i) any act or omission of the company or a related person has had a result that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of the applicant; (ii) the business of the company or a related person is being or has been carried on or conducted in a manner that is oppressive or unfairly prejudicial to, or that unfairly disregards the interests of the applicant; or (iii) the powers of a director or prescribed officer of the company or a person related to the company are being or have been exercised in a manner that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of the applicant.

[70] See s 163(2)(*f*)(ii) of the Companies Act.

[71] The oppression remedy as a remedy which may be relied on by a director who has been removed from office is discussed further in chapter 7, para 4. For a general overview of the oppression remedy see Delport *Henochsberg on the Companies Act 71 of 2008* 574-574(17); MF Cassim "Shareholder Remedies and Minority Protection" in FHI Cassim et al *Contemporary Company Law* at 756-775 and MF Cassim *The New Derivative Action under the Companies Act: Guidelines for Judicial Discretion* 179-217.

[72] [2013] 1 All SA 580 (GSJ).

[73] *Msimang NO and Another v Katuliiba and Others* [2013] 1 All SA 580 (GSJ) para 24.

where the pre-requisites for invoking the remedy were satisfied.[74] Having regard to the allegations made against the directors, the court declared the directors to be delinquent directors as contemplated in section 162(5)(*c*)(iv)(*aa*) of the Companies Act.[75] The court asserted as follows:

> " . . . the use of the remedy, under section 162 of the new Companies Act, to effect the removal of directors from a company who are acting in contravention of their statutory duties, for a commercial purpose, does not have an objectionable and improper purpose. The mere invocation of a statutory remedy for reasons other than those, for which it is primarily intended, although typical, is not, in my view, complete proof of *mala fides*. In order to prove *mala fides*, a further inference that an improper result was intended is needed. . ."[76]

In coming to this conclusion the court relied on the dictum of the Supreme Court of Appeal in *Brummer v Gorfil Brothers Investments (Pty) Ltd en Andere*,[77] where the court stated that the mere application of a particular court procedure for a purpose other than that for which it was primarily intended was typical, but not complete proof of *mala fides*. In order to prove *mala fides*, the court held that a further inference that an improper result was intended is needed.[78] In *Msimang NO and Another v Katuliiba and Others*[79] the court could not draw such an inference from the application.

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[74] *Msimang NO and Another v Katuliiba and Others* [2013] 1 All SA 580 (GSJ) para 26.

[75] *Msimang NO and Another v Katuliiba and Others* [2013] 1 All SA 580 (GSJ) para 74.

[76] *Msimang NO and Another v Katuliiba and Others* [2013] 1 All SA 580 (GSJ) para 27.

[77] 1999 (3) SA 389 (SCA) at 414.

[78] *Brummer v Gorfil Brothers Investments (Pty) Ltd en Andere* 1999 (3) SA 389 (SCA) at 414.

[79] [2013] 1 All SA 580 (GSJ). In this case the main basis for the application to declare the directors delinquent under s 162 of the Companies Act was that they had failed to prepare the annual financial statements of the company since the financial year ending 28 February 2004; they had failed to convene an annual general meeting of the company since the previous annual general meeting held in 2006, and they had failed to appoint an auditor since February 2011 when the company's auditor had resigned (paras 8 and 25). The applicants argued that the above failures by the directors constituted grounds for the relief claimed under s 162(5)(*c*)(iv)(*aa*) of the Companies Act (gross negligence, wilful misconduct or breach of trust in relation to the performance of the director's functions within, and duties to, the company). In light of the alleged breach of the directors' statutory duties, the court held that the invocation of the remedy under s 162 of the Companies Act to effect the removal of the directors from a company, for a commercial purpose, does not have an objectionable purpose without a further inference that an improper result was intended, which the court was unable to draw based on the application itself (para 27). The court found that the conduct of the directors constituted gross negligence and wilful misconduct (para 69). It held that the failure of the directors to cause the annual financial statements of the company to be prepared since 2004 and to hold an annual general meeting since its last annual general meeting in 2006, had been grossly negligent (para 69). This conduct was also found to constitute wilful misconduct, as contemplated in s 162(5)(*c*)(iv)(*aa*) of the Companies Act (para 69). The court found that both directors had known and had appreciated that such conduct was wrong but had nevertheless omitted to carry out their statutory duties to the

It follows that an applicant with the requisite *locus standi* may institute an application under section 162 of the Companies Act even if his primary purpose in doing so is to have a director removed from office by a court. Provided the pre-requisites for declaring a director delinquent under section 162 of the Companies Act are satisfied and there is no further inference indicating *mala fides*, the application under section 162 of the Companies Act is not objectionable.

The role and powers of the court in declaring directors delinquent and placing them under probation in terms of section 162 of the Companies Act, and hence in removing them from office, are discussed below.

3.1 Indirect Judicial Power to Remove Directors from Office

The power conferred on a court to remove a director under section 162 of the Companies Act is an indirect power of removal and not a direct power.[80] This is because a court is empowered to declare a director delinquent, which has the effect of disqualifying the person to be a director, and hence of removing him from office. Under section 71(6) of the Companies Act a court has the power to remove directors from office but may do so only after the board of directors has already voted not to remove the director concerned from office, and only on the application of a director or a holder of voting rights in the context of review proceedings. Thus under the Companies Act no person may directly apply to a court to remove a director from office. This must be done in the context of a section 71(6) review application or in the context of an application to declare a director delinquent.

This approach is modelled on the UK and Australian company legislation. In the UK the disqualification of directors is regulated by the UK Company Directors Disqualification Act 1986. A disqualification order under this Act has the effect that a person may not, without leave of the court, be a director of the company or be concerned in any way with, or take part in, the promotion, formation or management of a company.[81] Sections 206C, 206D, 206E and 206EEA

company, regardless of the consequences for the company (para 69). It consequently declared the directors delinquent (para 74).

[80] Ncube "You're Fired! The Removal of Directors under the Companies Act 71 of 2008" 45.

[81] See s 1 of the UK Company Directors Disqualification Act 1986. As part of the Small Business, Enterprise and Employment Act of 2015 various provisions relating to the UK Company Directors Disqualification Act 1986 were introduced in 2015. These provisions introduce new grounds for the disqualification of directors, make the

of the Australian Corporations Act of 2001, titled "Court power of disqualification" confer on the courts a power to disqualify directors from managing corporations for a period that the court considers appropriate, on specified grounds set out in these provisions, upon an application by ASIC. Should a court exercise this power it has the effect that the director in question is removed from office for a period prescribed by the court.

In contrast, under section 8.09(a) of the MBCA the courts have been conferred with a direct power to remove directors from office. Section 8.09(a) of the MBCA is titled "Removal of directors by judicial proceeding". The provision empowers a court to remove a director of a company from office upon an application by or in the right of the corporation. Section 8.09(a) of the MBCA states as follows:

> "The [name or describe] court may remove a director from office or may order other relief, including barring the director from reelection for a period prescribed by the court, in a proceeding commenced by or in the right of the corporation if the court finds that (i) the director engaged in fraudulent conduct with respect to the corporation or its shareholders, grossly abused the position of director, or intentionally inflicted harm on the corporation; and (ii) considering the director's course of conduct and the inadequacy of other available remedies, removal or such other relief would be in the best interest of the corporation."

The company legislation of most USA States contains statutory procedures regulating the judicial removal of directors from office.[82] A direct power to remove directors from office has also been conferred on the courts in these USA States.[83]

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disqualification regime more efficient and update the matters that courts must take into account when considering whether to disqualify a director from office.

[82] The legislation of some USA States do not contain any statutory procedures for the judicial removal of directors. For example, the States of Massachusetts, Indiana, Minnesota, Missouri, New Jersey, Ohio, Florida, Georgia, Kansas, Kentucky, Maryland, Louisiana, Nevada, New Mexico, Oklahoma, Puerto Rico, Texas and Virginia do not statutorily permit the judicial removal of directors from office.

[83] See for example s 10-809(A) of the Arizona Revised Statutes; s 10A-2-8.09(a) of the Alabama Business and Nonprofit Entities Code; s 10.06.463 of the Alaska Corporations Code; s 304 of the California Corporations Code; s 33-743(a) of the Connecticut General Statutes; s 29-306.09(a) of the District of Columbia Code; s 30-29-809(1) of the Idaho Code; s 490.809(1) of the Iowa Code; s 450.1514(1) of the Michigan Business Corporation Act; s 1726(c) of the Pennsylvania Business Corporation Law; s 33-8-109(a) of the South Carolina Code of Laws; s 47-1A-809 of the South Dakota Business Corporation Act; s 48-18-109(a) of the Tennessee Code; s 23B.08.090(1) of the Washington Business Corporation Act and s 17-16-809(a) of the Wyoming Business Corporation Act.

3.2 Purpose of Section 162 of the Companies Act

The *Memorandum on the Objects of the Companies Bill, 2008* states that the introduction of a regime allowing for a court, on application, to declare a director either delinquent (and thus prohibited from being a director) or under probation (and restricted to serving as a director within the conditions specified) is a major innovation and one of the remedies available to shareholders and other stakeholders to hold directors accountable.[84] In *Grancy Property Limited v Gihwala*[85] the court observed that the innovation in section 162 of the Companies Act lies in the introduction of a new civil remedy for those harmed by the conduct of delinquent directors. Section 162 of the Companies Act does not invoke criminal liability. The assessment of whether a director is delinquent will therefore be determined on a civil standard of proof and on a balance of probabilities.

In *Msimang NO and Another v Katuliiba and Others*[86] the court held that section 162 of the Companies Act is directed at protecting companies and corporate stakeholders against company directors who have proven themselves unable to manage the business of the company or have failed in, or are in neglect of, their duties and obligations as company directors. In *Gihwala and Others v Grancy Property Limited and Others*[87] the Supreme Court of Appeal further stated that section 162 of the Companies has a protective purpose. Its aim, the Supreme Court of Appeal confirmed, is not penal, but to ensure that those who invest in companies are protected against directors who engage in serious misconduct of the type that violates the "bond of trust" that shareholders have in the people they appoint to the board of directors.[88] In *Lewis Group Limited v Woollam*[89] the court likewise maintained that the object of section 162 of the Companies Act goes "essentially to the provision of a protective remedy in the public interest."

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[84] *Memorandum on the Objects of the Companies Bill, 2008*, Companies Bill [B 61D-2008] para 8.

[85] 2014 JDR 1292 (WCC) para 155.

[86] [2013] 1 All SA 580 (GSJ) para 29.

[87] 2017 (2) SA 337 (SCA) para 144. For a discussion of this case see R Cassim "Delinquent Directors under the Companies Act 71 of 2008: *Gihwala v Grancy Property Limited* 2016 ZASCA 35" 1-28 and J Du Plessis & Delport "'Delinquent Directors' and 'Directors under Probation': A Unique South African Approach Regarding Disqualification of Company Directors" 286-293.

[88] *Gihwala and Others v Grancy Property Limited and Others* 2017 (2) SA 337 (SCA) para 144.

[89] 2017 (2) SA 547 (WCC) para 40.

The Supreme Court of Appeal in *Gihwala and Others v Grancy Property Limited and Others*[90] relied on the Australian case of *Re Gold Coast Holdings Pty Ltd (In Liq); Australian Securities & Investments Commission v Papotto*[91] in ruling that section 162 of the Companies Act is not a penal provision, but its purpose is to protect the investing public. ASIC sought an order in this Australian case from the Supreme Court of Western Australia to prohibit the respondent from managing a company for a period to be determined by the court.[92] The respondent had been convicted of repeated acts of dishonesty as a director. In disqualifying the respondent from managing any company for seven years, the court stated that the purpose of the order sought by ASIC was protective and not punitive, and that the interests to be protected by the order included those of the public "who may unwittingly deal with companies run by people who are not suitable to be involved in the management of companies".[93]

To the extent that section 162 of the Companies Act does not impose a criminal sanction on a delinquent director, it is submitted that, as stated by the Supreme Court of Appeal in *Gihwala and Others v Grancy Property Limited and Others*[94] the provision is not a penal provision. However, it is further submitted that while the purpose of section 162 of the Companies Act may not be penal, the proceedings do indeed embody a punitive element. If the power to declare a director delinquent is exercised by the court, there is inevitably a substantial and significant interference with the individual's entrepreneurial freedom.[95] This is affirmed by Browne-Wilkinson V-C in *Re Lo-Line Electric Motors Ltd*.[96] It follows that the rights of the individual

[90] 2017 (2) SA 337 (SCA) para 142.

[91] 2000 WASC 201.

[92] The relevant provision of the Australian Corporations Act of 2001 which was applicable in this case was s 230(1)(c). This provision has since been repealed and replaced by s 206E which empowers a court to disqualify a person from managing corporations for a period the court considers appropriate, in the case of a repeated contravention of the Australian Corporations Act of 2001.

[93] *Re Gold Coast Holdings Pty Ltd (In Liq); Australian Securities & Investments Commission v Papotto* 2000 WASC 201 para 22.

[94] 2017 (2) SA 337 (SCA) para 142.

[95] See further R Cassim "Delinquent Directors under the Companies Act 71 of 2008: *Gihwala v Grancy Property Limited* 2016 ZASCA 35" 8.

[96] 1988 2 All ER 692 at 696. Brown-Wilkinson V-C asserted that the power to disqualify a person from acting as a director is not fundamentally penal but if the power to disqualify is exercised it does involve a substantial interference with the freedom of the individual.

must be fully protected.[97] In a similar vein, in *Re Crestjoy Products Ltd*[98] the Chancery Division approved of and adopted the approach of Browne-Wilkinson V-C and commented further that proceedings to disqualify a person from acting as a director are a very serious matter. The court stated that when a court is faced with a mandatory disqualification period once the facts are proved, the matter becomes more nearly penal.[99] In *Secretary of State for Trade and Industry v Collins & Ors*[100] the UK Court of Appeal also acknowledged that there are some penal elements involved in the disqualification of a director.

A further punitive effect of a declaration of delinquency is that it carries a definite stigma for a person who is disqualified from acting as a director.[101] The reputational damage caused by a delinquency order is extensive and is likely to endure for a long period of time.[102] This was affirmed in *Re Westminster Property Management Ltd Official Receiver v Stern*,[103] where the Chancery Division emphasised that while proceedings to disqualify a person from acting as a director are intended primarily for the protection of the public, they nevertheless do involve serious allegations and almost always carry a degree of stigma for anyone who is disqualified from acting as a director.

In *Lewis Group Limited v Woollam*[104] the court relied on the Australian case of *Re HIH Insurance Ltd (in prov liq); ASIC v Adler*[105] for the proposition that the purpose of disqualification orders is purely protective and that such orders are not punitive. In this latter decision the Supreme Court of New South Wales, per Santow J, had declared that

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[97] *Re Lo-Line Electric Motors Ltd* 1988 2 All ER 692 at 696. See further *Re Gibson Davies Ltd* [1995] BCC 11 at 14 where the Chancery Division approved of this dictum.

[98] 1990 BCC 23 at 26.

[99] *Re Crestjoy Products Ltd* 1990 BCC 23 at 26. See Dine "Disqualification of Directors" 6-7 for a discussion of this case and of the quasi-penal nature of disqualification orders.

[100] [2000] BCC 998 at 1007.

[101] See Hannigan *Company Law* 374 for a discussion on the effects of the disqualification of directors under the UK Company Directors Disqualification Act 1986.

[102] R Cassim "Delinquent Directors under the Companies Act 71 of 2008" 29.

[103] 2001 BCC 121 para 36.

[104] 2017 (2) SA 547 (WCC) para 40.

[105] [2002] NSWSC 483 para 56.

disqualification orders are designed to protect the public from the harmful use of the corporate structure but that such orders are not punitive.[106] However, in *Rich v Australian Securities and Investments Commission*[107] the High Court of Australia, per McHugh J, strongly disagreed with this aspect of Santow J's judgment. McHugh J proclaimed that protective proceedings and punitive proceedings are not mutually exclusive categories. The court asserted that the supposed distinction between "punitive" and "protective" was "elusive".[108] It observed that proceedings brought to protect the public could also have the effect of penalising the defendant.[109] The factors taken into account in the criminal jurisdiction, the High Court of Australia pointed out, such as retribution, deterrence, reformation, contrition and the protection of the public, are also central to determining whether a disqualification order should be made as well as to the period of the disqualification.[110] These factors, the court emphasised, strongly resemble sentencing principles under the criminal law and further support the finding that the granting of a disqualification order cannot properly be characterised as purely protective, but that it also has a punitive element.[111]

Several subsequent decisions of the Australian courts concurred with McHugh J in *Rich v Australian Securities and Investments Commission*[112] that contrary to the finding of Santow J in *Re HIH Insurance Ltd (in prov liq); ASIC v Adler*,[113] disqualification orders are not purely protective and that they do include a penal element. For instance, in *Australian Securities and Investments Commission v Vizard*[114] the Federal Court of Australia affirmed that while it may be accepted that the principal object to be achieved by a disqualification order is protective, it would be a mistake to treat this as its sole purpose. The court held that it followed from the decision of the High Court of Australia in *Rich v Australian Securities and Investments*

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[106] *Re HIH Insurance Ltd (in prov liq); ASIC v Adler* [2002] NSWSC 483 para 56.

[107] [2004] 220 CLR 129 para 35.

[108] *Rich v Australian Securities and Investments Commission* [2004] 220 CLR 129 para 32.

[109] *Rich v Australian Securities and Investments Commission* [2004] 220 CLR 129 para 35.

[110] *Rich v Australian Securities and Investments Commission* [2004] 220 CLR 129 para 52.

[111] *Rich v Australian Securities and Investments Commission* [2004] 220 CLR 129 paras 50-52.

[112] *Rich v Australian Securities and Investments Commission* [2004] 220 CLR 129 paras 32, 35, 50-52.

[113] [2002] NSWSC 483 para 56.

[114] [2005] FCA 1037 para 35.

Commission[115] that a disqualification order could be imposed not only to protect the shareholders against further abuse, but also by way of punishment and general deterrence.[116] The importance of giving due consideration to the objective of general and personal deterrence was reinforced in *Australian Securities and Investments Commission v Beekink*[117] where the full Federal Court concurred with McHugh J that disqualification proceedings have a punitive element to them. The Court of Appeal of New South Wales in *Gilfillan & Ors v Australian Securities and Investments Commission*[118] likewise concurred with McHugh J and further observed that disqualification orders are not purely protective but do have a punitive element to them in that they may be imposed by way of punishment and deterrence. In *Australian Securities and Investments Commission v Axis International Management Pty Ltd (No 6)*[119] the Federal Court of Australia likewise concurred with McHugh J that the conclusion reached by Santow J in *Re HIH Insurance Ltd (in prov liq); ASIC v Adler*[120] that disqualification proceedings have no punitive element was wrong.[121] It is submitted that in *Lewis Group Limited v Woollam*[122] the court, with respect, overlooked the fact that the notion that disqualification orders are purely protective, as asserted in *Re HIH Insurance Ltd (in prov liq); ASIC v Adler*,[123] on which it relied as authority for this proposition, has in fact been rejected several times by the High Court of Australia, the Federal Court of Australia and the Court of Appeal of New South Wales in subsequent decisions, which have proclaimed that disqualification proceedings do in fact have a punitive element as well.[124]

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[115] [2004] 220 CLR 129.

[116] *Australian Securities and Investments Commission v Vizard* [2005] FCA 1037 para 35.

[117] [2007] FCAFC 7 paras 80-91.

[118] [2012] NSWCA 370 paras 180-185.

[119] [2011] FCA 811 (2011) para 9.

[120] [2002] NSWSC 483 para 56.

[121] See further Austin and Ramsay *Ford, Austin and Ramsay's Principles of Corporations Law* para 3.400 at 104-105 and para 7.191 at 265-266 for a discussion on the punitive aspects of a disqualification order.

[122] 2017 (2) SA 547 (WCC).

[123] [2002] NSWSC 483 para 56.

[124] R Cassim "The Launching of Delinquency Proceedings under the Companies Act 71 of 2008 by means of the Derivative Action: *Lewis Group Limited v Woollam* 2017 (2) SA 547 (WCC)" 676.

It is telling that section 162(12)(*b*)(i) of the Companies Act uses the term "rehabilitation" in the context of a court deciding whether to suspend an order of delinquency or to set aside an order of delinquency or probation. The term "rehabilitation" is akin to "reformation" which was found by the High Court of Australia in *Rich v Australian Securities and Investments Commission*[125] to resemble sentencing principles under the criminal law, and to indicate that there is a punitive element to a disqualification order. In light of the above dicta and in light of section 162(12)(*b*)(i) of the Companies Act, it is submitted that while the purpose of section 162 of the Companies Act may not be penal, as was maintained by the Supreme Court of Appeal in *Gihwala and Others v Grancy Property Limited and Others*[126] proceedings to declare a director delinquent that have the effect of preventing him from acting as a director do have a punitive effect.

In *Cape Empowerment Trust Ltd v Druker*[127] the Western Cape High Court declared that in the determination of the question of whether or not a person may be declared a delinquent director, the purposes of the Companies Act as set out in section 7 must always be borne in mind. The purposes of the Companies Act as emphasised by the court in this context are to promote compliance with the Bill of Rights as provided in the Constitution in the application of company law, to encourage the efficient and responsible management of companies, and to provide a predictable and effective environment for the efficient regulation of companies.[128] It is submitted that, at the same time, a further purpose must be considered, namely to promote the development of the South African economy by encouraging entrepreneurship and enterprise efficiency, as set out in section 7(*b*)(i) of the Companies Act. Declaring a director delinquent is a severe remedy with harsh consequences for directors. It must not be applied without due and proper consideration by a court. As the UK Court of Appeal in *Secretary of State for Trade*

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[125] [2004] 220 CLR 129 para 52. The meaning of the term "rehabilitation" in s 162(12)(*b*)(i) of the Companies Act is discussed further in para 3.11.4.3 below.

[126] 2017 (2) SA 337 (SCA) para 142.

[127] 2013 JDR 1360 (WCC) para 85.

[128] *Cape Empowerment Trust Ltd v Druker* 2013 JDR 1360 (WCC) para 85. The directors in this case had consistently failed to hold annual general meetings and to prepare financial statements for presentation at annual general meetings. The court found the omissions of the directors to be grossly negligent bordering on wilful misconduct or breach of trust in relation to the performance of their functions within, and duties to, the company (para 88). Such omissions, the court stated, are inconsistent with the objectives of the Companies Act in relation to the efficient and responsible management of companies and to provide a predictable and effective environment for the efficient regulation of companies (para 88).

and Industry v Davies and Others[129] emphasised, per Hobhouse LJ, to be a director of a company is a privilege, but it is not one of which a person should be unjustly deprived.

3.3 *Locus Standi* to Institute an Application under Section 162 of the Companies Act

A wide range of persons may apply to court for an order declaring directors delinquent or placing them under probation under section 162 of the Companies Act. It is noteworthy that an application to declare a director delinquent or to place him under probation may be instituted by any person with *locus standi* against a person who was a director of the company within the twenty four months immediately preceding the application.[130] It follows that a director who has resigned from a company or who has been removed as a director of a company would not necessarily escape a court order against him in terms of section 162 of the Companies Act.

Even though the misconduct in issue in section 162 of the Companies Act is in respect of duties towards the company, a shareholder has direct standing in terms of section 162 to apply to court to declare a director delinquent. The misconduct of the director need not be in respect of the shareholder's personal rights.[131] This also applies to the other stakeholders listed in section 162 of the Companies Act, in that *locus standi* has been conferred on such stakeholders irrespective of whether the duties of the directors of the company are owed to them directly.[132]

In the UK, under the UK Company Directors Disqualification Act 1986, applications to court for a disqualification order against a director may be made by the Secretary of State for Business Enterprise and Regulatory Reform, or in certain instances by the official receiver of a company[133] in a winding-up of the company, the liquidator, or any past or present

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[129] 1996 4 All ER 289 at 302.

[130] See s 162(2)(*a*), 162(3)(*a*) and 163(4)(*a*) of the Companies Act.

[131] J Du Plessis & Delport "'Delinquent Directors' and 'Directors under Probation': A Unique South African Approach Regarding Disqualification of Company Directors" 293.

[132] J Du Plessis & Delport "'Delinquent Directors' and 'Directors under Probation': A Unique South African Approach Regarding Disqualification of Company Directors" 293.

[133] A receiver is a person appointed by the court or an individual for the collection or protection of property. If a receiver is appointed by a court he is an officer of the court and derives authority from the court order. If he is appointed by an individual he derives powers and duties from the terms of the appointment. A receiver who is appointed by the court is under the supervision of the court and is responsible to the court for carrying out orders regarding the property (James *Stroud's Judicial Dictionary of Words and Phrases* 2183; *Osborn's Concise Law Dictionary* 345; *The Wolters Kluwer Bouvier Law Dictionary* 914).

shareholders or creditors of a company "in relation to which that person has committed or is alleged to have committed an offence or other default."[134] Section 162 of the (South African) Companies Act does not permit the liquidator of a company or a creditor to apply for a court order declaring a director delinquent. Under the Australian Corporations Act of 2001, ASIC is the only body endowed with *locus standi* to apply to court to obtain a disqualification order against a director.[135] Under the MBCA and the corporate legislation of various USA States, generally the board of directors or a shareholder suing derivatively in the name of the company has *locus standi* to apply to court to remove a director from office.[136] In some USA States a shareholder holding a prescribed percentage of shares may, in certain circumstances, lodge an application to court to remove a director from office.[137] Section 162 of the Companies Act is consequently more far-reaching compared to the foreign jurisdictions reviewed in that it empowers a much wider range of persons to apply to court to remove a director from office.

The persons who have *locus standi* to institute an application under section 162 of the (South African) Companies Act are discussed below.

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[134] Section 16(2) of the UK Company Directors Disqualification Act 1986. Section 1A of the UK Company Directors Disqualification Act 1986 permits the Secretary of State to accept a disqualification undertaking by a director. Instead of applying to court for a disqualification order, in certain circumstances the Secretary of State may accept a disqualification undertaking from the director if it is expedient to do so in the public interest (s 1A of the UK Company Directors Disqualification Act 1986). A disqualification undertaking has the same effect as a disqualification order which is made by a court after a court hearing. It is an undertaking by a person that for a period specified in the undertaking he will not be a director of a company, act as a receiver of a company's property or directly or indirectly be concerned or take part in the promotion, formation or management of a company unless he has the leave of a court, and that he will further not act as an insolvency practitioner (s 1A(1) of the UK Company Directors Disqualification Act 1986). Disqualification undertakings may be obtained on the ground of unfitness, in the case of certain convictions abroad and in the case of persons disqualified for instructing unfit directors (s 1A(1) of the UK Company Directors Disqualification Act 1986). They enable non-contentious cases to be dealt with promptly and reduce the burden of costs on the disqualified director (Hannigan *Company Law* 376). A director is not obliged to accept a disqualification undertaking, and disputed cases are heard in court (Hannigan *Company Law* 376). See further on the disqualification undertaking Birds et al *Boyle and Birds' Company Law* 579-580; French, Mayson & Ryan *Mayson, French & Ryan on Company Law* 712 and Davies & Worthington *Gower Principles of Modern Company Law* 237-238.

[135] See Part 2D.6 (Disqualification from Managing Corporations) of the Australian Corporations Act of 2001.

[136] See s 8.09(a) of the MBCA.

[137] For example, under s 706(d) of the New York Business Corporation Law and s 7-1.2-805 of the Rhode Island Business Corporation Act, a shareholder holding ten per cent of the outstanding shares may apply to court to remove a director from office. The attorney-general may also apply to court to remove a director from office.

3.3.1 *Locus Standi* of Insiders under Section 162 of the Companies Act

Various insiders have *locus standi* under section 162 of the Companies Act to apply to court to declare a director delinquent or to place him under probation. These are a shareholder, a director, the company secretary, a prescribed officer of a company, and a registered trade union that represents employees of the company or another employee representative. In addition, the company itself has such *locus standi* under section 162 of the Companies Act. These persons are discussed below.

3.3.1.1 Shareholder and Director

As discussed earlier,[138] section 71(6) of the Companies Act empowers "any holder of voting rights entitled to be exercised in the election of that director" to bring an application to review the board's decision not to remove a director from office. In contrast section 162(2) of the Companies Act empowers a "shareholder" to apply to court for an order declaring a director delinquent. Consequently, in order to apply for a delinquency order a shareholder need not have any voting rights entitled to be exercised in the election of the director concerned. This broadens the group of persons who are entitled to apply to court for an order declaring a director delinquent. However, the person must be registered as a shareholder in the certificated or uncertificated register of the company.[139]

In *Lewis Group Limited v Woollam*[140] the Western Cape Division, Cape Town stated that the right of a shareholder to apply to declare a director delinquent under section 162 of the Companies Act is a personal right that every shareholder enjoys individually. The court explained that the personal nature of this right is demonstrated by the fact that a declaration of delinquency obtained by a shareholder in company A will also ordinarily result in the disqualification of the director as a director of companies B and C, even though it might be practically impossible for companies B and C to continue in business without the director.[141]

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[138] Refer to chapter 6, para 2.1.

[139] See s 1 of the Companies Act which defines a "shareholder" as meaning the holder of a share issued by a company and who is entered as such in the certificated or uncertificated securities register, as the case may be.

[140] 2017 (2) SA 547 (WCC) para 43. The court's classification of s 162 of the Companies Act as a personal right of shareholders is discussed further in para 3.3.1.2 below.

[141] *Lewis Group Limited v Woollam* 2017 (2) SA 547 (WCC) para 43.

Even the best interests of company A, the court proclaimed, would not stand in the way of the right of a shareholder of company A to have a director declared delinquent if the shareholder were able to prove misconduct by the director in respect of the management of company A that showed that it would be in the public interest to have the director declared delinquent.[142] The court, with respect, appears to have overlooked the fact that this is not necessarily the case since a court has the power to make a declaration of delinquency subject to conditions that limit the application of the declaration of delinquency to one or more particular categories of companies.[143]

In *Kukama v Lobelo & Others*[144] Kukama applied to court for Lobelo to be declared a delinquent director and thus for his removal as a director of two companies. Kukama and Lobelo were both fifty per cent shareholders of the two companies, as well as directors of the first company. Lobelo was the sole director of the second company. It is not clear from the judgment whether Kukama had instituted the application to declare Lobelo a delinquent director in his capacity as a director or as a shareholder.[145] With regard to the first company,

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[142] *Lewis Group Limited v Woollam* 2017 (2) SA 547 (WCC) para 43.

[143] The conditions limiting a declaration of delinquency to one or more particular companies is discussed further in para 3.6.3 below.

[144] 2012 JDR 0663 (GSJ) para 27. The first delinquency order in South African law was granted in this case, by the South Gauteng High Court, Johannesburg. Kukama applied to court for Lobelo to be declared a delinquent director and for his removal as a director of two companies, Peolwane Properties (Pty) Ltd ("Peolwane") and Diphuka Construction (Pty) Ltd ("Diphuka"), of which Kukuma and Lobelo were both fifty per cent shareholders. Kukama and Lobelo were also directors of Peolwane but Lobelo was the sole director of Diphuka. In 2010 and 2011 the South African Revenue Service ("SARS") had made two payments of approximately twenty two million Rands and thirty nine million Rands into the banking account of Diphuka. The amount of twenty two million Rands was a rebate due by SARS to Peolwane but SARS had in error paid this amount into the bank account of Diphuka instead of the bank account of Peolwane. It transpired that the payment of thirty nine million Rands was not due by SARS at all to either Peolwane or Diphuka and appeared to have been made following certain fictitious invoices submitted to SARS by Peolwane's tax consultant, who had been appointed by Lobelo without Kukama's consent to handle the tax affairs of the companies. The twenty two million Rand payment had not been transferred to Peolwane's bank account as it should have been and Lobelo had not used it for the benefit of Peolwane but had used it for the benefit of other companies that were not subsidiaries of Peolwane. Kukuma averred that Lobelo had engaged in reckless trading (s 22 of the Companies Act), using his position as a director and information acquired as a director to gain a personal advantage (s 76), not acting in good faith and for a proper purpose or in the best interests of the company (s 76(3)) and that he had grossly abused his position as a director in the manner envisaged in s 162(5) of the Companies Act. The court held that the conduct of Lobelo fell short of the standard expected of a director of Peolwane to such an extent that it amounted to wilful misconduct, breach of trust and a gross abuse of his position as a director (paras 13 and 20.1). It consequently declared Lobelo a delinquent director (para 28). The court did not specify the duration of Lobelo's declaration of delinquency, but in terms of s 162(6)*(b)* of the Companies Act a declaration of delinquency in terms of s 162(5)*(c)* to *(f)* subsists for seven years from the date of the order (or such longer period as determined by the court at the time of making the declaration).

[145] Delport *Henochsberg on the Companies Act 71 of 2008* 569.

Kukama could have instituted the application either in his capacity as a director or as a shareholder. It is submitted that since Lobelo was the sole director of the second company, the application would have to have been instituted by Kukama in his capacity as a shareholder of the second company.

Section 162 empowers a single shareholder or a single director to bring an application to declare a director delinquent. This confers considerable power on such a person to launch legal proceedings to declare a director to be delinquent. In contrast, under the UK Company Directors Disqualification Act 1986 a director as such does not have *locus standi* to apply to court to disqualify another director. In the UK a shareholder may institute such an application but only in certain instances as a personal application.[146] Under the Australian Corporations Act of 2001 neither a shareholder nor a director has *locus standi* to apply to court to disqualify a director and hence to remove him from office. Under section 8.09 of the MBCA a single shareholder or a single director does not have *locus standi* to apply to court to remove a director. Instead, the application must be brought "by or in the right of the corporation". Likewise, in terms of section 225(c) of the DGCL a single shareholder or a single director does not have *locus standi* to apply to court to remove a director from office since the application must be brought by the "corporation, or derivatively in the right of the corporation by any stockholder". Several USA

[146] See s 16(2) of the UK Company Directors Disqualification Act 1986. A shareholder is empowered to institute an application to disqualify a director under the UK Company Directors Disqualification Act 1986 only under s 2 (disqualification on conviction of indictable offence), s 3 (disqualification for persistent breaches of companies legislation), s 4 (disqualification for fraud in the winding-up of a company) and s 5 (disqualification on summary conviction) of this Act.

States, such as New York,[147] Rhode Island,[148] Illinois,[149] California,[150] Alabama,[151] Alaska,[152] Tennessee[153] and Washington[154] require shareholders holding at least ten per cent of the

[147] Section 706(d) of the New York Business Corporation Law states that an action to procure a judgment removing a director for cause may be brought by the attorney-general or by the holders of ten per cent of the outstanding shares, whether or not entitled to vote. The court may bar from re-election any director so removed for a period fixed by the court.

[148] Section 7-1.2-805(d) of the Rhode Island Business Corporation emulates s 706(d) of the New York Business Corporation Law. The court may bar from re-election any director so removed for a period fixed by the court. This provision is codified in Title 7 (Corporations, Associations and Partnerships), Chapter 7-1.2 (Rhode Island Business Corporation Act) of the Rhode Island General Laws.

[149] Section 8.35(b) of the Illinois Business Corporation Act of 1983 provides that the circuit court of the county in which the corporation's office is registered may remove a director of the corporation from office in a proceeding commenced either by the corporation or by shareholders of the corporation holding at least ten per cent of the outstanding shares of any class if the court finds that the director is engaged in fraudulent or dishonest conduct or has grossly abused his position to the detriment of the corporation and removal is in the best interest of the corporation. This provision is codified in Chapter 805 (Business Organizations), 805 ILCS 5 (Business Corporation Act of 1983) of the Illinois Compiled Statutes.

[150] Section 304 of the California Corporations Code states that the superior court of the proper county may, at the suit of shareholders holding at least ten per cent of the number of outstanding shares of any class, remove from office any director in the case of fraudulent or dishonest acts or gross abuse of authority or discretion with reference to the corporation and may bar from re-election any director so removed for a period prescribed by the court. Section 304 of the California Corporations Code is codified in Chapter 3 (Directors and Management), Title 1 (Corporations), Division 1 (General Corporation Law) of the California Corporations Code.

[151] Section 10A-2-8-09(a) of the Alabama Business and Nonprofit Entities Code provides that the circuit court of the county where a corporation's principal office is located (or if none in this state, its registered office) may remove a director of the corporation from office in a proceeding commenced either by the corporation or by its shareholders holding at least ten per cent of the outstanding shares of any class if the court finds that the director engaged in fraudulent or dishonest conduct, or gross abuse of authority or discretion, with respect to the corporation, and removal is in the best interest of the corporation. This provision is codified in Title 10A (Alabama Business and Nonprofit Entities Code), Chapter 2 (Business Corporations) of the Code of Alabama.

[152] Section 10.06.463 of the Alaska Corporations Code provides that the superior court may, at the suit of the board or the shareholders holding at least ten per cent of the number of outstanding shares of any class, remove from office a director for fraudulent or dishonest acts, gross neglect of duty, or gross abuse of authority or discretion with reference to the corporation and may bar from re-election a director removed in that manner for a period prescribed by the court. This provision is codified in Chapter 10.06 (Alaska Corporations Code), Title 10 (Corporations and Associations) of the Alaska Statutes.

[153] Section 48-18-109(a) of the Tennessee Business Corporation Act provides that any court of record having equity jurisdiction in the county where a corporation's principal office (or if none in this state, its registered office) is located may remove a director of the corporation from office in a proceeding commenced either by the corporation or by its shareholders holding at least ten per cent of the outstanding shares of any class if the court finds that the director engaged in fraudulent or dishonest conduct, or gross abuse of authority or discretion with respect to the corporation, and removal is in the best interest of the corporation. This provision is codified in Chapter 18 (Directors and Offices), Title 48 (Corporations and Associations For-Profit Business Corporations) of the Tennessee Code.

[154] Section 23B.08.090(1) of the Washington Business Corporation Act states that the superior court of the county where a corporation's principal office or its registered office is located may remove a director of the corporation from office in a proceeding commenced either by the corporation or by its shareholders holding at least ten per cent of the outstanding shares of any class if the court finds that the director engaged in fraudulent or dishonest conduct with respect to the corporation, and removal is in the best interest of the corporation. This provision is

outstanding shares to institute a court application to remove a director from office. South Carolina requires five per cent of the outstanding shares to be held by a shareholder in order to bring an action to remove a director from office.[155] Only one USA State, Pennsylvania, permits a single shareholder to bring an action to remove a director from office. Section 1726(d) of the Pennsylvania Business Corporation Law[156] provides that "any" shareholder or director may apply to court to remove a director from office. The company must nevertheless be a party to the application and the shareholder must comply with the requirements relating to derivative actions. Section 162(2) of the (South African) Companies Act is distinctly much wider compared to the equivalent provisions in the UK Company Directors Disqualification Act 1986, the Australian Corporations Act of 2001, the MBCA, the DGCL and the legislation of several USA States since it permits a single director or a single shareholder to institute an application to court to declare a director delinquent or to place him under probation and thereby to remove him from office.

3.3.1.2 The Company

Section 162(2) of the Companies Act confers on companies standing to bring proceedings to declare their own directors as delinquent. In contrast, under both the UK Company Directors

codified in Chapter 23B.08 (Directors and Officers), Title 23B (Washington Business Corporation Act) of the Revised Code of Washington.

[155] Section 33-8-109(a) of the South Carolina Code of Laws provides that the circuit court of the county where a corporation's principal office (or, if none in this state, its registered office) is located may remove a director of the corporation from office in a proceeding commenced either by the corporation or by its shareholder holding at least five per cent of the outstanding shares of any class if the court find that the director engaged in fraudulent or dishonest acts, or gross abuse of authority in discharge of duties to the corporation, and the removal is in the best interest of the corporation. This provision is codified in Chapter 8 (Directors and Officers), Title 33 (Corporations, Partnerships and Associations) of the South Carolina Code of Laws.

[156] Section 1726(c) of the Pennsylvania Business Corporation Law states that "[u]pon application of any shareholder or director, the court may remove from office any director in case of fraudulent or dishonest acts, or gross abuse of authority or discretion with reference to the corporation, or for any other proper cause, and may bar from office any director so removed for a period prescribed by the court. The corporation shall be made a party to the action and as a prerequisite to the maintenance of any action under this subsection a shareholder shall comply with Subchapter F (relating to derivative actions)."

Disqualification Act 1986 and the Australian Corporations Act of 2001 the company does not have *locus standi* to apply to court to disqualify its own directors.

In *Lewis Group Limited v Woollam*[157] the question arose whether a shareholder may institute proceedings to declare a director delinquent under section 162 of the Companies Act by means of a derivative action.[158] In this case Woollam, a minority shareholder, had served a notice in terms of section 165(2)(*a*) of the Companies Act requesting the company to commence proceedings to declare its chief executive officer, chief financial officer, chairperson of the board and the chairperson of the audit and risk committee delinquent.[159] In terms of section

[157] 2017 (2) SA 547 (WCC).

[158] In the corporate context, the term "derivative action" relates to proceedings instituted by persons given standing "to litigate in their own names for and behalf of the corporation" in respect of wrongs done to the corporation (*Lewis Group Limited v Woollam* 2017 (2) SA 547 (WCC) para 27). The derivative action is brought by a minority shareholder or other applicant on behalf of a company in order to protect the legal interests of the company (MF Cassim *The New Derivative Action under the Companies Act: Guidelines for Judicial Discretion* 5). The essential rationale of derivative proceedings is that they permit the institution or continuance of proceedings in a company's best interests in circumstances in which the company does not act on its own initiative, and which would otherwise not reach the court (*Lewis Group Limited v Woollam* 2017 (2) SA 547 (WCC) para 31). The classic scenario of the derivative action is where the wrongdoers who have harmed the company are the controllers of the company, who use their control of the company to prevent the company from instituting legal proceedings against them to remedy the wrong that they themselves have committed on the company (MF Cassim *The New Derivative Action under the Companies Act: Guidelines for Judicial Discretion* 7; see further Delport *Henochsberg on the Companies Act 71 of 2008* 587.) Where a wrong is done to the company the "proper plaintiff" is the company itself and not the shareholders (see *Foss v Harbottle* (1983) 2 Hare 461; 67 ER 189). Therefore, the derivative action is an exception to the "proper plaintiff" rule. The basis of the rule is the fundamental tenet of company law that a company is a separate legal entity distinct from its shareholders, as laid down in *Salomon v Salomon & Co* [1897] AC 22 (see Delport *Henochsberg on the Companies Act 71 of 2008* 587 and MF Cassim *The New Derivative Action under the Companies Act: Guidelines for Judicial Discretion* 5). The term "derivative" is applied because although the litigation is instituted and prosecuted in A's name (the applicant) the right of action concerned is derived from B (the company) in order to redress a wrong done to the company (MF Cassim *The New Derivative Action under the Companies Act: Guidelines for Judicial Discretion* 5). Moreover, the benefits of any judgment obtained in favour of A (the applicant) in such an action, accrue to B (the company) and not to A (*Lewis Group Limited v Woollam* 2017 (2) SA 547 (WCC) para 27). In other words the shareholder is seeking to protect the rights of the company and not his own interests or his own personal shareholder rights (MF Cassim *The New Derivative Action under the Companies Act: Guidelines for Judicial Discretion* 5). For a detailed discussion of the derivative action under the Companies Act see Coetzee "A Comparative Analysis of the Derivative Litigation Proceedings under the Companies Act 61 of 1973 and the Companies Act 71 of 2008" 290-305; Delport *Henochsberg on the Companies Act 71 of 2008* 586-596(8); MF Cassim *The Statutory Derivative Action under the Companies Act of 2008: Guidelines for the Exercise of the Judicial Discretion* (Unpublished PhD Thesis) and MF Cassim *The New Derivative Action under the Companies Act: Guidelines for Judicial Discretion*.

[159] Some of the grounds for the contention that the directors should be declared delinquent were that (i) Lewis Stores (Pty) Ltd (a subsidiary of Lewis Group Limited) had sold employment insurance to its customers who were pensioners and self-employed persons who had no insurable interest in terms of the relevant insurance policies; (ii) the customers of Lewis Stores (Pty) Ltd were required, whether they wished to or not, to purchase extended warranties on goods purchased; (iii) compulsory delivery fees were charged, irrespective of whether the customers required delivery of the goods to be effected; (iv) the accounts of Lewis Group Limited appeared to overstate revenue from the sale of insurance policies; (v) Lewis Group Limited had inappropriate revenue obligation policies with regard to the sale of extended warranted that resulted in the on-going overstatement of reported revenue; and (vi) there were various accounting policy errors in the interim financial statements for the period ended 30 September 2015.

165(2)(*a*) of the Companies Act a shareholder is empowered to serve a demand on a company to commence legal proceedings or to take related steps to protect the legal interests of the company.[160] The statutory demand provided for in section 165(2) of the Companies Act is a procedural precursor to the possible institution of derivative proceedings under section 165(5) of the Companies Act.[161] Lewis Group Limited applied to court to set aside Woollam's demand on the ground that it was frivolous, vexatious and without merit.[162] The court was required to decide whether "a person is able to proceed derivatively for the given relief when that person is given standing under the [Companies] Act to proceed for such relief personally."[163]

In finding that Woollam was not entitled to use the remedy of a derivative action in section 165 of the Companies Act to achieve a declaration of delinquency in terms of section 162, the court stated that a shareholder's right to seek a declaration of delinquency against a director under section 162 co-exists with the same right separately invested in the company by the same provision.[164] After investigating the preliminary procedures in terms of section 165 of the Companies Act with regard to derivative proceedings, the court opined that these procedures are not well suited to proceedings by shareholders to declare directors delinquent.[165] Accordingly the court ruled that "it is not within the scheme" of the Companies Act that shareholders should ordinarily seek to proceed derivatively to obtain a delinquency order in

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[160] Under s 165(2) of the Companies Act a person may serve a demand upon a company to commence or continue legal proceedings, or take related steps, to protect the legal interests of the company if the person (i) is a shareholder or a person entitled to be registered as a shareholder of the company or of a related company; (ii) is a director or prescribed officer of the company or of a related company; (iii) is a registered trade union that represents employees of the company or another representative of employees of the company; or (iv) has been granted leave of the court to do so, which may be granted only if the court is satisfied that it is necessary or expedient to do so to protect a legal right of that other person.

[161] *Mouritzen v Greystones Enterprises (Pty) Ltd* 2012 (5) SA 74 (KZD) para 22; *Mbethe v United Manganese of Kalahari (Pty) Ltd* 2016 JDR 0271 (GJ) para 47; *Lewis Group Limited v Woollam* 2017 (2) SA 547 (WCC) para 6.

[162] In terms of s 165(3) of the Companies Act a company that has been served with a demand in terms of s 165(2) of the Companies Act may apply within fifteen business days to a court to set aside the demand on the grounds that it is frivolous, vexatious or without merit. If a company does not make such an application or the court does not set aside the demand, the company must appoint an independent and impartial person or committee to investigate the demand (s 165(4) of the Companies Act).

[163] *Lewis Group Limited v Woollam* 2017 (2) SA 547 (WCC) para 19. For a discussion of this case see R Cassim "The Launching of Delinquency Proceedings under the Companies Act 71 of 2008 by means of the Derivative Action: *Lewis Group Limited v Woollam* 2017 (2) SA 547 (WCC)" 673-688.

[164] *Lewis Group Limited v Woollam* 2017 (2) SA 547 (WCC) para 27.

[165] *Lewis Group Limited v Woollam* 2017 (2) SA 547 (WCC) paras 45-49.

terms of section 162 of the Companies Act.[166] The court consequently set aside Woollam's demand in terms of section 165(3) of the Companies Act, and held that he must institute a delinquency application personally, and not by means of a derivative action.[167] The court held further, *obiter*, that there was in any case no merit in Woollam's demand to have the four directors declared delinquent as he had due to insufficient evidence failed to prove that the conduct of the directors fell within the scope of section 162(5)(*c*) of the Companies Act.[168]

The High Court in *Lewis Group Limited v Woollam*[169] proclaimed that when both the company and the shareholder have the same standing to sue for the same relief on the basis of the same facts, a shareholder has no need in the interests of justice to litigate in the corporation's own name when he can do so in his own name. In coming to this conclusion the court relied on the decision of the Ontario Court of Appeal in *Goldex Mines Ltd v Revill*.[170] The matter concerned the calling of an annual general meeting by Probe Mines Limited. The issue before the Ontario Court of Appeal related to alleged misconduct by the directors and defendant shareholders, including allegations of having sent out a false and misleading information circular with a notice calling for the annual general meeting of the company. The relief sought was an injunction against holding the annual general meeting, and a declaration that the proxies which had been solicited had been null and void. The plaintiff shareholders had not clearly stated in their action whether their claim was a personal or a derivative one. Counsel for Probe Mines Limited argued that the matter was not properly before the court as the plaintiff had not obtained the leave of the court to bring a derivative action, pursuant to section 99 of the Ontario Business Corporations Act R.S.O. 1970.[171] In ascertaining whether the action was to be instituted by the

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[166] *Lewis Group Limited v Woollam* 2017 (2) SA 547 (WCC) para 49.

[167] *Lewis Group Limited v Woollam* 2017 (2) SA 547 (WCC) para 52.

[168] See *Lewis Group Limited v Woollam* 2017 (2) SA 547 (WCC) paras 53-82 where the court examined the various grounds of complaint and found that it did not satisfy the grounds set out in s 162(5)(*c*) of the Companies Act. On 1 November 2016 the applicant applied for leave to appeal this judgment. His application for leave to appeal was refused on 9 December 2016. The applicant thereafter petitioned the Supreme Court of Appeal for leave to appeal. On 4 April 2017 he was granted leave to appeal (see JSE SENS announcement (4 April 2017) available at https://www.moneyweb.co.za/mny_sens/lewis-group-limited-woollams-first-demand-in-terms-of-section-1652-of-the-companies-act/ (accessed on 7 April 2017). The outcome of the appeal is awaited at the time of writing this thesis.

[169] 2017 (2) SA 547 (WCC) para 48.

[170] (1974) 54 DLR (3d) 672 (Ont CA).

[171] Under s 99 of the Ontario Business Corporations Act R.S.O. 1970 c.53 a shareholder was entitled to bring a derivative action only after obtaining a court order permitting him to commence it. This provision has now been replaced by s 246 of the Ontario Business Corporations Act R.S.O. 1990, which states as follows:

shareholders personally or derivatively, the Ontario Court of Appeal applied the following test, which was relied on by the High Court in *Lewis Group Ltd v Woollam*:[172]

> "In one sense every injury to a company is indirectly an injury to its shareholders. On the other hand, if one applies the test: 'Is this wrongful act one in respect of which the company could sue?', a shareholder who is personally and directly injured must surely be entitled to say, as a matter of logic, 'the company cannot sue for my injury; it can only sue for its own'."[173]

The Ontario Court of Appeal proclaimed that a personal action would not arise simply because the corporation itself has been damaged and as a consequence of the damage to it, its shareholders have been injured.[174] In other words, an incidental injury would not be regarded as a wrong to the shareholders personally.[175] The Court of Appeal held that while the preparation, approval and circulation to shareholders of a misleading annual report was undoubtedly a wrong to the company, the circulation of such a report to shareholders was also a wrong to the shareholders.[176] The court held that the sending out of a misleading information circular by the directors was a breach not only of the directors' fiduciary duty to the company but also a breach of duty to the shareholders.[177] It stated that the shareholders had a right to expect that the information sent to them was fairly presented, reasonably accurate and not misleading.[178] On this basis the Ontario Court of Appeal ruled that an action challenging the information circular was not a derivative one, but was a personal action of the shareholders.[179] It consequently held that leave of the court to institute the action was not necessary.[180]

> "Subject to subsection (2), a complainant may apply to court for leave to bring an action in the name and on behalf of a corporation or any of its subsidiaries, or intervene in an action to which any such body corporate is a party, for the purpose of prosecuting, defending or discontinuing the action on behalf of the body corporate."

[172] 2017 (2) SA 547 (WCC) para 48.

[173] *Goldex Mines Ltd v Revill* (1974) 54 DLR (3d) 672 (Ont CA) at 677.

[174] *Goldex Mines Ltd v Revill* (1974) 54 DLR (3d) 672 (Ont CA) at 679.

[175] MSP Baxter "The Derivative Action under the Ontario Business Corporations Act: A Review of Section 97" 456.

[176] *Goldex Mines Ltd v Revill* (1974) 54 DLR (3d) 672 (Ont CA) at 679.

[177] *Goldex Mines Ltd v Revill* (1974) 54 DLR (3d) 672 (Ont CA) at 679.

[178] *Goldex Mines Ltd v Revill* (1974) 54 DLR (3d) 672 (Ont CA) at 679.

[179] *Goldex Mines Ltd v Revill* (1974) 54 DLR (3d) 672 (Ont CA) at 681.

[180] *Goldex Mines Ltd v Revill* (1974) 54 DLR (3d) 672 (Ont CA) at 681.

In *Lewis Group Ltd v Woollam*[181] the court held that the corollary to the above test applied by the Ontario Court of Appeal in *Goldex Mines Ltd v Revill*[182] must "surely be that when both the company and the shareholder have the same standing to sue for the same relief on the basis of the same facts the company must be entitled to say the shareholder has no need in the interests of justice to litigate in the corporation's name when he can do so in his own." In finding that Woollam had a right to a personal action, the High Court held that the duty of company directors to act honestly and in accordance with their fiduciary duties is owed not only to the company, but "also to the shareholders personally."[183] The High Court found justification for this statement in the provisions of section 218(2) of the Companies Act.[184] It proclaimed that the debate whether at common law directors owe a fiduciary duty to an individual shareholder is rendered largely academic by section 218(2), which makes it clear that such a duty is owed to individual shareholders.[185] The court consequently held that the fact that directors owe a duty to shareholders personally, as indicated by section 218(2), meant that a shareholder could not seek to proceed derivatively to obtain the remedy available in terms of section 162 of the Companies Act because a shareholder had personal standing to seek the relief.[186]

It is respectfully submitted that the reliance by the High Court in *Lewis Group Limited v Woollam*[187] on the dictum of *Goldex Mines Ltd v Revill*[188] is questionable for two reasons. The first is that the validity of the test formulated by the Ontario Court of Appeal, in terms of which a distinction is drawn between personal and derivative actions, has been questioned and criticised.[189] It has been argued that shareholder actions cannot all be arbitrarily placed in one

[181] 2017 (2) SA 547 (WCC) para 48.

[182] (1974) 54 DLR (3d) 672 (Ont CA) at 677.

[183] *Lewis Group Limited v Woollam* 2017 (2) SA 547 (WCC) para 49.

[184] *Lewis Group Limited v Woollam* 2017 (2) SA 547 (WCC) para 49.

[185] *Lewis Group Limited v Woollam* 2017 (2) SA 547 (WCC) para 49.

[186] *Lewis Group Limited v Woollam* 2017 (2) SA 547 (WCC) para 49.

[187] 2017 (2) SA 547 (WCC) para 48.

[188] (1974) 54 DLR (3d) 672 (Ont CA) at 677.

[189] A derivative action is one for the redress of a wrong to the company itself while a personal action by a shareholder is to redress the wrong done to the shareholder as distinct from the company (Beck "The Shareholders' Derivative Action" 185; McGuiness *Canadian Business Corporations Law* 1360; Coetzee "A Comparative

category to the exclusion of others.[190] It has further been argued that there will always remain grey areas of wrongs that do not lend themselves to easy categorisation, and that in practice, the line between personal and derivative actions is not clear.[191] It has been contended that it is particularly difficult to distinguish one from the other, particularly when personal and derivative actions are interrelated.[192]

Likewise, in South African law there could in many instances be an overlap between a personal claim and a derivative action in that the same wrong may violate the rights of both the shareholder personally as well as those of the company.[193] It is argued that merely because an applicant has available to him, or has already commenced, a personal claim against the defendant is an insufficient basis for concluding that a derivative action is contrary to the best interest of the company, and for withholding leave to institute a derivative action.[194] The attempt made by the court in *Group Limited v Woollam*[195] to classify the enforcement rights in section 162 of the Companies Act as a personal or a statutory derivative action has been criticised.[196] It has been argued that any attempt to do so would lead to confusion and would

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Analysis of the Derivative Litigation Proceedings under the Companies Act 61 of 1973 and the Companies Act 71 of 2008" 292-293; Delport *Henochsberg on the Companies Act 71 of 2008* 590-591; MF Cassim *The New Derivative Action under the Companies Act: Guidelines for Judicial Discretion* 85-88).

[190] Ahmed "Disentanglement of Shareholders' Personal Action from Derivative Action – Recent Canadian Experience" 268; MSP Baxter "The Derivative Action under the Ontario Business Corporations Act: A Review of Section 97" 456-457; Griggs "A Statutory Derivative Action: Lessons that May be Learnt from its Past" 76-77; McGuiness *Canadian Business Corporations Law* 1359.

[191] Ahmed "Disentanglement of Shareholders' Personal Action from Derivative Action – Recent Canadian Experience" 268; MSP Baxter "The Derivative Action under the Ontario Business Corporations Act: A Review of Section 97" 456-457; Griggs "A Statutory Derivative Action: Lessons that May be Learnt from its Past" 76-77; McGuiness *Canadian Business Corporations Law* 1359.

[192] MSP Baxter "The Derivative Action under the Ontario Business Corporations Act: A Review of Section 97" 456-457; Griggs "A Statutory Derivative Action: Lessons that May be Learnt from its Past" 76-77; McGuiness *Canadian Business Corporations Law* 1359; Welling, Smith & Rotman *Canadian Corporate Law: Cases, Notes & Materials* 510.

[193] MF Cassim *The Statutory Derivative Action under the Companies Act of 2008: Guidelines for the Exercise of the Judicial Discretion* (Unpublished PhD Thesis) 88-89; MF Cassim *The New Derivative Action under the Companies Act: Guidelines for Judicial Discretion* 87.

[194] MF Cassim *The Statutory Derivative Action under the Companies Act of 2008: Guidelines for the Exercise of the Judicial Discretion* (Unpublished PhD Thesis) 89; MF Cassim *The New Derivative Action under the Companies Act: Guidelines for Judicial Discretion* 87.

[195] 2017 (2) SA 547 (WCC) para 43.

[196] Delport *Henochsberg on the Companies Act 71 of 2008* 565.

detract from the importance of the remedy since the remedy in section 162 is *sui generis* to the Companies Act, and to justify or interpret section 162 with reference to the personal right or statutory derivative action would serve no purpose.[197]

It is submitted that the second reason why the High Court's reliance in *Lewis Group Limited v Woollam*[198] on the dictum of *Goldex Mines Ltd v Revill*[199] is questionable is that the assertion by the Ontario Court of Appeal that directors owe a fiduciary duty to the shareholders[200] is, respectfully, generally regarded as being incorrect.[201] Welling[202] states that it "is absolutely clear in Canadian law that the person to whom corporate managers owe their duty is the corporation: not the shareholders, not the creditors, not the general public, but the corporate entity itself." Welling, Smith & Rotman[203] assert further that *Goldex Mines Ltd v Revill*[204] contains "many dangerous statements which, as they come from the Court of Appeal, will inevitably be picked up and cited in support of further extensions of fiduciary duties". In the leading Canadian case of *Peoples Department Stores Inc. (Trustee of) v Wise*[205] the Supreme Court of Canada affirmed that

> "[a]t all times, directors and officers owe their fiduciary obligation to the corporation. The interests of the corporation are not to be confused with the interests of the creditors or those of any other stakeholders."

It is respectfully submitted that the ruling by the High Court in *Lewis Group Limited v Woollam*[206] that directors owe a duty to shareholders personally, as indicated by section

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[197] Delport *Henochsberg on the Companies Act 71 of 2008* 565.

[198] 2017 (2) SA 547 (WCC) para 48.

[199] (1974) 54 DLR (3d) 672 (Ont CA) at 679.

[200] *Goldex Mines Ltd v Revill* (1974) 54 DLR (3d) 672 (Ont CA) at 679.

[201] See McGuiness *Canadian Business Corporations Law* 1170; Welling *Corporate Law in Canada: The Governing Principles* 377 and 625 and Welling, Smith & Rotman *Canadian Corporate Law: Cases, Notes & Materials* 471.

[202] Welling *Corporate Law in Canada: The Governing Principles* 377.

[203] Welling, Smith & Rotman *Canadian Corporate Law: Cases, Notes & Materials* 471.

[204] (1974) 54 DLR (3d) 672 (Ont CA).

[205] 2004 SCC 68 para 43.

[206] 2017 (2) SA 547 (WCC) para 49.

218(2) of the Companies Act, is likewise questionable. It is widely accepted that under the South African common law directors stand in a fiduciary relationship to the company and do not owe a fiduciary duty to the shareholders individually.[207] There may be certain specific or special circumstances based on the facts of the particular case where directors may be found to owe a fiduciary duty to a specific individual shareholder.[208] It is nevertheless generally accepted that under the common law, although a director may owe fiduciary duties to an individual shareholder, he does not do so by the mere fact of being a director, but only where some personal relationship arises between the director and shareholder, or because of some particular dealing or transaction between them.[209]

Section 218(2) of the Companies Act states that a person who contravenes "any provision" of the Companies Act is liable to "any other person" for any loss or damage suffered by that person as a result of that contravention. While the words "any other person" in section 218(2) would include shareholders and the reference to "any provision" of the Companies Act would include the directors' fiduciary duties set out in section 76 of the Companies Act[210] in order for a shareholder to rely on section 218(2) to institute an action against a director for a breach of his fiduciary duties, the shareholder must have personally suffered some "loss or damage" as a result of the breach of fiduciary duty. A plaintiff under a section 218(2) claim must specify the exact loss or damage sustained by him as a result of the contravention of the Companies Act.[211]

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[207] See *Percival v Wright* [1902] 2 Ch 421 (ChD); *Pergamon Press Ltd v Maxwell* [1970] 2 All ER 809 (Ch) at 814; *Kuwait Asia Bank EC v National Mutual Life Nominees Ltd* [1991] 1 AC 198 (PC) 217-219; *Minister of Water Affairs and Forestry v Stilfontein Gold Mining Co Ltd* 2006 (5) SA 333 (W) para 16.6; Havenga *Fiduciary Duties of Company Directors with Specific Regard to Corporate Opportunities* (Unpublished LLD Thesis) 27; Havenga "Directors' Fiduciary Duties under our Future Company-Law Regime" 321; Blackman et al *Commentary on the Companies Act* 5-381-5-383; FHI Cassim "The Duties and the Liability of Directors" in FHI Cassim et al *Contemporary Company Law* 515-517 and MF Cassim *The New Derivative Action under the Companies Act: Guidelines for Judicial Discretion* 87.

[208] Such circumstances may arise for instance if directors act as agents for shareholders, due to the family character of a company, the position of the directors in the company and their families, or their high degree of inside knowledge (see *Coleman v Myers* [1977] 2 NZLR 225 CA (NZ); *Sage Holdings Ltd v The Unisec Group Ltd* 1982 (1) SA 337 (W) 365-366; *Re Chez Nico (Restaurants) Ltd* [1992] BCLC 192; *Glandon Pty Ltd v Strata Consolidated Pty Ltd* (1993) 11 ACSR 543 CA (NSW); *Peskin v Anderson* [2001] 1 BCLC 372; Havenga *Fiduciary Duties of Company Directors with Specific Regard to Corporate Opportunities* (Unpublished LLD Thesis) 27-30; Blackman et al *Commentary on the Companies Act* 5-384-5-393 and FHI Cassim "The Duties and the Liability of Directors" in FHI Cassim et al *Contemporary Company Law* 515).

[209] See *Sharp v Blank* [2015] EWHC 3220 (Ch) para 12.

[210] *Grancy Property Limited v Gihwala* 2014 JDR 1292 (WCC) para 104; *Sanlam Capital Markets (Pty) Ltd v Mettle Manco (Pty) Ltd* [2014] 3 All SA 454 (GJ) para 42.

[211] *Rabinowitz v Van Graan* 2013 (5) SA 315 (GSJ) para 11.

To succeed on the basis of section 218(2), it must not only be shown that a person had contravened a provision of the Companies Act and that another person had suffered loss or damage, but it must also be shown that such loss or damage suffered was as a result of that contravention.[212] In other words, there must be proof of a causal link or connection between the contravention of the Companies Act, and the damage or loss for which the person may be held liable.[213]

A director's breach of a fiduciary duty would in most instances not necessarily result in personal loss or damage being suffered by a shareholder. In most instances the loss or damage would be suffered by the company itself. The so-called loss suffered by a shareholder by way of a reduction in the value of his shares is merely reflective of the loss suffered by the company and is not a loss in its own right.[214] In *Lewis Group Limited v Woollam*[215] the court accepted that the reflective loss suffered by a shareholder by way of a diminution in the value of his shares may not be claimed under section 218(2) of the Companies Act. Accordingly, it is submitted that section 218(2) of the Companies Act is not in fact any indication that directors owe their fiduciary duties to shareholders personally since a shareholder may not generally institute an action against a director for breach of his fiduciary duty under section 218(2). He may do so only if he has personally suffered some loss or damage, which he is able to accurately quantify, as a result of the breach of the director's fiduciary duty. It is with respect, submitted that section 218(2) has not altered the common law position that directors generally stand in a fiduciary relationship to the company and not to the individual shareholders, as proclaimed by the court in *Lewis Group Limited v Woollam*.[216] It follows that the High Court's assertion that Woollam

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[212] *Burco Civils CC v Stolz* [2017] JOL 39331 (GP) para 47.

[213] *Burco Civils CC v Stolz* [2017] JOL 39331 (GP) para 47. See further chapter 4, para 4.3 for a discussion on s 218(2) of the Companies Act.

[214] See *Prudential Assurance Company Ltd v Newman Industries Ltd (No 2)* [1982] 1 All ER 354 at 366-367 where the UK Court of Appeal held that a shareholder cannot recover a sum equal to the diminution in the market value of his shares because such a "loss" is merely a reflection of the loss suffered by the company; *Stein v Blake* [1998] 1 All ER 724 (CA) 729; *Johnson v Gore, Wood & Co* [2002] 2 AC 1 (HL) 62; *Itzikowitz v Absa Bank Ltd* 2016 (4) SA 432 (SCA) paras 10-11 and MF Cassim *The New Derivative Action under the Companies Act: Guidelines for Judicial Discretion* 87-88.

[215] 2017 (2) SA 547 (WCC) para 49.

[216] 2017 (2) SA 547 (WCC) para 49. See further on this point R Cassim "The Launching of Delinquency Proceedings under the Companies Act 71 of 2008 by means of the Derivative Action: *Lewis Group Limited v Woollam* 2017 (2) SA 547 (WCC)" 678-680.

could not seek to proceed derivatively to obtain the remedy available in terms of section 162 of the Companies Act because he had personal standing to seek the relief, is contentious.

It is moreover respectfully submitted that, contrary to the assertion of the High Court in *Lewis Group Limited v Woollam*,[217] there is merit, in the interests of justice, in a shareholder proceeding derivatively for the relief provided for in section 162 of the Companies Act, instead of instituting the proceedings himself. One cogent reason why a shareholder may wish to choose to serve a demand on a company in terms of section 165(2) of the Companies Act to commence legal proceedings to declare its directors delinquent is that the shareholder would not have to personally bear the high costs and expenses of legal proceedings. If the company complies with the shareholder's demand under section 165(2) of the Companies Act to initiate delinquency proceedings, the shareholder's legal costs would be minimal and he may not even have to enter a court room.[218]

Section 165(10) of the Companies Act provides that a court may make any order it considers appropriate about the costs of the person who applied for or was granted leave to institute derivative proceedings, the company or any other party to the proceedings. If a shareholder is successful under section 165 of the Companies Act in instituting derivative proceedings, the company may be ordered by the court to bear his legal costs and expenses. Even if a shareholder is not successful in instituting derivative action proceedings, a court may, in its discretion, require the company to bear the legal costs and expenses of the proceedings. A court may for instance make such a determination if the shareholder had acted *bona fide* and his application was meritorious despite the fact that it was unsuccessful. In contrast, section 162 of the Companies Act does not contain any provisions relating to the costs orders which a court may grant. Presumably, the common law rule that costs follow the event would apply, that is, that costs are generally awarded against the unsuccessful party and that the successful party should be awarded his costs.[219] This means that a shareholder who is unsuccessful under section 162

[217] 2017 (2) SA 547 (WCC) para 48.

[218] R Cassim "The Launching of Delinquency Proceedings under the Companies Act 71 of 2008 by means of the Derivative Action: *Lewis Group Limited v Woollam* 2017 (2) SA 547 (WCC)" 680.

[219] See for instance *Union Government v Gass* 1959 (4) SA 401 (A) at 413; *Kunene v South African Mutual Fire And General Insurance Co Ltd* 1977 (4) SA 508 (D) at 511; *Nxumalo v Mavundla* 2000 (4) SA 349 (D) at 354; *Mancisco & Sons CC (in liquidation) v Stone* 2001 (1) SA 168 (W) at 181; *Gauteng Provincial Legislature v Kilian* 2001 (2) SA 68 (SCA) para 24; *Nzimande v Nzimande* 2005 (1) SA 83 (W) para 75 and chapter 6, para 2.4 where this is discussed further.

would have to bear the legal costs and expenses of all the parties involved in the application. It seems onerous and burdensome to require a shareholder who institutes an action under section 162 of the Companies Act to bear all the legal costs, particularly if the purpose of section 162 is said to be "essentially to the provision of a protective remedy in the public interest."[220] The unfairness of the costs burden on a single shareholder is further underscored if one considers that all the shareholders of a company would benefit from the shareholder's efforts if his application to declare a director delinquent is successful. A *bona fide* shareholder who does not have deep pockets but wishes to protect the company or the public from the future misconduct of a director of a company would be discouraged and disincentivised from instituting a section 162 application, if he is required to bear the risk of personally paying for the legal costs. This may result in shareholder apathy, and in delinquent directors escaping accountability for their misconduct. On the other hand, if the *bona fide* shareholder were empowered to serve a demand on a company in terms of section 165(2) to commence legal proceedings or to institute delinquency proceedings by means of a derivative action, this could encourage and incentivise him, to do so in the public interest and the interest of the company. On this basis it is submitted that there is certainly merit, in the interests of justice, in permitting shareholders to institute delinquency proceedings in terms of section 165 of the Companies Act.[221]

The court in *Lewis Group Limited v Woollam*[222] conceded that the language of sections 162 and 165 of the Companies Act read together do not explicitly exclude the use of the derivative action procedure in section 162 proceedings. It held that it is not inconceivable that, exceptionally, it might be "appropriate in certain circumstances"[223] for a shareholder to institute delinquency proceedings derivatively. One example the court gave where a shareholder may do so is where a company has already instituted proceedings for a declaration of delinquency, but has failed to prosecute the proceedings to conclusion. In these circumstances the best interests of the company might be served, the court stated, by the continuation by the shareholder of the proceedings derivatively because the costs that had already been incurred by the company would be squandered if the shareholder were to initiate proceedings afresh for the

[220] *Lewis Group Limited v Woollam* 2017 (2) SA 547 (WCC) para 40.

[221] R Cassim "The Launching of Delinquency Proceedings under the Companies Act 71 of 2008 by means of the Derivative Action: *Lewis Group Limited v Woollam* 2017 (2) SA 547 (WCC)" 681.

[222] 2017 (2) SA 547 (WCC) para 50.

[223] *Lewis Group Limited v Woollam* 2017 (2) SA 547 (WCC) para 50.

same relief on the same facts in his own name.[224] However, this is an exception, and in general, the court held that a shareholder must institute delinquency proceedings personally rather than by means of a derivative action.

The legislature explicitly empowered a shareholder, director, prescribed officer, registered trade union that represents employees of the company or another representative of employees of the company to apply to court both for an order declaring a director delinquent and to institute proceedings by means of the derivative action procedure.[225] As the court in *Lewis Group Limited v Woollam*[226] itself conceded, the language of sections 162 and 165 read together do not expressly exclude the use of the derivative action procedure in section 162 proceedings. It is submitted that had the legislature wished to exclude delinquency proceedings being instituted by means of a derivative action, it would have expressly done so.

The High Court in *Lewis Group Limited v Woollam*[227] failed to comprehensively define when it might be "appropriate in certain circumstances" for a shareholder to institute delinquency proceedings derivatively and when these exceptional circumstances may arise. Only one example of when it might be appropriate was provided, that is, when a company has already instituted delinquency proceedings but fails to prosecute them to conclusion.[228] Should a shareholder wish to use the derivative action procedure in section 162 proceedings, he may first have to overcome the hurdle of convincing the court that he is doing so in "appropriate" circumstances. This additional hurdle is expressly required by neither section 165 nor by section 162 of the Companies Act. It may well unnecessarily complicate the already complex and multifaceted procedures laid down in section 165 of the Companies Act. It is submitted that the circumstances when it would be appropriate to use the derivative action procedure in

[224] *Lewis Group Limited v Woollam* 2017 (2) SA 547 (WCC) para 51.

[225] See ss 162(2) and 165(2) of the Companies Act. A company secretary is explicitly empowered to apply to court for an order declaring a director delinquent but not to institute proceedings by means of the derivative action procedure. Leave may however be granted to a company secretary to do so under s 165(2)(*d*) of the Companies Act, in terms of which a court may grant leave to a person to institute proceedings by means of the derivative action if the court is satisfied that it is necessary or expedient to do so to protect a legal right of that other person.

[226] 2017 (2) SA 547 (WCC) para 50.

[227] 2017 (2) SA 547 (WCC) para 50.

[228] *Lewis Group Limited v Woollam* 2017 (2) SA 547 (WCC) para 50.

section 162 proceedings are vague and have not been clearly defined by the court in *Lewis Group Limited v Woollam*.[229]

In contrast, the MBCA and the DGCL make explicit provision for derivative action proceedings to be instituted by a shareholder to remove a director from office. Under section 8.09(a) of the MBCA, a court may remove a director of the company from office in proceedings commenced "by or in the right of the corporation" (that is, derivative actions). The proceedings must be brought by the board of directors, or by a shareholder, who must sue derivatively.[230] Section 8.09(b) of the MBCA states that a shareholder proceeding on behalf of the corporation under section 8.09(a) must comply with all the requirements of subchapter 7D of the MBCA, dealing with derivative actions (save for section 7.41(i)).[231] Likewise, section 225(c) of the DGCL states that judicial removal proceedings must be instituted "upon application by the corporation, or derivatively in the right of the corporation by any stockholder". Other USA States which also require judicial removal proceedings of a director to be commenced derivatively in the

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[229] 2017 (2) SA 547 (WCC). See further R Cassim "The Launching of Delinquency Proceedings under the Companies Act 71 of 2008 by means of the Derivative Action: *Lewis Group Limited v Woollam* 2017 (2) SA 547 (WCC)" 683.

[230] See further *Model Business Corporation Act with Official Comments and Reporter's Annotations* 8-95. Section 8.09(a) of the MBCA sets out various grounds upon which a director may be removed from office by a court. These grounds are very similar to the grounds that are set out in s 162(5) of the (South African) Companies Act. In fact, some of the grounds set out in s 162(5) of the (South African) Companies Act mirror those set out in s 8.09(a) of the MBCA. These grounds are discussed in para 3.4 below.

[231] Subchapter D sets out in detail the requirements which must be complied with in order to institute a derivative action under the MBCA. The relevant provisions of the MBCA which must be complied with are ss 7.41 to 7.47. Briefly, these procedures are that a shareholder must serve a written demand on the corporation to take suitable action (s 7.42(i)). Derivative proceedings may thereafter not be commenced until ninety days have expired from the date of delivery of the demand, unless the shareholder has been notified that the demand has been rejected by the corporation or unless irreparable injury to the corporation would result by waiting for the ninety-day period to expire (s 7.42(ii)). If the corporation commences an inquiry into the allegations made in the demand, the court may stay the derivative proceeding for such period as the court determines appropriate (s 7.43). In terms of s 7.44(a), the derivative proceeding must be dismissed by the court on motion by the corporation if it is established that, after a reasonable inquiry has been conducted, the maintenance of the derivative proceeding is not in the best interests of the corporation. Derivative proceedings may not be discontinued or settled without the court's approval (s 7.45). Section 7.46 deals with the costs orders which a court may make, while s 7.47 deals with the applicability of derivative proceedings to foreign corporations. On the whole, these provisions are analogous to the derivative action proceedings under s 165 of the (South African) Companies Act. The only provision that a shareholder is not required to comply with in terms of s 8.09(b), is s 7.41(i). Section 7.41(i) provides that a shareholder may not commence or maintain a derivative proceeding unless the shareholder was a shareholder of the corporation at the time of the act or omission complained of or became a shareholder through transfer by operation of law from one who was a shareholder at that time. In other words, the plaintiff must have been an owner of shares in the company at the time of the act or omission complained of. This rule has been expressly relaxed for purposes of instituting a derivative action in terms of s 8.09 of the MBCA to judicially remove a director from office, which means that a person who purchases shares subsequent to the act or omission complained of may institute a derivative action under s 8.09 of the MBCA. The shareholder must nevertheless fairly and adequately represent the interests of the corporation in enforcing the right of the corporation (see s 7.41(ii) of the MBCA).

right of the company by the shareholders are Connecticut,[232] the District of Columbia,[233] Idaho,[234] Iowa,[235] South Dakota[236] and Wyoming.[237] As was mentioned above[238] only one USA State, Pennsylvania, permits a single shareholder to bring an action to remove a director from office. Section 1726(d) of the Pennsylvania Business Corporation Law is akin to section 162 of the (South African) Companies Act in that it empowers a single shareholder to apply to court to remove a director from office. The former provision nevertheless states that the company must be a party to the application, and the shareholder must in addition comply with the requirements relating to derivative actions.[239] Section 162(2) of the (South African) Companies Act is comparatively much wider than the MBCA, the DGCL and the corporate legislation of several USA States in that it permits not only a single shareholder to commence judicial removal proceedings under section 162 but, according to *Lewis Group Limited v Woollam*,[240]

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[232] Section 33-743(a) and (b) of the Connecticut General Statutes provides that judicial removal proceedings must be commenced "either by or in the right of the corporation" and that a shareholder proceeding on behalf of the corporation must comply with the requirements of derivative actions, contained in ss 33-720 to 33-727. This provision is codified in Chapter 601 (Business Corporations), Title 33 (Corporations) of the Connecticut General Statutes.

[233] Section 29-306.09(a) of the District of Columbia Code provides that judicial removal proceedings must be commenced "by or in the right of the corporation" and that a shareholder proceeding on behalf of the corporation must comply with the requirements of derivative actions. This provision is codified in Chapter 3 (Business Corporations), Subchapter VI (Directors and Officers), Title 29 (Business Organizations) of the District of Columbia Code.

[234] Section 30-29-809(2) of the Idaho Code provides that judicial removal proceedings must be commenced "by or in the right of the corporation" and that a shareholder proceeding on behalf of the corporation must comply with the requirements of derivative actions, contained in ss 30-29-741 to 30-29-747 of the Idaho Code. This provision is codified in Chapter 29 (General Business Corporations), Title 30 (Corporations) of the Idaho Statutes.

[235] Section 490.809(1) of the Iowa Code provides that judicial removal proceedings must be commenced "by or in the right of the corporation" and that a shareholder proceeding on behalf of the corporation must comply with the requirements of derivative actions. This provision is codified in Chapter 490 (Business Corporations), Title XII (Business Entities) of the Iowa Code.

[236] Section 47-1A-809 of the South Dakota Business Corporation Act provides that judicial removal proceedings must be commenced "by or in the right of the corporation" and that a shareholder proceeding on behalf of the corporation must comply with the requirements of derivative actions, contained in ss 47-1A-740 to 47-1A-747. This provision is codified in Chapter 01A (South Dakota Business Corporation Act), Title 47 (Corporations) of the South Dakota Codified Laws.

[237] Section 17-16-809(a) of the Wyoming Business Corporation Act provides that judicial removal proceedings must be commenced "by or in the right of the corporation" and that a shareholder proceeding on behalf of the corporation must comply with the requirements of derivative actions, contained in ss 17-16-740 to 17-16-747. This provision is codified in Chapter 16 (Wyoming Business Corporation Act), Title 17 (Corporations, Partnerships and Associations) of the Wyoming Code.

[238] See para 3.3.1.1 above.

[239] Section 1726(c) of the Pennsylvania Business Corporation Law.

[240] 2017 (2) SA 547 (WCC).

such proceedings may not be commenced derivatively by the shareholder but must be commenced in the shareholder's own name.

The High Court in *Lewis Group Limited v Woollam*[241] asserted that it had not encountered a case in South Africa or abroad, in which the type of relief sought by Woollam under section 162 of the Companies Act had been sought or granted in derivative proceedings. The court did not, however, consider USA law on the question whether proceedings to court to remove a director from office may be instituted by means of the derivative actions. As mentioned,[242] section 5(2) of the Companies Act states that, to the extent appropriate, a court interpreting or applying the Companies Act may consider foreign company law. In *Nedbank Ltd v Bestvest 153 (Pty) Ltd; Essa and Another v Bestvest 153 (Pty) Ltd and Others*[243] the High Court observed that company law in South Africa has for many decades tracked the English system and had taken its lead from the relevant English Companies Act and jurisprudence, but section 5(2) of our Companies Act now encourages our courts in interpreting the Companies Act to look further afield and to have regard in appropriate circumstances to other corporate law jurisdictions, be they American, European, Asian or African. Since USA law makes explicit provision for derivative action proceedings to be instituted by a shareholder to remove a director from office, under section 5(2) of the Companies Act, the court in *Lewis Group v Woollam*[244] ought to have also considered USA law in determining whether a shareholder may institute court proceedings to remove a director from office by means of the derivative action. The court's judgment may have been influenced in a different direction had it considered USA law on this point.[245]

3.3.1.3 Company Secretary, Prescribed Officer, Trade Union and Employee Representative

A company secretary, prescribed officer of the company, registered trade union that represents employees of the company or another representative of the employees of the company may

[241] 2017 (2) SA 547 (WCC) para 6.

[242] See chapter 1, para 3.

[243] 2012 (5) SA 497 (WCC) para 26.

[244] 2017 (2) SA 547 (WCC).

[245] R Cassim "The Launching of Delinquency Proceedings under the Companies Act 71 of 2008 by means of the Derivative Action: *Lewis Group Limited v Woollam* 2017 (2) SA 547 (WCC)" 685-687.

apply to court, under section 162(2) of the Companies Act, for an order declaring a director delinquent or under probation. It should be noted that this group of persons is not empowered to institute proceedings to remove a director from office under section 71(3). This widens considerably the range of persons who have *locus standi* to apply to court to remove a director from office compared to the equivalent provisions under the UK Company Directors Disqualification Act 1986, the Australian Corporations Act of 2001, the MBCA and the corporate legislation of various USA States, which do not confer *locus standi* on this group of persons to apply to court to remove a director from office. There is much potential for a registered trade union that represents employees of the company or another representative of the employees of the company to put directors under considerable pressure by exercising or threatening to exercise such rights.[246] The mere fact that this group of persons has *locus standi* to apply to court under section 162 of the Companies to declare directors delinquent may be daunting for most directors even if the prospects of a court declaring them delinquent may be minimal in the circumstances.[247]

3.3.2 *Locus Standi* of the CIPC and the Takeover Regulation Panel under Section 162 of the Companies Act

The CIPC and the Takeover Regulation Panel may institute proceedings to declare a director delinquent or to place him under probation.[248] One example where the CIPC exercised its rights

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[246] J Du Plessis & Delport "'Delinquent Directors' and 'Directors under Probation': A Unique South African Approach Regarding Disqualification of Company Directors" 277.

[247] J Du Plessis & Delport "'Delinquent Directors' and 'Directors under Probation': A Unique South African Approach Regarding Disqualification of Company Directors" 277.

[248] Section 162(3) of the Companies Act. The Takeover Regulation Panel is established by s 196 of the Companies Act as a juristic person, to function as an organ of state within the public administration, but as an institution outside the public service. It has jurisdiction throughout South Africa. It is independent, and is subject only to the Constitution, the law and any policy statement, directive or request issued to it by the Minister in terms of the Companies Act. It must be impartial and must perform its functions without fear, favour or prejudice. In carrying out its functions the Takeover Regulation Panel may have regard to international developments in the field of company law. It may also consult any person, organisation or institution with regard to any matter. The Takeover Regulation Panel is responsible for regulating affected transactions and offers to the extent provided for in Parts B (Authority of Panel and Takeover Regulations) and C (Regulation of affected transactions and offers) of Chapter 5 (Fundamental transactions, takeovers and offers) of the Companies Act and the Takeover Regulations, investigating complaints with respect to affected transactions and offers in accordance with Part D of Chapter 7 of the Companies Act, applying for a court order to wind up a company in the manner contemplated in s 81(1)(*f*) of the Companies Act, and consulting with the Minister in respect of additions, deletions or amendments to the Takeover Regulations (see ss 196 and 201 of the Companies Act). On 30 January 2018 Steinhoff International Holdings N.V. (Incorporated in the Netherlands) ("Steinhoff International") announced the receipt of a compliance notice by the CIPC. The compliance notice gave the directors of Steinhoff International six months to identify the individuals involved in the falsification of accounting records. The notice further required the board of directors

under section 162 of the Companies Act was with regard to a director of a state-owned company, the South African Nuclear Energy Corporation SOC Limited (NECSA). In 2016 the CIPC applied to the Gauteng High Court, Pretoria for the chief executive officer of NECSA to be placed under probation in terms of section 162(7) of the Companies Act. Some of the directors of NECSA had complained to the CIPC that the chief executive officer had violated NECSA's motor vehicle policy, and had refused to comply with a board instruction to reimburse NECSA for the personal use of a company vehicle. Following an investigation, the CIPC applied to the Gauteng High Court, Pretoria to have the director placed under probation. The basis for the application was that the director had acted in a manner materially inconsistent with the duties of a director.[249]

3.3.3 *Locus Standi* of an Organ of State under Section 162 of the Companies Act

An organ of state responsible for the administration of any legislation may institute proceedings to declare a director delinquent. An "organ of state" has the meaning set out in section 239 of the Constitution.[250] Section 239 of the Constitution defines an "organ of state" as meaning:

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to institute criminal action against the individuals identified in the falsification of accounts. In addition, the compliance notice required the board to institute civil action in terms of ss 77 (liability of directors and prescribed officers) and 162 of the Companies Act against the directors responsible for the falsification of accounting records (see JSE SENS announcement (30 January 2018) available at https://www.moneyweb.co.za/wp-content/uploads/ftp/senspdfs/SENS_20180130_S394527.pdf?x31826 (accessed on 31 January 2018) and Crotty "Steinhoff served with hard-hitting compliance notice" (31 January 2018) available at https://www.businesslive.co.za/bd/companies/retail-and-consumer/2018-01-31-steinhoff-served-with-hard-hitting-compliance-notice/ (accessed on 31 January 2018)). Irrespective of whether or not the board of directors of Steinhoff International takes steps to declare any of its directors delinquent, the CIPC has *locus standi* in terms of s 162(3) of the Companies Act to apply to court to declare any such directors delinquent if valid grounds to do so exist.

[249] See s 162(7)(*a*)(ii) of the Companies Act. Soon after this application was made, a former director of NECSA applied to have the chief executive officer of NECSA declared a delinquent director on the grounds that, *inter alia*, he had misled the board of directors, he had failed to inform it that he had not obtained security clearance, he had appointed a chief financial officer who had been suspended from his former position for procurement irregularities, he had provided funds to a political party without the consent of the board and he would not co-operate with the auditor-general in providing necessary documentation. Despite this pending court application, the chief executive officer was reappointed in December 2016 to the board of directors of NECSA for a further three years. The chairman of NECSA declared that the complaints by the previous board over the conduct of the chief executive officer, which included the abuse of the company car, had been defeated (Paton "Regulator seeks to penalize Necsa CE" (22 January 2016) available at https://www.businesslive.co.za/bd/companies/energy/2016-01-22-regulator-seeks-to-penalise-necsa-ce/ (accessed on 3 April 2017); Phandle "Necsa hit by second court case" (27 January 2016) available at http://www.dispatchlive.co.za/business/2016/01/27/necsa-hit-by-second-court-case/ (accessed on 3 April 2017); Paton "Necsa boss gets three more years at the helm" (12 December 2016) available at https://www.pressreader.com/south-africa/business-day/20161212/281500750884840 (accessed on 3 April 2017).

[250] Section 1 of the Companies Act.

"*(a)* any department of state or administration in the national, provincial or local sphere of government; or

(b) any other functionary or institution-

(i) exercising a power or performing a function in terms of the Constitution or a provincial constitution; or

(ii) exercising a public power or performing a public function in terms of any legislation, but does not include a court or a judicial officer"

It follows from the above definition that any Department of State or Department of administration in the national, provincial or local sphere of government which administers any legislation may institute proceedings to declare a director delinquent. A court or a judicial officer may not institute proceedings to declare a director delinquent since they fall outside the scope of the definition.[251] An organ of state responsible for the administration of any legislation may institute proceedings to declare a director delinquent, but not to place him under probation.[252] When an organ of state applies to court for an order declaring a director delinquent it must serve a copy of its application on the CIPC.[253]

3.3.4 Guarding Against Abuse of Section 162

It is important to guard against abuse of applications to declare directors delinquent. Persons with *locus standi* may use the mechanism of applying to court to declare a director delinquent or to place him under probation to lodge vexatious claims. This may result in damage being caused to the company and the reputation of the directors.[254] This is especially important with regard to a public company that is listed on the Johannesburg Stock Exchange, where the value of the company's shares may easily be affected by the mere fact of the institution of an application in terms of section 162 of the Companies Act.

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[251] On the meaning of "organ of state" see *Minister of Education, Western Cape, and Others v Governing Body, Mikro Primary School, and Another* 2006 (1) SA 1 (SCA) para 20; *Mittalsteel South Africa Ltd (formerly Iscor Ltd) v Hlatshwayo* 2007 (1) SA 66 (SCA) paras 6 and 19 and *Katshwa and Others v Cape Town Community Housing Co (Pty) Ltd and Four Similar Cases* 2014 (2) SA 128 (WCC) paras 46-47.

[252] Section 162(4) of the Companies Act gives standing to an organ of state to apply to a court for an order declaring a person delinquent, but does not make any mention of an order to place a person under probation.

[253] Section 162(13) of the Companies Act.

[254] R Cassim "Governance and the Board of Directors" in FHI Cassim et al *Contemporary Company Law* 436.

For example, in *Lewis Group Limited v Woollam*[255] Lewis Group Limited, a public company listed on the Johannesburg Stock Exchange, argued that Woollam had not acted in good faith by launching proceedings to have four directors of the company declared delinquent, and that his application had been vexatious. The company contended that Woollam was involved in short-selling activities,[256] and that his conduct in instituting delinquency proceedings against the directors of the company was directed at driving down the share price of the company in order to benefit these activities.[257] The negative publicity given to the company as a result of the delinquency proceedings instituted by the shareholder had an adverse effect on the share price of the company.[258] The court noted that Woollam had failed to disclose his short-selling activities when making public his adverse opinions of the business activities of the company.[259] The court proclaimed that this had raised an ethical question, but the court did not decide on whether Woollam had acted in bad faith as the company had already referred this issue to the Financial Services Board for investigation.[260] Due to insufficient evidence the Financial Services Board subsequently cleared Woollam of insider trading.[261] The decision in *Lewis Group Limited v Woollam*[262] illustrates the extent of the power conferred on a single

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[255] 2017 (2) SA 547 (WCC). This case is discussed in para 3.3.1.2 above.

[256] Short-selling is an investment strategy whereby the investor "borrows" shares for an agreed fee from a holder thereof, and sells them into the market at a time when he expects the price to drop. The investor then purchases an equivalent number of shares at the lower price to which they have fallen to be able to return them to the "lender", which is usually a brokerage firm. The investor's profit is the difference between the price at which he sold the shares and that at which he purchased replacements to return to the "lender", less the costs of the transactions (see *Lewis Group Limited v Woollam* 2017 (2) SA 547 (WCC) para 85; *S v Mcpherson* 1972 (2) SA 348 (E) at 354; *Hannover Group Reinsurance (Pty) Ltd and Another v Gungudoo and Another* [2011] 1 All SA 549 (GSJ) para 6; Chitimira *A Comparative Analysis of the Enforcement of Market Abuse Provisions* (2012) (Unpublished LLD Thesis) 178-181; Chitimira "Unpacking Selected Key Elements of the Insider Trading and Market Manipulation Offences in South Africa" at 36).

[257] *Lewis Group Limited v Woollam* 2017 (2) SA 547 (WCC) para 86.

[258] *Lewis Group Limited v Woollam* 2017 (2) SA 547 (WCC) para 86.

[259] *Lewis Group Limited v Woollam* 2017 (2) SA 547 (WCC) para 87.

[260] *Lewis Group Limited v Woollam* 2017 (2) SA 547 (WCC) para 87.

[261] FSB Press Release (28 September 2016) available at https://www.fsb.co.za/Departments/communications/Documents/2016-09-28%20(2).pdf (accessed on 7 April 2017); Smith "Consumer watchdog cleared of Lewis allegations" (30 September 2016) available at http://www.fin24.com/Companies/Retail/consumer-watchdog-cleared-of-lewis-allegations-20160930 (accessed on 7 April 2017); S Cassidy "Woollam shrugs off 'dirty tricks and lies' in Lewis fight" (30 September 2016) available at http://www.iol.co.za/business-report/companies/woollam-shrugs-off-dirty-tricks-and-lies-in-lewis-fight-2074840 (accessed on 7 April 2017).

[262] 2017 (2) SA 547 (WCC).

shareholder to institute proceedings to declare a director delinquent. If done in bad faith, not only the reputation of the directors concerned but also the share price of a company may potentially be detrimentally affected. Of course, if the application under section 162 of the Companies Act is proved to be vexatious, frivolous or without any merit, a court would not grant an order of delinquency against the director concerned, but while pending the application may nevertheless still affect the reputation of the director concerned as well as the share price of the company.

As the court in *Lewis Group Limited v Woollam*[263] pointed out, section 162 of the Companies Act does not contain any filters or safeguards to guard against applications that are vexatious, frivolous or without merit. It is submitted that if a shareholder were to institute proceedings to declare a director delinquent by means of a derivative action, this would have the advantage of quickly curbing the abuse of section 162 since a court would be able to screen out at a preliminary stage any proceedings instituted with an ulterior motive. The court held further that in considering whether to set aside a shareholder's demand in terms of section 165(3) of the Companies Act, a court may take the good faith of the shareholder into account.[264] Accordingly if a shareholder were to institute proceedings to declare a director delinquent by means of a derivative action, the good faith requirement would serve to filter out at any early stage any applications that are frivolous or vexatious. The damage done to the share price of Lewis Group Limited and to the reputation of directors could well have been more extensive had the application been instituted by Woollam personally, and had the directors of the company been involved in a protracted legal battle, in terms of section 162 of the Companies Act.[265] Moreover, if a company is able to successfully apply to court to set aside a demand in terms of section 165(3) on the ground that it is frivolous, vexatious or without merit, this may well serve to discourage a shareholder from thereafter proceeding under section 162 to declare the directors of the company delinquent.[266]

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[263] 2017 (2) SA 547 (WCC) para 47.

[264] *Lewis Group Limited v Woollam* 2017 (2) SA 547 (WCC) para 89.

[265] See further R Cassim "The Launching of Delinquency Proceedings under the Companies Act 71 of 2008 by means of the Derivative Action: *Lewis Group Limited v Woollam* 2017 (2) SA 547 (WCC)" 683-685.

[266] R Cassim "The Launching of Delinquency Proceedings under the Companies Act 71 of 2008 by means of the Derivative Action: *Lewis Group Limited v Woollam* 2017 (2) SA 547 (WCC)" 682.

3.4 The Grounds for a Declaration of Delinquency

Section 162(5) of the Companies Act lists the grounds which may be relied on by a person with *locus standi* to apply to court to declare a director delinquent. Each group of persons with *locus standi* to apply to court to declare a person delinquent[267] may raise specific grounds of delinquency and probation, as set out in sections 162(2), 162(3) and 162(4) of the Companies Act. A declaration of delinquency must be made in relation to one of the statutory grounds set out in section 162 of the Companies Act.[268] In *Cook: Geoffrey v Hesber Impala (Pty) Ltd and Others*[269] the application to declare a director delinquent was unsuccessful because the applicant was unable to establish that any one of the specific grounds stipulated in section 162 of the Companies Act had been contravened.[270]

While the first two grounds of delinquency referred to in paragraphs 3.4.1 and 3.4.2 below relate to individuals serving as directors when already prohibited from doing so,[271] in *Grancy Property Limited v Gihwala*[272] the court termed the other grounds listed in section 162(5)(*c*) of the Companies Act as "substantive" abuses of office. The court commented that the conduct listed in section 162(5)(*c*) falls under the description of conduct that evinces a lack of genuine

[267] The groups of persons with *locus standi* to apply to court to declare a director delinquent are discussed above in paras 3.3.1, 3.3.2 and 3.3.3.

[268] *Cook: Geoffrey v Hesber Impala (Pty) Ltd and Others* (2014/45832) [2016] ZAGPJHC 23 (19 February 2016) paras 60-61.

[269] (2014/45832) [2016] ZAGPJHC 23 (19 February 2016).

[270] The applicant and respondent were directors of Hesber Impala (Pty) Ltd. The applicant argued that the respondent had grossly abused his position as a director, taken personal advantage of an opportunity and intentionally inflicted harm upon the company by constructing an illegal structure on the company's property without municipal planning or environmental approval, and further conducting illegal tourist activities thereon. The applicant argued that this action of the respondent had exposed the company to the danger of having an illegal structure erected on its property for which no public liability insurance could be obtained. Therefore, the applicant argued, the company had been exposed to substantial risk and possible criminal proceedings. The respondent contended that the structure was merely temporary and had been erected on the property with the consent of the applicant. The court found that there was a dispute of material facts whether the applicant had consented to the erection by the respondent of the structure, and whether or not the structure had been permanent or temporary. In light of the dispute of material facts the court held that the application to declare the respondent a delinquent director could not be resolved on the papers. For this reason the court dismissed the application to declare the respondent a delinquent director.

[271] *Grancy Property Limited v Gihwala* 2014 JDR 1292 (WCC) para 156.

[272] 2014 JDR 1292 (WCC) para 156.

concern for the company's prosperity.[273] In *Lewis Group Limited v Woollam*[274] the court observed that for a company or any of its shareholders to succeed in obtaining a declaration of delinquency in respect of any of the company's directors they must demonstrate very serious misconduct by the director concerned. Establishing so-called "ordinary" negligence, poor business decision-making, or misguided reliance by a director on incorrect professional advice would not be enough under section 162 of the Companies Act.[275] A similar sentiment was expressed by Sir Nicholas Browne-Wilkinson V-C in *Re Lo-Line Electric Motors Ltd*[276] in respect of the equivalent remedy under section 295 of the UK Companies Act of 1985 (the predecessor of the UK Company Directors Disqualification Act 1986). The learned judge remarked in this case that ordinary commercial misjudgment is in itself not sufficient to justify disqualification, and that in the normal case the conduct complained of must display a lack of commercial probity.[277]

The grounds on which a declaration of delinquency may be made by a court, stipulated in section 162 of the Companies Act, are next discussed. Thereafter, other grounds for the judicial removal of directors in the UK, Australia and the USA, which are not provided for in the (South African) Companies Act, are considered.

3.4.1 Consenting to Serve as a Director while Ineligible or Disqualified

The first ground of delinquency in section 162(5)(*a*) of the Companies Act is that the person consented to serve as a director or acted in the capacity of a director or prescribed officer whilst ineligible or disqualified in terms of section 69 of the Companies Act.[278]

Section 162(5)(*a*) of the Companies Act states that this ground of delinquency does not apply if the person was acting under the protection of a court order contemplated in section 69(11) or

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[273] *Grancy Property Limited v Gihwala* 2014 JDR 1292 (WCC) para 176.

[274] 2017 (2) SA 547 (WCC) para 18.

[275] *Lewis Group Limited v Woollam* 2017 (2) SA 547 (WCC) para 18.

[276] 1988 2 All ER 692.

[277] *Re Lo-Line Electric Motors Ltd* 1988 2 All ER 692 at 696.

[278] See chapter 3, paras 6.1.2 and 6.1.3 for a discussion of the grounds of ineligibility and disqualification to be a director.

as a director contemplated in section 69(12). In terms of section 69(11) of the Companies Act a court may exempt a person from the application of the grounds of disqualification set out in section 69(8)(*b*) of the Companies Act.[279] The reference to section 69(12) in section 162(5)(*a*)(ii) is an error as section 69(12) was deleted by section 46(*c*) of the Companies Amendment Act 3 of 2011.

As was mentioned above, this ground of delinquency relates to a person serving or acting as a director when already prohibited from doing so.[280] It may be relied on by the first and the second group of persons with *locus standi* under section 162 of the Companies Act referred to in paragraphs 3.3.1 and 3.3.2 above.[281]

3.4.2 Acting as a Director while under a Probation Order

In terms of section 162(5)(*b*) of the Companies Act a court must make an order declaring a person to be a delinquent director if the person while under a probation order in terms of section 162 of the Companies Act or in terms of section 47 of the Close Corporations Act 69 of 1984, acted as a director in a manner that contravened that order.[282] A contravention of a probation order is thus a ground for being declared a delinquent director. This ground of delinquency relates to a person acting as a director when already prohibited from doing so[283] and may be relied on by the first and the second group of persons with *locus standi* under section 162 of the Companies Act referred to in paragraphs 3.3.1 and 3.3.2 above.[284]

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[279] The exemption from the application of the grounds of disqualification is discussed further in chapter 3, para 6.1.3.

[280] See *Grancy Property Limited v Gihwala* 2014 JDR 1292 (WCC) para 156.

[281] Sections 162(2)(*b*)(i) and 162(3)(*b*)(i) of the Companies Act.

[282] Section 47 of the Close Corporations Act 69 of 1984 disqualifies certain persons from managing a close corporation. These persons include a person under legal disability, an unrehabilitated insolvent, a person who is disqualified from being a director of a company in terms of s 69(8) to (11) of the Companies Act and a person who has been placed under probation by a court in terms of s 162 of the Companies Act or s 47(1C) of the Close Corporations Act 69 of 1984. Section 47(1C) confirms that s 162 of the Companies Act, read with the changes required by the context, applies to a close corporation.

[283] See *Grancy Property Limited v Gihwala* 2014 JDR 1292 (WCC) para 156.

[284] Sections 162(2)(*b*)(i) and 162(3)(*b*)(i) of the Companies Act.

3.4.3 Gross Abuse of the Position of a Director

In terms of section 162(5)(*c*)(i) of the Companies Act a court must make an order declaring a person a delinquent director if the person, while a director, grossly abused the position of director. This ground of delinquency may be relied on by the first and the second group of persons with *locus standi* under section 162 of the Companies Act referred to in paragraphs 3.3.1 and 3.3.2 above.[285] The term "gross abuse" has not been defined in the Companies Act. A court would have a discretion to determine whether a director's conduct amounts to "gross abuse" of the position of director.

The inclusion of the ground of "gross abuse of the position of director" as a basis for the judicial removal of a director in the (South African) Companies Act appears to have been influenced by the corresponding section 8.09(a) of the MBCA. The section states that a court may remove a director from office in a proceeding commenced by or in the right of the company if the court finds that the director "grossly abused the position of director". USA States which have adopted the ground of grossly abusing the position of director include Connecticut,[286] the District of Columbia,[287] Idaho,[288] Iowa,[289] South Dakota[290] and Wyoming.[291] Section 8.35(b) of the Illinois Business Corporation Act of 1983 requires the gross abuse of the position of director to have been "to the detriment of the corporation". In contrast, under section 162 of the (South African) Companies Act, whether or not the director's gross abuse of his position was to the detriment of the company is irrelevant – it is sufficient as a ground of delinquency if the director grossly abused his position, even if this was not to the detriment of the corporation.

In *Gihwala and Others v Grancy Property Limited and Others*[292] the Supreme Court of Appeal found that gross abuse is not a trivial misdemeanour or an unfortunate fall of grace. As Binns-

[285] Sections 162(2)(*b*)(i) and 162(3)(*b*)(i) of the Companies Act.

[286] Section 33-743(a) of the Connecticut General Statutes.

[287] Section 29-306.09(a)(1) of the District of Columbia Code.

[288] Section 30-29-809(a) of the Idaho Code.

[289] Section 490.809(1)(a) of the Iowa Code.

[290] Section 47-1A-809 of the South Dakota Business Corporation Act.

[291] Section 17-16-809(a)(i) of the Wyoming Business Corporation Act.

[292] 2017 (2) SA 337 (SCA) para 143.

Ward J in *Lewis Group Limited v Woollam*[293] stated, the adjective "gross" used in a context like "gross abuse" denotes obvious and egregious conduct. The learned judge stated further that gross abuse of the position of director must relate to the use of the position as director, and not the performance by the person concerned of his duties and functions as a director, because that is a matter dealt with in terms of section 162(5)(*c*)(iv) of the Companies Act.[294]

An example of a gross abuse of the position of a director in a South African company is found in *Demetriades and Another v Tollie and Others*.[295] In this case the court declared a director of a company delinquent on the basis that he had grossly abused the position of director in that he took advantage of information of the company of which he was a director, and had seized an opportunity to directly compete with the company by means of another company of which he was also a director.[296] This case seems to indicate that directors who are found to have taken personal advantage of information or to have appropriated corporate opportunities in breach of their fiduciary obligations to the company,[297] will generally be found to have grossly abused their positions as directors.

A further example of a gross abuse of the position of director emanates from the USA case of *Markovitz v Markovitz*.[298] It was alleged in this case, as a ground for the removal of a director

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[293] 2017 (2) SA 547 (WCC) para 14.

[294] *Lewis Group Limited v Woollam* 2017 (2) SA 547 (WCC) para 14. See paras 3.4.6 and 3.4.7 below where the provisions of s 162(5)(*c*)(iv) of the Companies Act are discussed.

[295] 2015 ZANCHC 17.

[296] The court found further that the director had acted in a manner that had amounted to a breach of trust by using the information of the company with the intention to compete with it through another company of which he was also a director. Such acts, the court held, satisfy the requirements set out in s 162(5)(*c*) of the Companies Act (*Demetriades and Another v Tollie and Others* 2015 ZANCHC 17 para 60).

[297] Taking personal advantage of information or an opportunity, contrary to s 76(2)(*a*) of the Companies Act, is listed as a ground of delinquency, in s 162(5)(*c*)(ii) of the Companies Act. This ground of delinquency is discussed below in para 3.4.4.

[298] 8 A.2d 46 (Pa. 1939). See also chapter 2, para 6 where this case is discussed. The shareholders who had the power to remove the director from office did not wish to do so because the shareholders who had elected him to office were his mother and brother. The majority shareholders instituted proceedings under Article IV, s 405C of the Pennsylvania Business Corporation Law of 1933 requesting the court to remove the director from office and to bar him from re-election for a period prescribed by the court. Section 405C of the Pennsylvania Business Corporation Law of 1933 empowered shareholders holding at least ten per cent of the shares of the company to institute proceedings requesting a court to remove a director in the case of fraudulent or dishonest acts, or gross abuse of authority or discretion. Prior to the enactment of the Pennsylvania Business Corporation Law the power to remove a director from office could be exercised only by the shareholders.

from office, that the director in question had grossly abused the authority and discretion vested in him as a director by deliberately annoying and harassing the other officers of the company in the performance of their duties to the detriment and harm of the business.[299] It was further alleged that the director had demoralised the office force by making requests for detailed information which he already possessed; insisting that private drawers in the offices be opened; changing locks on doors, and making himself personally objectionable to the officers, employees and customers of the company such that its interests were jeopardised and the morale of the company was impaired.[300] The Supreme Court of Pennsylvania found that the director had indeed harassed his fellow officers and employees in the transaction of the company's business.[301] The court held that the director was under a duty and responsibility to discharge the functions of his office with fidelity to the best interests of the corporation and its shareholders, and to co-operate with the other officers of the company – and not to thwart or obstruct them in the performance of their duties.[302] Based on the above conduct, the court held that the director was guilty of "gross abuse of authority".[303] The court consequently removed the director from his position as director and barred him from re-election for a period of two years.[304]

3.4.4 Taking Personal Advantage of Information or an Opportunity

In terms of section 162(5)(*c*)(ii) of the Companies Act a court must make an order declaring a person a delinquent director if the person, while a director, took "personal" advantage of information or an opportunity, contrary to section 76(2)(*a*) of the Companies Act. In *Gihwala and Others v Grancy Property Limited and Others*[305] the Supreme Court of Appeal found that

[299] *Markovitz v Markovitz* 8 A.2d 46 (Pa. 1939) at 47.

[300] *Markovitz v Markovitz* 8 A.2d 46 (Pa. 1939) at 47.

[301] *Markovitz v Markovitz* 8 A.2d 46 (Pa. 1939) at 48.

[302] *Markovitz v Markovitz* 8 A.2d 46 (Pa. 1939) at 48.

[303] *Markovitz v Markovitz* 8 A.2d 46 (Pa. 1939) at 48.

[304] *Markovitz v Markovitz* 8 A.2d 46 (Pa. 1939) at 48. The Supreme Court of Pennsylvania remarked that the two-year period during which the director had been barred from re-election was not unduly prolonged in view of the director's behaviour in the company. It opined that this two-year period would undoubtedly afford a reasonable time for the existing friction and dissension in the company to disappear, and would serve as a warning that a repetition of such misconduct may serve in the future as a ground for further disqualification to hold the office of director (at 48).

[305] 2017 (2) SA 337 (SCA) para 143.

this ground of delinquency covers two types of conduct. The first is insider trading, whereby a director makes use of confidential price-sensitive information which is known only because of his position as a director, for personal advantage. The second type of conduct is where a director appropriates a business opportunity that should have accrued to the company.[306] This provision is aimed at deterring directors from making use of their positions as directors or from using corporate information obtained while acting as directors for their personal benefit.[307] This ground of delinquency may be relied on by the first and the second group of persons with *locus standi* under section 162 of the Companies Act referred to in paragraphs 3.3.1 and 3.3.2 above.[308]

Section 76(2)(*a*)(i) of the Companies Act provides that a director must not use the position of director or any information obtained while acting in the capacity of a director to gain an advantage for the director, or for another person other than the company or a wholly-owned subsidiary of the company. The specific reference to the word "personal" in section 162(5)(*c*)(ii) appears to impliedly indicate that this ground of delinquency applies only if the director in question took advantage of his position or information to gain an advantage for *himself*. This ground is therefore narrower than section 76(2)(*a*) of the Companies Act which prohibits a director from using his position or any information to gain an advantage for himself "or for another person other than the company or a wholly-owned subsidiary of the company".

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[306] *Gihwala and Others v Grancy Property Limited and Others* 2017 (2) SA 337 (SCA) para 143. On the corporate opportunity doctrine see *Cook v Deeks* [1916] 1 AC 554 (PC); *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168; *Industrial Development Consultants Ltd v Cooley* [1972] 2 All ER 162; *Canadian Aero Service Ltd v O'Malley* (1973) 40 DLR (3d) 371 (SCC); *Bhullar v Bhullar* [2003] 2 BCLC 241 (CA); *Da Silva and Others v CH Chemicals (Pty) Ltd* 2008 (6) SA 620 (SCA); Havenga *Fiduciary Duties of Company Directors with Specific Regard to Corporate Opportunities* (Unpublished LLD Thesis); Havenga "Corporate Opportunities: A South African Update (Part 1)" 40-55; Havenga "Corporate Opportunities: A South African Update (Part 2)" 233-251; Griffin *Company Law Fundamental Principles* 302-306; Havenga "Appropriation of Corporate Opportunities by Directors and Employees" 169-178; Dignam *Hicks & Goo's Cases and Materials on Company Law* 395-409; Kershaw *Company Law in Context* 514-575; Delport *Henochsberg on the Companies Act 71 of* 2008 298-298(5); FHI Cassim "The Duties and Liability of Directors" in FHI Cassim et al *Contemporary Company Law* at 538-554; Havenga "Directors' Exploitation of Corporate Opportunities and the Companies Act 71 of 2008" 257-268; Birds et al *Boyle and Birds' Company Law* 616-621; French, Mayson & Ryan *Mayson, French & Ryan on Company Law* 504-508; Worthington *Sealy & Worthington's Text, Cases and Materials in Company Law* 387-426; Davies & Worthington *Gower Principles of Modern Company Law* 543-551 and Hannigan *Company Law* 264-274.

[307] FHI Cassim "The Duties and Liability of Directors" in FHI Cassim et al *Contemporary Company Law* at 550. For a detailed discussion of s 76(2)(*a*)(i) of the Companies Act see Delport *Henochsberg on the Companies Act 71 of 2008* 297-298(6); FHI Cassim "The Duties and Liability of Directors" in FHI Cassim et al *Contemporary Company Law* 550-553 and Havenga "Directors' Exploitation of Corporate Opportunities and the Companies Act 71 of 2008" 265-266.

[308] Sections 162(2)(*b*)(i) and 162(3)(*b*)(i) of the Companies Act.

In terms of section 206C of the Australian Corporations Act of 2001, on application by ASIC, a court may disqualify a person from managing corporations for a period that the court considers appropriate if a declaration is made under section 1317E (civil penalty provision) that the person has contravened a corporation or scheme civil penalty provision, and if a court is satisfied that the disqualification is justified. Civil penalty provisions include the fiduciary duties of company directors, such as the duty to exercise powers and discharge duties in good faith in the best interests of the corporation and for a proper purpose; the duty not to improperly use one's position as a director or information obtained in the capacity as a director to gain an advantage for oneself or someone else, or to cause detriment to the corporation.[309] These grounds are very similar to the grounds provided for in section 162(5)(*c*) of the Companies Act. While section 162(5)(*c*)(i) of the Companies Act lists as a ground of delinquency the taking of "personal" advantage or information of an opportunity by a director, section 206C of the Australian Corporations Act of 2001 lists as a ground of judicial disqualification a director gaining an advantage for themselves "or someone else", or using information to gain an advantage for themselves or "someone else".[310] Section 206C of the Australian Corporations Act of 2001 is thus wider in scope than section 162(5)(*c*)(i) of the (South African) Companies Act.

3.4.5 Inflicting Harm Intentionally or by Gross Negligence

In terms of section 162(5)(*c*)(iii) of the Companies Act a court must make an order declaring a person a delinquent director if the person, while a director, "intentionally, or by gross negligence" inflicted harm upon the company or a subsidiary of the company, contrary to section 76(2)(*a*) of the Companies Act. Section 76(2)(*a*)(ii) of the Companies Act states that a director must not use the position of director or any information obtained while acting in the capacity of a director to knowingly cause harm to the company or a subsidiary of a company.

[309] Sections 1317E, 180(1), 181(1), 182(1) and 183(1) of the Australian Corporations Act of 2001. There are several other civil penalty provisions on which ASIC may rely to apply to court to disqualify a director from managing corporations, such as contraventions in relation to financial records and financial reports (s 344(1)), contraventions of certain requirements regarding share capital (ss 254L(2), 256D(3), 259F(2) and 260D(2)), insolvent trading (s 588G(2)) and insider trading (ss 1043A(1) and 1043A(2)).

[310] Section 206C read with ss 1317E, 182(1)(a) and 183(1)(a) of the Australian Corporations Act of 2001.

This ground of delinquency may be relied on by the first and the second group of persons with *locus standi* under section 162 of the Companies Act referred to in paragraphs 3.3.1 and 3.3.2 above.[311]

In *Lewis Group Limited v Woollam*[312] the court commented that the section 162(5)(*c*)(iii) ground of delinquency is "somewhat clumsily worded". This is because section 76(2)(*a*)(ii) of the Companies Act, on which this ground is based, refers to "knowingly" causing harm to the company, while section 162(5)(*c*)(iii) refers to inflicting harm upon the company "intentionally, or by gross negligence". The court stated that while "knowingly" is readily reconcilable with "intentionally" it is not readily reconcilable with "gross negligence". Nevertheless, the court commented, it is clear enough that what is required by section 162(5)(*c*)(iii) is conduct intended to harm the company, alternatively, an attitude of recklessness by the director in the face of an appreciation that his conduct could cause the company harm.[313] The meaning of the phrase "gross negligence" is this context is discussed further in paragraph 3.4.6 below.

In *Profica (Pty) Ltd v Dunkley*[314] the South Gauteng High Court, Johannesburg declared a director delinquent on the basis that he had knowingly inflicted harm upon a company contrary to section 76(2)(*a*) of the Companies Act. The facts, briefly, are that the first respondent had been employed by the first applicant initially as a senior project manager and was later appointed to the position of a director at Profica Project Management (Pty) Ltd. The applicants applied to court for an order interdicting the first respondent (the director) and the second respondent (a company) from utilising, exploiting and divulging its confidential and proprietary information, and declaring the first respondent to be a delinquent director. The court found that the first respondent had acted in breach of various obligations in terms of a restraint of trade agreement; he had breached his common law duty not to unlawfully compete with the applicant;

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[311] Sections 162(2)(*b*)(i) and 162(3)(*b*)(i) of the Companies Act.

[312] 2017 (2) SA 547 (WCC) para 16.

[313] *Lewis Group Limited v Woollam* 2017 (2) SA 547 (WCC) para 16. For a detailed discussion of s 76(2)(*a*)(ii) of the Companies Act see FHI Cassim "The Duties and Liability of Directors" in FHI Cassim et al *Contemporary Company Law* 550-553 and Havenga "Directors' Exploitation of Corporate Opportunities and the Companies Act 71 of 2008" 265-266.

[314] 2012 JDR 2394 (GSJ).

he had unlawfully misused the applicants' confidential and proprietary information as a springboard whilst acting in competition with the applicants; he had breached his duties in terms of section 76(5) of the Companies Act by not declaring a personal financial interest in relation to the applicants' contracts, and he had acted in breach of section 76(3) of the Companies Act in that he had failed to exercise his powers and perform his functions as a director in good faith or in the best interest of the company.[315] Based on the above breaches, the court declared that the first respondent had used his position as a director to gain an advantage for himself and for the second respondent and had knowingly caused harm to the applicants. The court consequently granted the interdict which had been requested by the applicants and declared the first respondent delinquent in terms of section 162(5)(*c*)(iii) of the Companies Act.[316]

Section 8.09(a) of the MBCA contains an equivalent ground for the judicial removal of directors as that contained in section 162(5)(*c*)(iii) of the (South African) Companies Act. In terms of section 8.09(a) of the MBCA a court may remove a director from office if the director "intentionally inflicted harm on the corporation". USA States which have also listed the ground of intentionally inflicting harm on the corporation as a basis for the judicial removal of a director, include Connecticut,[317] the District of Columbia,[318] Idaho,[319] Iowa,[320] South Dakota[321] and Wyoming.[322] This ground is, however, narrower than the one provided for in section 162(5)(*c*)(iii) of the (South African) Companies Act in that gross negligence will not suffice for the removal by the court of a director from office under the MBCA and these USA statutes, as is the case under section 162 of the (South African) Companies Act. The threshold for the misconduct of a director before a court will remove him from office is set much higher in the MBCA and the legislation of these USA States than in section 162 of the (South African)

[315] *Profica (Pty) Ltd v Dunkley* 2012 JDR 2394 (GSJ) para 31.

[316] *Profica (Pty) Ltd v Dunkley* 2012 JDR 2394 (GSJ) paras 37.1 and 37.2.

[317] Section 33-743(a) of the Connecticut General Statutes.

[318] Section 29-306.09(a)(1) of the District of Columbia Code.

[319] Section 30-29-809(1)(a) of the Idaho Code.

[320] Section 490.809(1)(a) of the Iowa Code.

[321] Section 47-1A-809 of the South Dakota Business Corporation Act.

[322] Section 17-16-809(a)(i) of the Wyoming Business Corporation Act.

Companies Act, where gross negligence would suffice to remove the director from office. A further respect in which the equivalent ground under section 8.09(a) of the MBCA (and the USA States listed above) is much narrower than section 162(5)(*c*)(iii) of the (South African) Companies Act is that under these USA provisions it must be shown that the director inflicted harm upon the company itself, while section 162(5)(*c*)(iii) extends this ground to the infliction of harm on a subsidiary of the company.

3.4.6 Gross Negligence, Wilful Misconduct and Breach of Trust

In terms of section 162(5)(*c*)(iv) of the Companies Act a court must make an order declaring a person a delinquent director if the person, while a director, acted in a manner that amounted to gross negligence, wilful misconduct or breach of trust in relation to the performance of the director's functions within, and duties to, the company. This ground of delinquency may be relied on by the first and the second group of persons with *locus standi* under section 162 of the Companies Act referred to in paragraphs 3.3.1 and 3.3.2 above.[323]

A court has a discretion to determine whether a director's conduct amounts to "gross negligence" or "wilful misconduct". These terms have not been defined in the Companies Act. A court would have to interpret these terms in the context of section 162(5)(*c*) of the Companies Act, although they are not new terms in our law.

Regarding the meaning of "gross negligence", in *MV Stella Tingas: Transnet Ltd t/a Portnet v Owners of the MV Stella Tingas and Another*[324] the Supreme Court of Appeal stated that while gross negligence is not an exact concept capable of precise definition, it differs from ordinary negligence in that it involves a departure from the standard of the reasonable person to such an extent that it may properly be categorised as extreme. In *Gihwala and Others v Grancy Property Limited and Others*[325] the Supreme Court of Appeal found that there was a long history of courts treating gross negligence as the equivalent of recklessness when dealing with the conduct of those responsible for the administration of companies,[326] and that recklessness

[323] Sections 162(2)(*b*)(i) and 162(3)(*b*)(i) of the Companies Act.

[324] 2003 (2) SA 473 (SCA) para 7.

[325] 2017 (2) SA 337 (SCA) para 144.

[326] See for example *Philotex (Pty) Ltd v Snyman*; *Braitex (Pty) Ltd v Snyman* 1998 (2) SA 138 (SCA) 143-144; *Ebrahim v Airport Cold Storage (Pty) Ltd* 2008 (6) SA 585 (SCA) para 13 and *Tsung v Industrial Development*

is plainly serious misconduct.[327] In *KLM Royal Dutch Airlines v Hamman*[328] the court approved of and adopted into South African law the dictum regarding the meaning of the concept of "wilful misconduct" as propounded in the UK case of *Rustenburg Platinum Mines Ltd v South African Airways*.[329] In this case the concept of "wilful misconduct" was described as meaning conduct which goes far beyond negligence and involves a person doing or omitting to do that which is not only negligent but that which he knows and appreciates is wrong, and is done or omitted regardless of the consequences.[330] In *Msimang v Katuliiba*[331] the court ruled that in the determination of the terms "gross negligence" and "wilful misconduct" in the context of section

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Corporation of South Africa 2013 (3) SA 468 (SCA) paras 29-31. In *Philotex (Pty) Ltd v Snyman*; *Braitex (Pty) Ltd v Snyman* 1998 (2) SA 138 (SCA) the appellants, being former concurrent creditors of the company, had instituted an action against the respondents, being the directors of the company, in terms of s 424(1) of the Companies Act 61 of 1973 (liability of directors for reckless or fraudulent conduct of business). Their action was dismissed. On appeal, the Supreme Court of Appeal held the directors personally liable to the appellants for debts incurred to the company, in terms of s 424(1) of the Companies Act 61 of 1973, where it had been established that at the relevant times there was no reasonable prospect of payment of the company's debts when due. The Supreme Court of Appeal noted that the ordinary meaning of "recklessly" includes gross negligence and that recklessness itself connotes at the very least gross negligence (at 143-144). In *Ebrahim v Airport Cold Storage (Pty) Ltd* 2008 (6) SA 585 (SCA) a father and son had run a close corporation without proper books or documentation and had allowed a debt due to the respondent to be transferred to the close corporation from another close corporation without receiving any consideration. The respondent approached the High Court for an order holding the father and son (the appellants) personally liable for payment of the debt on the basis of s 64(1) of the Close Corporations Act 69 of 1984 (liability for carrying on the business of a close corporation recklessly, with gross negligence, with intent to defraud any person or for any fraudulent purpose). The High Court gave judgment against the appellants for the full amount claimed. The Supreme Court of Appeal dismissed the appeal by the father and son. It held that it was not necessary for it to be decided at this stage whether there is a meaningful difference between "reckless" and "gross negligence". The court stated that acting recklessly meant a failure to give consideration to the consequences of one's actions (paras 13-14). It found that the father and son had shown a reckless disregard for the solvency of the close corporation and for its ability to repay the debts it had incurred, and had been knowing parties to the reckless operation of the business of the close corporation (para 18 and paras 23-24). In *Tsung v Industrial Development Corporation of South Africa* 2013 (3) SA 468 (SCA) the appellants, who were directors of a company that ran a textile-manufacturing business in the Western Cape, had borrowed a substantial amount of money from the respondents to set up the business. Despite becoming factually and commercially insolvent the appellants had concluded transactions which had the effect of recovery of their investment in the company at the expense of creditors. They had also used the company's bank account to pay their personal expenses. The respondents instituted an action to recover their investment in the company from the appellants personally in terms of s 424 of the Companies Act 61 of 1973 on the basis that the business had been carried on recklessly or with intent to defraud creditors. The High Court held that the conduct of the appellants fell within the ambit of s 424 of the Companies Act 61 of 1973. The directors of the company appealed this decision on the ground that there had been no deliberate or reckless wrongdoing in the conduct of the business. On appeal, the Supreme Court of Appeal confirmed the decision of the High Court. It held that if one has deliberately depleted the company's assets or misused its corporate form for one's own purposes, then that conduct would fall within the ambit of s 424 (para 31).

[327] *Gihwala and Others v Grancy Property Limited and Others* 2017 (2) SA 337 (SCA) para 144.

[328] 2002 (3) SA 818 (W) para 17.

[329] 1977 1 Lloyd's Rep 564.

[330] *Rustenburg Platinum Mines Ltd v South African Airways* 1977 1 Lloyd's Rep 564 at 569.

[331] 2012 JDR 2391 (GSJ) para 39. The facts of this case are discussed above in note 79.

162(5)(*c*) of the Companies Act, a court must have regard to the conduct of the directors in the performance of their duties as directors of the company in terms of the company's memorandum of incorporation and the statutory framework. This approach was approved in *Cape Empowerment Trust Ltd v Druker*.[332]

In *Companies and Intellectual Property Commission v Cresswell and Others*[333] the High Court advised that in determining the question of gross negligence, a court should resist examining the various allegations made against a director in a singular fashion, but should rather look holistically at the alleged conduct and performance of the director pursuant to the application in terms of section 162 of the Companies Act. In this case the court declared a director delinquent in terms of section 162(5)(*c*)(iv)(*aa*) of the Companies Act on the basis that he had been grossly negligent. The main basis for the director's gross negligence was that he had traded the company in insolvent circumstances and had permitted a public company to operate without proper accounting systems.[334]

In *Gihwala and Others v Grancy Property Limited and Others*[335] the Supreme Court of Appeal found that the conduct of the first and second appellants had amounted to gross abuse of the

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[332] 2013 JDR 1360 (WCC) para 84. This case is discussed above in note 128.

[333] (21092/2015) [2017] ZAWCHC 38 (27 March 2017) para 36.

[334] *Companies and Intellectual Property Commission v Cresswell and Others* (21092/2015) [2017] ZAWCHC 38 (27 March 2017) para 37. The facts of this case are that the CIPC brought an application in terms of s 162 of the Companies Act to declare the third respondent a delinquent director. The third respondent was a director of Skyport Corporation Limited (in liquidation). It had applied to the Civil Aviation Authority for a licence to operate an international airport near Malmesbury, but this licence had not been granted. The company nevertheless continued to receive funds from investors. An investigation revealed that the third respondent had allowed the company to carry on business while knowing that it was commercially insolvent; had made personal withdrawals from the company's bank account; had made offers for the sale of the company's shares directly to the public without a prospectus; had failed to hold annual general meetings; had failed to keep proper accounting records and had failed to follow proper procedures in the allocation of shares to directors and officers (para 20). The court held that the conduct of the third respondent was grossly negligent (para 37) and it granted an order declaring the third respondent delinquent in terms of s 162(5)(*c*)(iv)(*aa*) of the Companies Act, for a period of seven years (para 41).

[335] 2017 (2) SA 337 (SCA) para 139. Briefly the facts of this case are that the first and second appellants were directors of Seena Marena Investments (Pty) Ltd ("SMI"). The Dines Gihwala Family Trust and the second appellant were equal shareholders of SMI. In 2005 the first and second appellants entered into a verbal agreement with Grancy Property Limited for the company to acquire a one-third shareholding in SMI. SMI needed the funding from Grancy Property Limited to enable it to acquire a stake in a special purpose vehicle formed as part of a black economic transaction linked to a property loan stock company listed on the Johannesburg Stock Exchange. The second appellant did not have the resources to pay for his shares in SMI as a one-third shareholder. It was consequently agreed between the parties that the first appellant and Grancy Property Limited would each loan a sum of money to the second appellant to enable the second appellant to pay for his shares in SMI. The agreement between the parties was that the loans would attract interest at a commercial rate and if and when the

position of a director, gross negligence akin to recklessness, as well as breach of trust in relation to the performance of the director's duties to the company. The first and second appellants had failed to ensure that the share register of the company had properly reflected the persons who were entitled to be registered as shareholders. They had also failed to ensure that the company kept proper accounting records. Furthermore they had contravened the provisions of section 226 of the Companies Act 61 of 1973 which prohibited a company from making certain loans to a director of the company. The first and second appellants had further appropriated financial benefits for themselves and had excluded a shareholder of the company from the benefits of such investments. This conduct, the Supreme Court of Appeal held, fell squarely within the scope of section 162(5)(*c*) of the Companies Act.[336] The court also held that the actions of the first and second appellants had constituted wilful misconduct because such actions were intentional and were done with knowledge of the obligations owed to the shareholder under an investment agreement.[337] For the above reasons the Supreme Court of Appeal held that declaring the first and second appellants delinquent directors was entirely justified.[338]

In declaring the first appellant a delinquent director, the Supreme Court of Appeal in *Gihwala and Others v Grancy Property Limited and Others*[339] emphasised the fact that the first appellant was at the time both a businessman and attorney, and also the chairman of one of South Africa's largest law firms and the chairman of Redefine Income Fund Limited, which was one of the largest property loan stock companies listed on the Johannesburg Stock Exchange. These

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second appellant realised his interests at a profit, the first appellant and Grancy Property Limited would share in a proportion of the profit. It was agreed that the first appellant would draft an agreement acknowledging the one-third share of Grancy Property Limited in SMI. Thereafter the business relationship between the parties soured for various reasons. The first and second appellants failed to register Grancy Property Limited as a shareholder of SMI and resisted its attempts to secure its registration in the share register. Information sought by Grancy Property Limited regarding its investment was not forthcoming from the first appellant, and despite numerous requests, Grancy Property Limited was not given access to the books and records of SMI nor to its annual financial statements. Of great concern to Grancy Property Limited was that the first appellant had failed to conclude the agreement acknowledging its one-third share in SMI. Moreover, the first and second appellants had made various payments to themselves, and had received dividend payments from the special purpose vehicle in question but had failed to share with Grancy Property Limited any funds received by SMI, even though Grancy Property Limited was a shareholder of SMI. Instead of repaying Grancy Property Limited its loan to SMI, at the instigation of the first appellant, an investment was made by the first appellant in a property development company in which the first appellant's wife and the Dines Gihwala Family Trust had an interest.

[336] *Gihwala and Others v Grancy Property Limited and Others* 2017 (2) SA 337 (SCA) para 138.

[337] *Gihwala and Others v Grancy Property Limited and Others* 2017 (2) SA 337 (SCA) para 139.

[338] *Gihwala and Others v Grancy Property Limited and Others* 2017 (2) SA 337 (SCA) para 139.

[339] 2017 (2) SA 337 (SCA) para 136.

personal qualifications influenced the court in its decision to declare the first appellant a delinquent director.[340] In a similar vein, in *Lobelo v Kukama*[341] the court found that the conduct of the first appellant, who was declared a delinquent director by the court, was "particularly inexplicable" considering the facts that he was a well-qualified and experienced director who held more than one tertiary degree, owned significant business interests, held directorships in various companies and had been active in the corporate world for more than a decade. Based on these facts the court reasoned that the first appellant was quite able to familiarise himself with the obligations of a director of a company insofar as they related to the conduct of the business of the companies in question and that he was obliged to do so.[342] In *Cape Empowerment Trust Ltd v Druker*[343] too, the court drew attention to the fact that all the members of the board of directors, who were the respondents in the proceedings in terms of section 162(5)(*c)* of the Companies Act, were persons with substantial tertiary qualifications, there being a medical practitioner, a legal practitioner, an accounting practitioner and other directors who held doctoral qualifications in their respective areas of knowledge. For this reason the court asserted that each one of the members of the board of directors ought to and should apply such skill as each of them possessed for the benefit of the company.[344]

It is evident from a review of the case law that, in ascertaining whether a director has grossly abused his position as a director or has acted in a manner that amounted to gross negligence or wilful misconduct in the context of section 162(5)(*c*) of the Companies Act, a court will take into account the personal background and qualifications of the director in question. To this extent the test is subjective. The expectations of a director will vary according to his knowledge and experience, and a higher standard will be expected of educated and experienced persons.

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[340] *Gihwala and Others v Grancy Property Limited and Others* 2017 (2) SA 337 (SCA) para 136.

[341] 2013 JDR 1434 (GSJ) para 25. This was an appeal against the delinquency order granted against two directors in *Kukama v Lobelo & Others* 2012 JDR 0663 (GSJ) (discussed above in note 144). In the appeal, Lobelo argued that the court *a quo* should have placed him under probation as contemplated in s 162(7)(*a*)(ii) (acting in a manner materially inconsistent with the duties of a director), instead of granting a declaration of delinquency (para 14). The full bench of the South Gauteng High Court, Johannesburg held that the conduct of Lobelo was more than sufficient to justify the order declaring Lobelo a delinquent director as found by the court *a quo* (para 41). It found that the argument that Lobelo should have been placed under probation, was without substance (para 41). The court consequently dismissed the appeal on the basis that it could not find any fault with the reasoning of the court *a quo* (para 25).

[342] *Lobelo v Kukama* 2013 JDR 1434 (GSJ) para 25.

[343] 2013 JDR 1360 (WCC) para 9.

[344] *Cape Empowerment Trust Ltd v Druker* 2013 JDR 1360 (WCC) para 9.

Thus, if a director holds tertiary degrees and has extensive experience his conduct will be measured against this higher subjective standard. In ascertaining whether the grounds in section 162(5)(*c*) of the Companies Act have been breached, it thus seems that courts, in their discretion, apply both an objective and a subjective assessment. The objective element lies in ascertaining whether the conduct in question amounts to "gross abuse", "gross negligence" or "wilful misconduct", as referred to in section 162(5)(*c*) of the Companies Act and as defined in our law, while the subjective element lies in considering and weighing the personal qualifications and experience of the director in question in determining whether the offences in question have been committed by such a director.[345]

3.4.7 Unauthorised Acts, Reckless Trading and Fraud

In terms of section 162(5)(*c*)(iv)(*bb*) a court must make an order declaring a person a delinquent director if the person, while a director, acted in a manner contemplated in sections 77(3)(*a*), 77(3)(*b*) or 77(3)(*c*) of the Companies Act. This ground of delinquency may be relied on by the first and the second group of persons with *locus standi* under section 162 of the Companies Act referred to in paragraphs 3.3.1 and 3.3.2 above.[346]

Section 77(3)(*a*) provides that a director of a company is liable for any loss, damages or costs sustained by the company as a direct or indirect consequence of the director having acted in the name of the company, signed anything on behalf of the company, or purported to bind the company or authorised the taking of any action by or on behalf of the company, despite knowing that the director lacked the authority to do so. Section 77(3)(*b*) provides that a director of a company is liable for any loss, damages or costs sustained by the company as a direct or indirect consequence of the director having acquiesced in the carrying on of the company's business despite knowing that it was being conducted in a manner prohibited by section 22(1) of the Companies Act. Section 22(1) prohibits a company from carrying on its business recklessly, with gross negligence, with intent to defraud any person or "for any fraudulent purpose." Section 77(3)(*c*) also relates to fraudulent activities. It provides that a director of a company is liable for any loss, damages or costs sustained by the company as a direct or indirect

[345] R Cassim "Delinquent Directors under the Companies Act 71 of 2008: *Gihwala v Grancy Property Limited* 2016 ZASCA 35" 21.

[346] Sections 162(2)(*b*)(i) and 162(3)(*b*)(i) of the Companies Act.

consequence of the director having been a party to an act or omission by the company despite knowing that the act or omission was calculated to defraud a creditor, employee or shareholder of the company or had "another fraudulent purpose".

Section 4 of the UK Company Directors Disqualification Act 1986 similarly makes fraud and fraudulent trading (in the course of the winding-up of a company) a ground upon which a disqualification order may be made.[347] Section 10 of the UK Company Directors Disqualification Act 1986 further makes participation in fraudulent trading and wrongful trading a ground upon which a disqualification order may be made.[348] Likewise, section 206C of the Australian Corporations Act of 2001 makes insolvent trading a ground for a court to disqualify a director from managing a company.[349]

Section 8.09(a) of the MBCA also lists as a ground for the judicial removal of a director fraudulent conduct with respect to the company or its shareholders. However, the equivalent ground for judicial removal in section 8.09(a) of the MBCA is again narrower than section 162(5)(*c*)(iv)(*bb*) of the Companies Act. While both provisions regard fraudulent conduct as a ground for the judicial removal of a director, under section 8.09(a) of the MBCA the fraudulent conduct must be directed at the company or its shareholders, while under section 162(5)(*c*)(iv)(*bb*) read with section 77(3)(*c*) of the (South African) Companies Act the fraudulent conduct may extend to a creditor or an employee of the company. Even if, under section 162(5)(*c*)(iv)(*bb*) read with section 77(3)(*c*) of the (South African) Companies Act, the conduct does not extend to a shareholder, a creditor or an employee, a court may still declare a director delinquent if the conduct "had another fraudulent purpose". Some USA States which also list fraudulent conduct as a ground for the judicial removal of a director include

[347] Under s 4 of the UK Company Directors Disqualification Act 1986 a court may make a disqualification order against a person if in the course of the winding-up of the company it appears that he has been guilty of fraudulent trading or has otherwise been guilty of any fraud in relation to the company. The maximum period of disqualification under s 4 of the UK Company Directors Disqualification Act 1986 is fifteen years.

[348] In terms of s 10 of the UK Company Directors Disqualification Act 1986 if a person contravenes s 213 (fraudulent trading) or s 214 (wrongful trading) of the UK Insolvency Act of 1986 the court may, if it thinks fit, make a disqualification order against the person. The maximum period of disqualification under s 10 of the UK Company Directors Disqualification Act 1986 is fifteen years.

[349] See s 206C read with ss 1317E and 588G(2) of the Australian Corporations Act of 2001 which makes insolvent trading a ground for a court to disqualify a director from managing a company.

Connecticut,[350] the District of Columbia,[351] Idaho,[352] Iowa,[353] South Dakota,[354] Wyoming,[355] South Carolina,[356] Washington,[357] Tennessee, [358] Alaska,[359] Alabama,[360] Illinois[361] and California.[362]

3.4.8 Repeated Compliance Notices

In terms of section 162(5)(*d*) of the Companies Act a court must make an order declaring a director to be delinquent if the person has repeatedly been subject to a compliance notice or similar enforcement mechanism, for substantially similar conduct, in terms of any legislation. For the purposes of section 162 of the Companies Act "legislation" is defined in section 162(1) as meaning any national or provincial legislation (a) relating to the promotion, formation or management of a juristic person; (b) regulating an industry or sector of an industry; or (c) imposing obligations on, prohibiting any conduct by, or otherwise regulating the activities of, a juristic person. The CIPC or the executive director of the Takeover Regulation Panel may issue a compliance notice to any person whom they believe, on reasonable grounds, has contravened the Companies Act.[363] This ground is wider than a contravention of the Companies

[350] Section 33-743(a) of the Connecticut General Statutes.

[351] Section 29-306.09(a)(1) of the District of Columbia Code.

[352] Section 30-29-809(1)(a) of the Idaho Code.

[353] Section 490.809(1)(a) of the Iowa Code.

[354] Section 47-1A-809 of the South Dakota Business Corporation Act.

[355] Section 17-16-809(a)(i) of the Wyoming Business Corporation Act.

[356] Section 33-8-109(a) of the South Carolina Code of Laws lists as a ground for the judicial removal of a director the engagement by the director in fraudulent or dishonest acts.

[357] Section 23B.08.090(1) of the Washington Business Corporation Act.

[358] Section 48-18-109(a)(1) of the Tennessee Code.

[359] Section 10.06.463 of the Alaska Corporations Code.

[360] Section 10A-2-8-09(a) of the Alabama Business and Nonprofit Entities Code.

[361] Section 8.35(b) of the Illinois Business Corporation Act of 1983.

[362] Section 304 of the California Corporations Code.

[363] Section 171(1)(*a*) of the Companies Act. In terms of s 171(1) of the Companies Act, the CIPC or the executive director of the Takeover Regulation Panel may issue a compliance notice to any person whom they believe, on reasonable grounds (a) has contravened the Companies Act; or (b) has assented to, was implicated in, or directly

Act because it applies even if a person has repeatedly been personally subject to a similar enforcement mechanism, for substantially similar conduct, in terms of *any* legislation. Only the CIPC, the Takeover Regulation Panel and an organ of state may rely on this ground of delinquency.[364] If an organ of state relies on this ground of delinquency the legislation in question must be one which is administered by that organ of state.[365]

3.4.9 Conviction of Offences

In terms of section 162(5)(*e*) of the Companies Act a court must make an order declaring a person a delinquent director if the person has at least twice been personally convicted of an offence or subjected to an administrative fine or penalty in terms of any legislation. Only the CIPC, the Takeover Regulation Panel and an organ of state may rely on this ground of delinquency.[366] If an organ of state relies on this ground of delinquency the legislation in question must again be one which is administered by that organ of state.

Section 162(5)(*e*) of the Companies Act is akin to section 206E of the Australian Corporations Act of 2001. Section 206E empowers ASIC to apply to court to disqualify a person from managing corporations for the period that the court considers appropriate if the person has at least twice contravened the Australian Corporations Act of 2001 and the court is satisfied that the disqualification is justified. In order for this ground of disqualification to apply the person must have been a member of the body corporate that has contravened the Australian Corporations Act of 2001 and that each time a contravention occurred reasonable steps to prevent the contravention were not taken by that person.[367] In exercising its discretion whether to grant a disqualification order the court may have regard to the person's conduct in relation

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or indirectly benefited from, a contravention of the Companies Act, unless the alleged contravention could otherwise be addressed in terms of the Companies Act by an application to a court or to the Companies Tribunal.

[364] Sections 162(3)(*b*)(i) and 162(4)(*b*) of the Companies Act. The reason for this is that the other parties who have *locus standi* under s 162(2) of the Companies Act would probably not have any knowledge of non-compliance and would not be able to prove it without access to the records of the CIPC or the Takeover Regulation Panel (J Du Plessis & Delport "'Delinquent Directors' and 'Directors under Probation': A Unique South African Approach Regarding Disqualification of Company Directors" 278).

[365] Section 162(4)(*b*) of the Companies Act.

[366] Sections 162(3)(*b*)(i) and 162(4)(*b*) of the Companies Act.

[367] Section 206E(1)(a)(i) of the Australian Corporations Act of 2001.

to the management, business or property of any corporation, and any other matters that the court considers appropriate.[368]

Section 206E of the Australian Corporations Act of 2001 confines this ground of disqualification to a contravention of the Australian Corporations Act of 2001 – it does not extend to a contravention of *any* legislation, as is the case under the more far-reaching section 162(5)(*e*) of the (South African) Companies Act. "Legislation" is defined broadly in section 162(1) of the Companies Act.[369] This means that, for instance, an organ of state which administers legislation may launch an application to declare a director delinquent if the director has twice been subject to an administrative fine under that legislation notwithstanding that the legislation in issue has no connection with the director's position as a director or to his functions as a director. It is submitted that this ground is unnecessarily wide.

3.4.10 Director of Company Convicted of an Offence

In terms of section 162(5)(*f*) of the Companies Act a court must make an order declaring a person a delinquent director if within a period of five years, the person was a director of one or more companies or a managing member of one or more close corporations, or the person controlled or participated in the control of a juristic person, irrespective of whether concurrently, sequentially or at unrelated times, that was convicted of an offence or subjected to an administrative fine or similar penalty in terms of any legislation administered by that organ of state. The person in question must have been a director of each such company or a managing member of each such close corporation as the case may be or must have been responsible for the management of each such juristic person, at the time of the contravention that resulted in the conviction, administrative fine or other penalty.[370]

Before a declaration of delinquency may be granted by a court under this ground, the court must also be satisfied that the declaration of delinquency is justified, having regard to the nature of the contraventions, and the person's conduct in relation to the management, business or property of any company, close corporation or juristic person at the time. Unlike the grounds

[368] Section 206E(2) of the Australian Corporations Act of 2001.

[369] The definition of "legislation" for the purposes of s 162 of the Companies Act is set out in para 3.4.8 above.

[370] Section 162(5)(*f*)(i) of the Companies Act.

of delinquency referred to above, in respect of this ground the court has a discretion with regard to granting a declaration of delinquency since it must be "satisfied" that the declaration of delinquency is justified.[371] Only the CIPC, the Takeover Regulation Panel and an organ of state may rely on this ground of delinquency.[372]

3.4.11 Other Grounds of Delinquency in Foreign Jurisdictions

Section 162 of the Companies Act does not give a court a discretion to rely on any grounds of delinquency not listed in section 162(5) of the Companies Act. In *Cook: Geoffrey v Hesber Impala (Pty) Ltd and Others*[373] the court affirmed that a declaration of delinquency must be made in relation to one of the legislated grounds set out in section 162 of the Companies Act. It follows that if a director's conduct does not fall into any of the grounds listed in section 162(5) of the Companies Act, he may not be declared delinquent and consequently be removed from office.

The UK Company Directors Disqualification Act 1986 provides for a number of grounds on which a disqualification order may be made. These grounds include committing an indictable offence in connection with the promotion, formation, management or liquidation of a company;[374] persistent default in complying with the disclosure obligations of the UK Companies Act of 2006;[375] fraud;[376] fraudulent and wrongful trading[377] and conduct that makes the director unfit to be concerned in the management of the company.[378] The ground of being

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[371] Section 162(5)(*f*)(ii) of the Companies Act.

[372] Sections 162(3)(*b*)(i) and 162(4)(*b*) of the Companies Act.

[373] (2014/45832) [2016] ZAGPJHC 23 (19 February 2016) paras 60-61.

[374] Section 2 of the UK Company Directors Disqualification Act 1986. Examples of such offences are convictions for theft, other offences of dishonesty against outsiders, and insider trading (Birds et al *Boyle and Birds' Company Law* 580).

[375] Section 3 of the UK Company Directors Disqualification Act 1986. These disclosure requirements relate to provisions of the companies legislation requiring any return, account or other document to be filed with, delivered or sent, or notice of any matter to be given, to the registrar of companies. A person is conclusively proved to be a persistent defaulter under this provision if it is shown that within five years he has been adjudged guilty of three or more defaults (s 3(2) of the UK Company Directors Disqualification Act 1986).

[376] Section 4 of the UK Company Directors Disqualification Act 1986.

[377] Section 10 of the UK Company Directors Disqualification Act 1986.

[378] Section 6 of the UK Company Directors Disqualification Act 1986. In practice, most disqualification orders are made under s 6 of the UK Companies Directors Disqualification Act 1986 (unfit directors of insolvent

"unfit" to be concerned in the management of the company is only available as a ground for disqualification if the company has become insolvent, whether while the person was a director or subsequently.[379] Part I of Schedule 1 of the UK Company Directors Disqualification Act 1986 sets out a broad range of factors that are relevant in determining whether a director is unfit to be concerned in the management of a company. These factors include any misfeasance or breach of any fiduciary duty by the director in relation to a company or overseas company, any material breach of any legislative or other obligation of the director which applies as a result of being a director of a company or overseas company, and the frequency of such conduct.[380]

The Small Business, Enterprise and Employment Act of 2015 has proposed amendments to the UK Company Directors Disqualification Act 1986 in order to extend the grounds on which disqualification orders may be made and to strengthen the director disqualification regime in the UK. One of the new amendments implemented by the Small Business, Enterprise and Employment Act of 2015 is that the Secretary of State may apply to court for a disqualification order against a person who has been convicted of a "relevant foreign offence."[381] An example of a "relevant foreign offence" is an offence committed outside Great Britain in connection with the promotion, formation, management, liquidation or striking off of a company (or any similar procedure) and which corresponds to an indictable offence under the law of England

companies) (Belcher "What Makes a Director Fit: An Analysis of the Workings of Section 17 of the Company Directors Disqualification Act 1986" 388; Shopovski, Bezzina & Zammit "The Disqualification of Company Directors and its Effect on Entrepreneurship" 20; Davies & Worthington *Gower Principles of Modern Company Law* 248; Hannigan *Company Law* 175).

[379] Section 6(1)(*a*) of the UK Company Directors Disqualification Act 1986. This provision obliges a court to make a disqualification order against an individual if it is satisfied that he is or has been a director of a company that has at any time become insolvent and that his conduct as a director of that company makes him unfit to be concerned in the management of a company. For a further discussion of s 6 of the UK Company Directors Disqualification Act 1986 see Dine "Disqualification of Directors" 7-9; Walters "Directors' Duties: The Impact of the UK Company Directors Disqualification Act 1986" 113-119; Griffin *Company Law Fundamental Principles* 353-361; Dignam *Hicks & Goo's Cases and Materials on Company Law* 340-350; Kershaw *Company Law in Context* 807-810; Birds et al *Boyle and Birds' Company Law* 581-584; French, Mayson & Ryan *Mayson, French & Ryan on Company Law* 711-717; Worthington *Sealy & Worthington's Text, Cases and Materials in Company Law* 309-319; Davies & Worthington *Gower Principles of Modern Company Law* 241-243; Hannigan *Company Law* 379-383.

[380] See Part I of Schedule 1 of the UK Company Directors Disqualification Act 1986 and s 106(6) of the Small Business, Enterprise and Employment Act of 2015. Under s 6 of the UK Company Directors Disqualification Act 1986 the minimum period of disqualification is two years and the maximum period is fifteen years (s 6(4) of the UK Company Directors Disqualification Act 1986).

[381] Section 5A of the UK Company Directors Disqualification Act 1986.

and Wales or Scotland.[382] In a similar vein, under section 206EAA(3) of the Australian Corporations Act of 2001 ASIC has the power to apply to court to disqualify a director who has been disqualified under the law of a foreign jurisdiction. The court must be satisfied that the disqualification is justified. In determining whether the disqualification is justified a court may have regard to the person's conduct in relation to the management, business or property of the foreign company, as well as any other matters that the court considers appropriate.[383] In contrast, section 162(5) of the (South African) Companies Act does not contain a ground of delinquency relating to whether a director has been convicted of a foreign offence or has been disqualified under the law of a foreign country.[384]

As is the case under section 162 of the (South African) Companies Act, the MBCA also limits the grounds for the judicial removal of a director to the grounds listed in section 8.09(a) of the MBCA. In contrast, some USA States give courts a statutory discretion to rely on grounds for the removal of a director that are not listed in the applicable legislation. For instance, section 1726(c) of the Pennsylvania Business Corporation Law states that, upon the application of any shareholder or director, a court may remove from office any director in the case of fraudulent or dishonest acts, or gross abuse of authority or discretion with reference to the corporation, or "for any other proper cause". The court is given a wide discretion to determine whether a particular act of a director constitutes "proper cause". Section 706(d) of the New York Business Corporation Law also states that directors may be removed for "cause" by a court, without specifying what that cause may be. Similarly, section 7-1.2-805 of the Rhode Island Business Corporation Act states that directors may be judicially removed by a court for cause.[385]

It is submitted that in light of the fact that the effects of a declaration of delinquency are harsh, it is preferable to have a closed list of grounds on which a director may be declared delinquent.

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[382] Section 5A(3) of the UK Company Directors Disqualification Act 1986. The maximum period of disqualification under s 5A is fifteen years (s 5A(6)).

[383] Section 206EAA(3) of the Australian Corporations Act of 2001. In terms of regulation 2D.6.01 of the Corporations Regulations 2001 made under the Australian Corporations Act of 2001, only New Zealand is currently designated as a prescribed foreign jurisdiction.

[384] In terms of s 69(8)(*b*) of the Companies Act a person will however be disqualified to be a director of a company if he has been convicted in South Africa or elsewhere and imprisoned without the option of a fine or fined not more than the prescribed amount for *inter alia* theft, fraud or perjury.

[385] See chapter 3, para 6.5 where the meaning of the phrase "for cause" as used in the legislation in the USA is discussed.

Such an approach would also be in line with the UK Company Directors Disqualification Act 1986, the Australian Corporations Act of 2001, the MBCA and most USA States that permit the judicial removal of directors.

3.5 The Grounds for a Probation Order

Section 162(7) of the Companies Act lists the grounds which may be relied on by a person with *locus standi* to apply to court to make an order placing a person under probation. As indicated, an organ of state responsible for the administration of any legislation is not empowered by the Companies Act to apply to court for an order placing a person under probation. It is only empowered to apply to court for an order declaring a person delinquent.[386] The grounds for a probation order and the parties who may rely on them are considered below.

3.5.1 Failing to Vote against Solvency and Liquidity Resolution

In terms of section 162(7)(*a*)(i) of the Companies Act a court may make an order placing a person under probation if, while serving as a director, the person was present at a meeting[387] and failed to vote against a resolution despite the inability of the company to satisfy the solvency and liquidity test,[388] contrary to the Companies Act. This ground for a probation order may be relied on by the first and the second group of persons with *locus standi* under section 162 of the Companies Act referred to in paragraphs 3.1 and 3.3.2 above.[389]

3.5.2 Acting Materially Inconsistent with Duties of a Director

In terms of section 162(7)(*a*)(ii) of the Companies Act a court may make an order placing a person under probation if, while serving as a director, the person acted in a manner that was materially inconsistent with the duties of a director. This ground for a probation order may be relied on by the first and the second group of persons with *locus standi* under section 162 of

[386] See s 162(4) of the Companies Act and para 3.3.3 above.

[387] Section 1 of the Companies Act defines the phrase "present at a meeting" to mean present in person, or able to participate in the meeting by electronic communication, or to be represented by a proxy who is present in person or able to participate in the meeting by electronic communication.

[388] The solvency and liquidity test is set out in s 4 of the Companies Act.

[389] Sections 162(2)(*b*)(ii) and 162(3)(*b*)(ii) of the Companies Act.

the Companies Act referred to in paragraphs 3.3.1 and 3.3.2 above.[390]

It is not sufficient for a director to have acted inconsistently with the duties of a director, in order to meet the standard set in section 162(7). He must have acted in a manner that was "materially" inconsistent with the duties of a director. Section 1 of the Companies Act defines "material" as meaning significant in the circumstances of a particular matter to a degree that is of consequence in determining the matter, or to a degree that might reasonably affect a person's judgment or decision-making in the matter. In *Motale v Abahlobo Transport Services (Pty) Limited and Others*[391] the Western Cape High Court, Cape Town placed a director under probation for one year, in terms of section 162(7)(*a*)(ii) of the Companies Act, on the basis that he had acted in a manner that was materially inconsistent with the duties of a director. The applicant, who was a director and a shareholder of the company, had repeatedly applied for access to certain company records. The documents related essentially to the tax affairs of the company, and also included certain bank statements. The applicant contended that the conduct of the second respondent, also a director of the company, in ignoring his requests was materially inconsistent with his obligations as a director of the company, and that he should be placed under probation in terms of section 162 of the Companies Act. The court concurred with the applicant. It held that the applicant had certain rights to the company documentation by virtue of the fact that he was a director and shareholder of the company.[392] The court ruled that by failing to provide the applicant with the documents requested by him, the respondent had acted in a manner that was materially inconsistent with the duties of a director.[393]

3.5.3 Oppressive or Prejudicial Conduct

In terms of section 162(7)(*a*)(iii) of the Companies Act a court may make an order placing a person under probation if, while serving as a director, the person acted in, or supported a decision of the company to act in, a manner that was oppressive or unfairly prejudicial in terms

[390] Sections 162(2)(*b*)(ii) and 162(3)(*b*)(ii) of the Companies Act.

[391] [2015] JOL 34696 (WCC).

[392] *Motale v Abahlobo Transport Services (Pty) Limited and Others* [2015] JOL 34696 (WCC) at 11.

[393] *Motale v Abahlobo Transport Services (Pty) Limited and Others* [2015] JOL 34696 (WCC) at 17.

of section 163(1) of the Companies Act.[394] A court may declare a person under probation under section 162(7)(*a*)(iii) only if the court is satisfied that the declaration is justified having regard to the circumstances of the company's (or close corporation's) conduct, if applicable, and the person's conduct in relation to the management, business or property of the company (or close corporation) at the time.[395] This ground for a probation order may be relied on by the first and the second group of persons with *locus standi* under section 162 of the Companies Act referred to in paragraphs 3.3.1 and 3.3.2 above.[396]

3.5.4 Failure of Companies to Pay Creditors or Meet Obligations

In terms of section 162(7)(*b*) of the Companies Act a court may make an order placing a person under probation if, within any period of ten years after the effective date[397] the person was a director of more than one company or a managing member of more than one close corporation (be it concurrently, sequentially or at unrelated times), and during that time two or more of those companies or close corporations had each failed to fully pay all their creditors or meet all their obligations (except under a business rescue plan resulting from a resolution of the board of directors in terms of section 129 of the Companies Act or a compromise with creditors in terms of section 155 of the Companies Act). This provision is aimed at "phoenix" companies where a director of a company that is liquidated due to commercial insolvency simply registers a new company and repeats the process several times.[398]

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[394] Under s 163(1) of the Companies Act a shareholder or a director of a company may apply to court for relief if (i) any act or omission of the company or a related person has had a result that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of the applicant; (ii) the business of the company or a related person is being or has been carried on or conducted in a manner that is oppressive or unfairly prejudicial to, or that unfairly disregards the interests of the applicant; or (iii) the powers of a director or prescribed officer of the company or a person related to the company are being or have been exercised in a manner that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of the applicant. For an overview of the oppression remedy see Delport *Henochsberg on the Companies Act 71 of 2008* 574-574(17); MF Cassim "Shareholder Remedies and Minority Protection" in FHI Cassim et al *Contemporary Company Law* at 756-775 and MF Cassim *The New Derivative Action under the Companies Act: Guidelines for Judicial Discretion* 179-205. The oppression remedy is discussed further in chapter 7, para 4.

[395] Section 162(8)(*a*) of the Companies Act.

[396] Sections 162(2)(*b*)(ii) and 162(3)(*b*)(ii) of the Companies Act.

[397] The "effective date" is defined in s 1 of the Companies Act as the date when a provision came into operation in terms of s 225 of the Companies Act. This date is 1 May 2011.

[398] J Du Plessis & Delport "'Delinquent Directors' and 'Directors under Probation': A Unique South African Approach Regarding Disqualification of Company Directors" 280.

A court may declare a person under probation under this ground only if it is satisfied that the manner in which the company or close corporation was managed was wholly or partly responsible for it failing to meet its obligations.[399] In addition, the court must be satisfied that the declaration is justified, having regard to the circumstances of the company's or close corporation's failure, and the person's conduct in relation to the management, business or property of the company or close corporation at the time.[400]

This ground for a probation order may only be relied on by the CIPC and the Takeover Regulation Panel.[401]

3.6 The Effect of a Declaration of Delinquency and a Probation Order

Both a declaration of delinquency and a probation order have significant implications for a director, which are discussed below.

3.6.1 Disqualification and Removal from Office

Section 69(8)(*a*) of the Companies Act states that a person is disqualified to be a director of a company if a court has declared such person to be delinquent in terms of section 162 of the Companies Act. In terms of section 69(11) of the Companies Act a court may exempt a person from any of the grounds of disqualification set out in section 69(8)(*b*) of the Companies Act, but it may not exempt a person from being disqualified from being a director of a company if a court has declared that person to be delinquent.[402] In both *Grancy Property Limited v Gihwala*[403] and *Lewis Group Limited v Woollam*[404] the Western Cape Division, Cape Town affirmed that the real effect of declaring a person delinquent is that he is thereupon disqualified,

[399] Section 162(8)(*b*)(i) of the Companies Act.

[400] Section 162(8)(*b*)(ii) of the Companies Act.

[401] Section 162(3)(*b*)(ii) of the Companies Act.

[402] See chapter 3, para 6.1.3 where the grounds of disqualification to be a director are discussed.

[403] 2014 JDR 1292 (WCC) para 159.

[404] 2017 (2) SA 547 (WCC) para 6.

for so long as the declaration remains in force, from being a director of a company.[405] This means that a delinquent director is denied the privilege of conducting business through a company with limited liability. He will however be able to conduct business as a sole trader, or as a partner in a partnership.[406]

A declaration of delinquency which is made on the ground that a person consented to serve as a director or acted in the capacity of a director while ineligible or disqualified in terms of section 69 of the Companies Act, or acted as a director in a manner that contravened an order of probation, is unconditional and subsists for the lifetime of the person declared delinquent.[407] On this basis a court is empowered to remove a director from office for the duration of his lifetime, which is rather harsh. In all other instances a declaration of delinquency subsists for seven years from the date of the court order, or such longer period as determined by the court at the time of making the declaration.[408] The declaration of delinquency may in such instances be made subject to any conditions that the court considers appropriate.[409] A court has a discretion to extend the duration of the declaration of delinquency but it has no discretion to reduce the seven year period.[410]

This is sustained by section 70(1)(*b*)(iv) of the Companies Act which states that a person ceases to be a director and a vacancy arises on the board of a company if the person is declared a delinquent director or is placed under probation on conditions that are inconsistent with continuing to be a director of the company, in terms of section 162 of the Companies Act. Consequently the effect of an order of delinquency is that a person is indirectly removed from office by a court. As the High Court in *Kukama v Lobelo*[411] proclaimed, there is no need for a

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[405] See further *Rabinowitz v Van Graan and Others* 2013 (5) SA 315 (GSJ) para 20 where the court stated that the consequence of an order of delinquency is that such a person is disqualified from being a director of the company.

[406] See Bradley "Enterprise and Entrepreneurship: The Impact of Director Disqualification" 66.

[407] Sections 162(5)(*a*), 162(5)(*b*) and 162(6)(*a*) of the Companies Act.

[408] Section 162(6)(*b*)(ii) of the Companies Act.

[409] Section 162(6)(*b*)(i) of the Companies Act.

[410] This is made clear from the wording of s 162(6)(*b*)(ii) which provides that a declaration of delinquency "subsists for seven years from the date of the order, or such longer period as determined by the court at the time of making the declaration".

[411] 2012 JDR 0062 (GSJ) para 22. The facts of this case are discussed in note 144 above.

court to order the removal of a delinquent person from office because of the "automatic inherent effect of such a declaration". This was affirmed by the High Court in *Msimang NO and Another v Katuliiba and Others*.[412]

The effect of an order of probation is that a person may not serve as a director except to the extent permitted by the order of probation.[413] A director who is under a probation order is thus restricted to serving as a director within the conditions of that probation order.[414] A probation order subsists for a period not exceeding five years, as determined by the court at the time it makes the declaration.[415] Like an order of delinquency, an order of probation may be subject to such conditions as the court considers appropriate.[416]

Under the UK Company Directors Disqualification Act 1986 a disqualified director is not only prohibited from being a director of a company[417] but is also prohibited, without leave of the court, from "in any way, whether directly or indirectly" being concerned or taking part "in the promotion, formation or management of a company".[418] Under section 219(1) of the Companies Act 61 of 1973[419] a court was empowered to make an order in certain circumstances disqualifying a director from being concerned or taking part in the management of any company "whether directly or indirectly". In contrast, under section 162 of the Companies Act a delinquent director is prohibited from being a director of a company but is not prohibited from taking part in the management of the company directly or indirectly.[420] It is submitted that the approach which was adopted under section 219(1) of the Companies Act 61 of 1973 and in the

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[412] [2013] 1 All SA 580 (GSJ) para 32.

[413] Section 69(5) of the Companies Act.

[414] *Memorandum on the Objects of the Companies Bill, 2008*, Companies Bill [B 61D-2008] para 8.

[415] Section 162(9)(*b*) of the Companies Act.

[416] Section 162(9) of the Companies Act.

[417] Section 1(1)(a) of the UK Company Directors Disqualification Act 1986.

[418] Section 1(1)(d) of the UK Company Directors Disqualification Act 1986.

[419] Section 219(1) of the Companies Act 61 of 1973 is discussed further below in para 3.7.

[420] See s 69(8)(*a*) of the Companies Act, which provides that a "person is disqualified to be a director of a company" if a court has declared the person to be delinquent in terms of s 162 of the Companies Act. No mention is made with regard to whether the person may directly or indirectly take part in the management of the company.

UK Company Directors Disqualification Act 1986 is commendable because it prohibits a disqualified director from being involved in the promotion, formation or management of a company in a capacity other than a director (such as giving instructions through a nominee director).[421] The UK Company Directors Disqualification Act 1986 further prohibits a disqualified person from being a liquidator or an administrator of a company, as well as a receiver or a manager of a company's property, for a specified period beginning with the date of the order.[422] A court must order the person to be disqualified from all of these activities or positions for the determined period.[423] It may not disqualify a person from only a selection of these activities or positions.[424]

Under the Australian Corporations Act of 2001, as discussed below,[425] a disqualification order made by a court disqualifies a person from managing corporations for the period that the court considers appropriate. Under the MBCA and the corporate legislation of those USA States which permit the judicial removal of directors, in addition to removing a director from office, the court may bar the director from re-election for a period prescribed by the court.[426]

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[421] See Davies & Worthington *Gower Principles of Modern Company Law* 238.

[422] Section 1(1) of the UK Company Directors Disqualification Act 1986.

[423] *Re Gower Enterprises Ltd (No 2)* [1995] BCC 1081 at 1084-1085; *R v Cole, Lees & Birch* [1998] BCC 87 (1997) at 92; *Re Adbury Park Estates Ltd* [2003] BCC 696 at 697-698.

[424] *Re Gower Enterprises Ltd (No 2)* [1995] BCC 1081 at 1084-1085; *R v Cole, Lees & Birch* [1998] BCC 87 (1997) at 92; *Re Adbury Park Estates Ltd* [2003] BCC 696 at 697-698. Thus a disqualification order under the UK Company Directors Disqualification Act 1986 is a sweeping prohibition in terms of which the disqualified person is prohibited from engaging in any of these activities in relation to any company, whether it is a private company or a public company (Walters "Leave to Act as a Company Director following Disqualification" 239).

[425] See para 3.6.2 below.

[426] See s 8.09(a) of the MBCA and see for example s 10A-2-8.09(b) of the Alabama Business and Nonprofit Entities Code; s 10.06.463 of the Alaska Corporations Code; s 304 of the California Corporations Code; s 33-743(c) of the Connecticut General Statutes; s 29-306.09(c) of the District of Columbia Code; s 30-29-809(3) of the Idaho Code; s 8.35(b) of the Illinois Business Corporation Act of 1983; s 490.809(3) of the Iowa Code; s 450.1514(2) of the Michigan Business Corporation Act; s 706(d) of the New York Business Corporation Law; s 1726(c) of the Pennsylvania Business Corporation Law; s 7-1.2-805(d) of the Rhode Island Business Corporation Act; s 33-8-109(b) of the South Carolina Code of Laws; s 47-1A-809 of the South Dakota Business Corporation Act; s 48-18-109(b) of the Tennessee Code; s 23B.08.090(2) of the Washington Business Corporation Act and s 17-16-809(c) of the Wyoming Business Corporation Act.

3.6.2 Period of Disqualification and Removal from Office

As was stated above,[427] section 162(6) of the Companies Act does not give a court any discretion to determine the minimum period of the declaration of delinquency. A court has a discretion only to extend the declaration of delinquency to a period longer than seven years. In contrast, a court is given a discretion to determine the minimum period for which a director is placed under probation. Section 162(9)(*b*) of the Companies Act places a cap of five years on the probation period, but a court is entitled in its discretion to impose a probationary period of less than five years.[428] Section 162(9)(*b*) of the (South African) Companies Act mirrors section 10-809(b) of the Arizona Revised Statutes, discussed below.

The period of disqualification under the UK Company Directors Disqualification Act 1986 varies depending on the grounds for disqualification. In most instances this Act does not prescribe minimum periods of disqualification, as the (South African) Companies Act does; instead it prescribes maximum periods of disqualification. In respect of a disqualification for persistent breaches of the companies legislation and a disqualification on summary conviction the maximum period of disqualification is five years,[429] but in the other instances the maximum period of disqualification is fifteen years.[430] It is only with regard to a disqualification of unfit directors of insolvent companies, in terms of section 6 of this Act, that a minimum period of disqualification has been prescribed (being two years) as well as a maximum period of disqualification (being fifteen years). Courts in the UK are thus given a discretion in most instances to determine the minimum period of the disqualification of a director. In *Re Sevenoaks Stationers (Retail) Ltd*[431] the UK Court of Appeal identified three brackets of periods of disqualification under the UK Company Directors Disqualification Act 1986 with regard to disqualifying unfit directors where the maximum period of disqualification is fifteen years. The top bracket for a period of over ten years should be reserved for particularly serious cases (for

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[427] See para 3.6.1 above.

[428] Section 162(9)(*b*) provides that a probation order subsists for a period not exceeding five years, as determined by the court at the time it makes the declaration.

[429] Sections 3(5) and 4(5) of the UK Company Directors Disqualification Act 1986.

[430] For example, in terms of ss 4(3) (disqualification for fraudulent trading), 6(4) (disqualification of unfit directors of insolvent companies) and 10(2) (participation in wrongful trading) the maximum period of disqualification is fifteen years.

[431] [1991] Ch 164, CA.

example, where a director who has already had one period of disqualification imposed on him falls to be disqualified again).[432] The minimum bracket of two to five years should be applied where, although disqualification is mandatory, the case is not very serious.[433] The middle bracket of six to ten years should be applied for serious cases which do not merit the top bracket.[434]

The Australian Corporations Act of 2001 gives courts a high degree of discretion to determine the disqualification period of directors. Courts in Australia are empowered to disqualify directors for the period that they consider appropriate.[435] It is only with regard to a disqualification where a director has managed failed companies within the past seven years that the Australian Corporations Act of 2001 imposes a maximum disqualification period of twenty years.[436] As is the case in the UK, courts in Australia are given a discretion to determine the minimum period of disqualification of a director. Some of the factors that are considered by courts in exercising this discretion are the specific deterrence of the director in question; the general deterrence and whether the penalty is harsh enough to discourage other people from engaging in similar conduct; the propensity that the director may engage in similar conduct in the future; the amount of loss suffered by the company; whether the director has a history of similar breaches; the degree of seriousness of the contraventions; whether dishonest conduct is involved (which attracts a longer disqualification period); the remorse shown by the director; the need to balance the personal hardship to the director against the public interest and the need for the protection of the public from any repetition of the conduct, and the likelihood of the director reforming his ways (which is stated to be a mitigating factor).[437] The factors used by the courts in Australia to determine an

[432] *Re Sevenoaks Stationers (Retail) Ltd* [1991] Ch 164, CA at 174.

[433] *Re Sevenoaks Stationers (Retail) Ltd* [1991] Ch 164, CA at 174.

[434] *Re Sevenoaks Stationers (Retail) Ltd* [1991] Ch 164, CA at 174.

[435] See ss 206C(1) (disqualification for a contravention of a civil penalty provision), 206D(1) (disqualification on the basis of insolvency and non-payment of debts), 206E(1) (disqualification for repeated contraventions of the Australian Corporations Act of 2001) and 206EAA(1) (disqualification under a law of a foreign jurisdiction) which provide that a court may disqualify a person from managing corporations for a period that the court considers appropriate.

[436] Section 206D(1) of the Australian Corporations Act of 2001.

[437] See *Re HIH Insurance Ltd (in prov liq); ASIC v Adler* [2002] NSWSC 483 para 56 where these factors were laid down. See further *Elliott v Australian Securities and Investments Commission; Plymin v Australian Securities and Investments Commission* [2004] VSCA 54 (2004) where the Victorian Court of Appeal approved of and applied these factors; *Rich v Australian Securities and Investments Commission* [2004] 220 CLR 129 paras 48-50

appropriate period of disqualification are useful guidelines for South African courts to consider in deciding whether or not to extend the period of delinquency in terms of section 162(6)(*b*)(ii) of the Companies Act to longer than seven years.

Section 8.09(a) of the MBCA confers a discretion on courts to bar the director concerned from re-election for a period prescribed by the court. A court thus has the discretion to determine the period of time for which the director concerned will be removed from office. Likewise, most of the USA States which permit the judicial removal of directors confer on the court a discretion to bar the director from re-election for a period prescribed by the court.[438] Section 10-809(b) of the Arizona Revised Statutes differs from this trend by imposing a maximum period of five years for which a court may bar a director from re-election, but it does not lay down a minimum period in this regard.

Section 162 of the (South African) Companies Act is patently much stricter than the equivalent legislation in foreign jurisdictions. South African courts do not have any discretion to deviate from the minimum period of delinquency prescribed by the Companies Act. In *Grancy Property Limited v Gihwala*[439] the Western Cape High Court observed that the purpose of prescribing minimum periods for an order of delinquency is to remove unscrupulous directors from office in order to protect investors. Further objectives, the court stated, are to ensure greater consistency in the application of section 162 of the Companies Act and to ensure that the section has a sufficient deterrent effect.[440] The Companies Act, however, offers some relief for directors to apply to court for the suspension of the order of delinquency after three years or to set aside an order of delinquency more than two years after it was suspended, or to set

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and *Australian Securities and Investments Commission v Axis International Management Pty Ltd (No 6)* [2011] FCA 811 (2011) paras 8-9 where these factors were generally approved and adopted.

[438] See for example s 10A-2-8.09(b) of the Alabama Business and Nonprofit Entities Code; s 10.06.463 of the Alaska Corporations Code; s 304 of the California Corporations Code; s 33-743(c) of the Connecticut General Statutes; s 29-306.09(c) of the District of Columbia Code; s 30-29-809(3) of the Idaho Code; s 8.35(b) of the Illinois Business Corporation Act of 1983; s 490.809(3) of the Iowa Code; s 450.1514(2) of the Michigan Business Corporation Act; s 706(d) of the New York Business Corporation Law; s 1726(c) of the Pennsylvania Business Corporation Law; s 7-1.2-805(d) of the Rhode Island Business Corporation Act; s 33-8-109(b) of the South Carolina Code of Laws; s 47-1A-809 of the South Dakota Business Corporation Act; s 48-18-109(b) of the Tennessee Code; s 23B.08.090(2) of the Washington Business Corporation Act and s 17-16-809(c) of the Wyoming Business Corporation Act.

[439] 2014 JDR 1292 (WCC) para 194.

[440] *Grancy Property Limited v Gihwala* 2014 JDR 1292 (WCC) para 194.

aside an order or probation more than two years after it was made.[441] It is submitted that the absence of a discretion given to courts to determine a minimum period of delinquency is justifiable because a disqualified director may apply to court after three years to suspend the order of delinquency.[442]

3.6.3 Conditions Imposed on Delinquency or Probation Orders

Some of the conditions that a court may impose on the order of delinquency or probation are that the director concerned be required to undertake a designated programme of remedial education relevant to the nature of his conduct as a director,[443] or to carry out a designated programme of community service.[444] It has been suggested that a condition compelling the director to undergo relevant training courses educating him on the legal requirements and responsibilities attached to his position would be useful.[445] A court may also order the miscreant director to pay compensation to any person adversely affected by his conduct as a director, to the extent that such a victim does not otherwise have a legal basis for claiming compensation.[446] The wide scope in the wording of this provision is questionable since it could be construed to mean that if one of the elements that ought to be present for contractual or delictual liability is not established, a court may nevertheless still order a director to pay compensation to a victim in circumstances when such an order would not ordinarily have been made under the principles

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[441] Section 162(11) of the Companies Act.

[442] Refer to para 3.11 below where the suspension of a declaration of delinquency and the setting aside of a probation order are discussed.

[443] Section 162(10)(*a*) of the Companies Act.

[444] Section 162(10)(*b*) of the Companies Act.

[445] Griffin "The Disqualification of Unfit Directors and the Protection of the Public Interest" 230. It is of interest that the chief executive officer of Telkom SA SOC Limited was required by the CIPC to complete a corporate governance course in 2014 after Telkom SA SOC Limited was found to have breached the Companies Act. The chief executive officer faced a penalty of one million Rand and referral to the National Prosecuting Authority if he did not attend the course. He duly attended a two week course on corporate governance. The notice to attend the course was issued by the CIPC after a six million Rand interest-free loan had been awarded to the chief financial officer in breach of relevant corporate rules. This was the first time that such a notice was issued to a director by the CIPC (see Business Report "Maseko forced to take director duties course" (30 May 2014) available at http://www.iol.co.za/business-report/economy/maseko-forced-to-take-director-duties-course-1696083 (accessed on 7 June 2017). The request that the chief executive officer attend the corporate governance course was not made in the context of a delinquency or a probation declaration, but it does provide some idea of the type of remedial education which may be imposed on a director who is declared delinquent or placed under probation.

[446] Section 162(10)(*c*) of the Companies Act.

of contract or delict law.[447] This is not a closed list, and a court's power to make conditions ancillary to the declaration of delinquency is not limited.[448]

Section 162(6)(*b*)(i) of the Companies Act also empowers a court to impose a condition limiting the application of the declaration of delinquency to one or more particular categories of companies. An example of such a limitation, as provided by the Supreme Court of Appeal in *Gihwala and Others v Grancy Property Limited and Others*,[449] is that a director may be declared delinquent in relation to a financial services company but may be permitted to be a director of an engineering firm. Another example emanates from *Cape Empowerment Trust Ltd v Druker*[450] where the court limited the declaration of delinquency to the directorship which the miscreant directors held in one particular company but did not extend it to any other corporate entities which the directors may have used in the conduct of their profession. In *Demetriades v Tollie*[451] the court likewise limited the declaration of delinquency to one particular company only.

A further condition that the court may impose when making a probation order is that the person concerned be limited to serving as a director of a private company, or of a company of which that person is the sole shareholder.[452] This condition is questionable because a private company and a company of which the director under probation is the sole shareholder may well have external stakeholders, such as creditors and employees, who would be at risk if the director under probation is not in fact fit to manage the company.[453]

Another condition that the court may impose when making a probation order is that the person concerned be supervised by a mentor in his future participation as a director while the order

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[447] R Cassim "Governance and the Board of Directors" in FHI Cassim et al *Contemporary Company Law* 438.

[448] See s 162(10) of the Companies Act. This is made clear from the words "[w]ithout limiting the powers of the court" in s 162(10) of the Companies Act.

[449] 2017 (2) SA 337 (SCA) para 144.

[450] 2013 JDR 1360 (WCC) para 91.

[451] 2015 ZANCHC 17 para 61.

[452] Section 162(10)(*d*) of the Companies Act.

[453] J Du Plessis & Delport "'Delinquent Directors' and 'Directors under Probation': A Unique South African Approach Regarding Disqualification of Company Directors" 282.

remains in force.[454] The concept of mentorship is recommended by the King IV Report, which encourages the mentorship of inexperienced directors.[455] An example of a case where a court appointed a mentor to supervise a director is *Motale v Abahlobo Transport Services (Pty) Limited and Others*.[456] In this case the court had placed a director of a company under probation for one year and appointed a mentor to supervise him in his future participation as a director of the company whilst the order of probation remained in force. Without limiting the mentor's discretion as to how the supervision was to be carried out, the court held that the mentor would be entitled to attend monthly directors' and shareholders' meetings of the company, and for half an hour prior to such meetings to meet with the directors of the company in order to discuss the business to be considered at the monthly meeting. The court ordered the director to pay the costs of the mentor.[457] A further appropriate condition where a director has mismanaged funds of the company would be to require supervision by a qualified accountant and to also restrict the director from operating bank accounts of the company.[458]

In *Grancy Property Limited v Gihwala*[459] the Western Cape High Court did not impose any conditions on the declaration of delinquency against the first and second appellants. The court asserted that, in view of the persistent serious misconduct of the first and second appellants, this was not a case where the court should consider imposing conditions that would limit the application of the declarations of delinquency.[460] The Supreme Court of Appeal in *Gihwala and Others v Grancy Property Limited and Others*[461] did not impose any conditions on the declaration of delinquency against the first and second appellants and did not consider whether

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[454] Section 162(10)(*d*)(i) of the Companies Act.

[455] The King IV Report, principle 7, recommended practice 23 recommends that members of the board of directors with no or limited governing experience should be provided with mentorship and encouraged to undergo training. The intention of the mentorship programme is to develop directors so that they could fully play an effective role as members of the board (Mongalo "Director Inductions and Board Evaluations" in Loubser & Mahony *Company Secretarial Practice* 10-5).

[456] [2015] JOL 34696 (WCC).

[457] *Motale v Abahlobo Transport Services (Pty) Limited and Others* [2015] JOL 34696 (WCC) at 20-21.

[458] Hicks "Director Disqualification: Can it Deliver?" 447. See para 3.11.3.3 below for a discussion on the type of conditions which may be imposed by courts on the suspension of a delinquency order under s 162(11) of the Companies Act.

[459] 2014 JDR 1292 (WCC) para 207.

[460] *Grancy Property Limited v Gihwala* 2014 JDR 1292 (WCC) paras 207-208.

[461] 2017 (2) SA 337 (SCA).

any conditions ought to be imposed.[462] A declaration of delinquency is a harsh and serious order, particularly so under section 162(5) of the Companies Act, which is much stricter than the comparable provisions in the foreign jurisdictions considered. In light of the fact that section 162(5) of the Companies Act is said by the Supreme Court of Appeal in *Gihwala and Others v Grancy Property Limited and Others*[463] to be protective of the public rather than penal, it is submitted that the courts ought to make more effective use of their power to impose appropriate ancillary conditions to declarations of delinquency in an effort to protect the public from any repetition of the delinquent conduct by the director in question and to facilitate the rehabilitation of delinquent directors.[464]

3.6.4 Name on Public register

A further consequence of being declared delinquent is that the director's name is put on a public register of persons who are disqualified from being directors. In terms of section 69(13) of the Companies Act the CIPC must establish and maintain a public register of persons who are disqualified from serving as a director in terms of an order of court pursuant to the Companies Act or any other law.[465] Under section 69(8)(*a*) of the Companies Act a person would be disqualified to be a director if the court has declared him to be delinquent in terms of section 162 of the Companies Act. Therefore the public register would include persons who have been declared delinquent by a court in terms of section 162 of the Companies Act. In terms of section 69(13) of the Companies Act, the public register must also list the persons who are subject to an order of probation as a director, whether in terms of an order of a court pursuant to the Companies Act or any other law. The public register of persons who are disqualified to be directors serves to heighten awareness of the disqualification and the delinquency order and has an important deterrence effect.[466]

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[462] 2017 (2) SA 337 (SCA).

[463] 2017 (2) SA 337 (SCA) para 142.

[464] R Cassim "Delinquent Directors under the Companies Act 71 of 2008: *Gihwala v Grancy Property Limited* 2016 ZASCA 35"at 25.

[465] The website of the CIPC (www.cipc.co.za) contains a list of disqualified directors.

[466] Hicks "Director Disqualification: Can it Deliver?" 448.

Neither section 69(13) of the Companies Act nor regulation 39(3)[467] dealing with the register of disqualified directors specify whether the entries on the public register are to be deleted once the court order expires. The UK Company Directors Disqualification Act 1986 also makes provision for the creation of a register of disqualification orders (to be created by the Secretary of State), that is open to public inspection.[468] Section 18(3) of the UK Company Directors Disqualification Act 1986 states that when an order of which an entry is made in the register ceases to be in force, the Secretary of State shall delete the entry from the register and all particulars relating to it. It is submitted that this would be a commendable approach to adopt with regard to the public register to be maintained in terms of section 69(13) of the Companies Act by the CIPC.

With regard to listed companies, the JSE Listings Requirements requires directors of the issuer (being a company whose shares have been admitted to listing) and its major subsidiaries to disclose in any pre-listing statements and circulars relating to rights offers and capitalisation issues, the details of any court orders declaring the directors delinquent or placing them under probation in terms of section 162 of the Companies Act or section 47 of the Close Corporations Act 69 of 1984.[469] This disclosure requirement applies only to directors of public listed companies.

3.7 Retrospectivity

In *Gihwala and Others v Grancy Property Limited and Others*[470] the question before the Supreme Court of Appeal was whether section 162(5)(*c*) of the Companies Act had

[467] Regulation 39(3) of the Companies Regulations, 2011 provides that in addition to the court orders received from the Registrar of the Court under s 69(11A), the CIPC may for purposes of maintaining the register of persons disqualified from serving as directors, obtain relevant information from the official records of the clerk of the magistrates court, the Master of the High Court, the South African police services, any regulatory authority or any institution that regulates any profession in South Africa.

[468] Section 18 of the UK Company Directors Disqualification Act 1986. The Disqualified Directors Register is kept by Companies House on behalf of the Secretary of State. It lists all directors that are currently prohibited from involving themselves with a company. It also shows the length of time the director has been disqualified, as well as the relevant section of the UK Company Directors Disqualification Act 1986 under which the director was disqualified. The register is available at https://www.gov.uk/government/organisations/companies-house (see further on the Disqualified Directors Register Shopovski, Bezzina & Zammit "The Disqualification of Company Directors and its Effect on Entrepreneurship" 20).

[469] Section 7B.2(m) of the JSE Listings Requirements.

[470] 2017 (2) SA 337 (SCA).

retrospective effect. In other words, in considering an application to declare a director delinquent or to place him under probation, may a court consider conduct of the director which had occurred prior to the effective date of the Companies Act, being 1 May 2011?

At common law a statute is presumed not to have retrospective effect, save if this presumption is rebutted by provisions or indications in the statute, whether expressly or by necessary implication.[471] The presumption against retrospectivity does not apply when it must be inferred from the provisions of the statute in question that the legislature intended the statute to be retrospective.[472] The presumption against retrospectivity is based on the elementary considerations of fairness that one should know what the law entails in order to adjust one's conduct accordingly, and that the legislature must not be taken to have intended anything unjust.[473] Lord Denman in a much quoted dictum in *R v St Mary's Whitechapel (Inhabitants)*,[474] a decision handed down by the Queens Bench Division, asserted that a statute is not retrospective merely "because a part of the requisites for its action is drawn from time antecedent to its passing". Relying directly on this dictum the Supreme Court of Appeal in

[471] *Mahomed NO v Union Government* 1911 AD 1 at 8; *R v Grainger* 1958 (2) SA 443 (A) at 446; *Adampol (Pty) Ltd v Administrator, Transvaal* 1989 (3) SA 800 (A) at 805-806; *National Iranian Tanker Co v MV Pericles GC* 1995 (1) SA 475 (A) at 483; *Workmen's Compensation Commissioner v Jooste* 1997 (4) SA 418 (SCA) 424; *Unitrans Passenger (Pty) Ltd t/a Greyhound Coach Lines v Chairman, National Transport Commission, and Others; Transnet Ltd (Autonet Division) v Chairman, National Transport Commission, and Others* 1999 (4) SA 1 (SCA) paras 12-13; *National Director of Public Prosecutions v Carolus* 2000 (1) SA 1127 (SCA) paras 31; *Western Cape Provincial Government and Others: In Re DVB Behuising (Pty) Ltd v North West Provincial Government and Another* 2001 (1) SA 500 (CC) para 65; Kellaway *Principles of Legal Interpretation of Statutes, Contracts and Wills* 323; Du Bois et al *Wille's Principles of South African Law* 61; LM Du Plessis "Statute Law and Interpretation" in *LAWSA* para 341.

[472] *Lek v Estate Agents Board* 1978 (3) SA 160 (C) at 169; Kellaway *Principles of Legal Interpretation of Statutes, Contracts and Wills* 323 and LM Du Plessis "Statute Law and Interpretation" in *LAWSA* para 341.

[473] *National Director of Public Prosecutions v Carolus* 2000 (1) SA 1127 (SCA) paras 31 and 36; LM Du Plessis "Statute Law and Interpretation" in *LAWSA* para 341. See further for a discussion on the retrospectivity of statutes *Lek v Estate Agents Board* 1978 (3) SA 160 (C) at 169; *Adampol (Pty) Ltd v Administrator, Transvaal* 1989 (3) SA 800 (A) at 805-806; *Swanepoel v Johannesburg City Council; President Insurance Co Ltd v Kruger* 1994 (3) SA 789 (A) 793-794; *National Iranian Tanker Co v MV Pericles GC* 1995 (1) SA 475 (A) at 483; *Workmen's Compensation Commissioner v Jooste* 1997 (4) SA 418 (SCA) at 424; *Krok v Commissioner, South African Revenue Service* 2015 (6) SA 317 (SCA) para 40; Kellaway *Principles of Legal Interpretation of Statutes, Contracts and Wills* 319-330; Du Bois et al *Wille's Principles of South African Law* 61 and LM Du Plessis "Statute Law and Interpretation" in *LAWSA* para 341.

[474] *R v St Mary's Whitechapel (Inhabitants)* 116 ER 811 (1848) at 814. See for instance *R v Grainger* 1958 (2) SA 443 (A) at 446; *Adampol (Pty) Ltd v Administrator, Transvaal* 1989 (3) SA 800 (A) 812 at 817-818; *Swanepoel v Johannesburg City Council; President Insurance Co Ltd v Kruger* 1994 (3) SA 789 (A) at 793-794 and *Krok v Commissioner, South African Revenue Service* 2015 (6) SA 317 (SCA) para 40 which referred to and approved of *R v St Mary's Whitechapel (Inhabitants)* 116 ER 811 (1848) at 814.

Gihwala and Others v Grancy Property Limited and Others[475] held that section 162(5) of the Companies Act is not retrospective.

It is submitted, however, that in considering the retrospectivity of section 162(5) of the Companies Act, the Supreme Court of Appeal in *Gihwala v Grancy Property Limited*[476] overlooked the definition of retrospectivity as propounded in *National Iranian Tanker Co v MV Pericles GC*,[477] where the Supreme Court of Appeal defined what it means for a statute to be retrospective, as follows:

> "A statute is retrospective in its effect if it takes away or impairs a vested right acquired under existing laws or creates a new obligation or imposes a new duty or attaches a new disability in regard to events already past."

If this definition of retrospectivity is applied to section 162(5) of the Companies Act, it is arguable that the provision is in fact retrospective as it creates "a new disability in regard to events already past".[478] In *Grancy Property Limited v Gihwala*[479] the court affirmed that section 162(5) of the Companies Act introduces prospective consequences to conduct that was already unlawful, and that the innovative aspect of section 162(5) of the Companies Act is that it introduces a new civil remedy for those harmed by the conduct of delinquent directors.[480]

Under section 219 of the Companies Act 61 of 1973 a court was, in certain circumstances, empowered to make an order prohibiting a director from taking part in the management of a company.[481] In *Grancy Property Limited v Gihwala*[482] the court stated that all the categories of

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[475] 2017 (2) SA 337 (SCA) para 41.

[476] 2017 (2) SA 337 (SCA).

[477] 1995 (1) SA 475 (A) at 483.

[478] *National Iranian Tanker Co v MV Pericles GC* 1995 (1) SA 475 (A) 483; R Cassim "Delinquent Directors under the Companies Act 71 of 2008: *Gihwala v Grancy Property Limited* 2016 ZASCA 35" 11.

[479] 2014 JDR 1292 (WCC) para 164.

[480] *Grancy Property Limited v Gihwala* 2014 JDR 1292 (WCC) para 155.

[481] See further on s 219 of the Companies Act 61 of 1973 Cilliers & Benade *Corporate Law* 125-126; Beuthin & Luiz *Beuthin's Basic Company Law* 182 and Kunst, Delport & Vorster *Henochsberg on the Companies Act* 420-422(1). It was observed by Cilliers & Benade that s 219 of the Companies Act 61 of 1973 was in "disuse" in South Africa and that there were no reported cases on s 219 (Cilliers & Benade *Corporate Law* 126).

[482] 2014 JDR 1292 (WCC) para 175.

conduct provided for in section 162(5)(*c*) of the Companies Act were covered by section 219(1)(*c*)(ii) of the Companies Act 61 of 1973. It is respectfully submitted, however, that the grounds provided in section 219(1)(*c*)(ii) of the Companies Act 61 of 1973 were in fact much narrower than those provided in section 162(5)(*c*) of the Companies Act.[483] Section 219(1)(*c*)(ii) of the Companies Act 61 of 1973 disqualified a person from being a director of a company if in the course of the winding-up or judicial management of the company it appeared that such a person had been guilty of fraud in relation to the company or of any breach of his duty to the company. Section 162(5)(*c*) of the Companies Act is much wider than section 219(1)(*c*)(ii) of the Companies Act 61 of 1973, since an application to declare a director delinquent and thus to disqualify him from acting as a director would apply if a director breached his duties to the company at any time while a director, and is not restricted to conduct that occurs in the course of the winding-up of the company. It is consequently submitted that, contrary to the observation of the court in *Grancy Property Limited v Gihwala*,[484] not all the categories of conduct provided for in section 162(5)(*c*) of the Companies Act were covered by section 219(1)(*c*)(ii) of the Companies Act 61 of 1973. The remedy of declaring a director delinquent is a new disability which did not exist prior to 1 May 2011. According to the dictum in *R v St Mary's Whitechapel (Inhabitants)*[485] the fact that some of the requisites for an action under section 162(5) of the Companies Act may be drawn prior to 1 May 2011 does not make section 162(5) retrospective. On the other hand, according to the dictum in *National Iranian Tanker Co v MV Pericles GC*[486] the fact that section 162 of the Companies Act creates a new disability in regard to past events would, it is submitted, make section 162(5) retrospective.[487]

In *Pride 73 Properties (Pty) Ltd v Theunis Christoffel Du Toit*[488] the North Gauteng High Court, Pretoria held that conduct which had occurred prior to 1 May 2011 could not be taken into account in any court application in terms of section 162(5) of the Companies Act. The court

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[483] R Cassim "Delinquent Directors under the Companies Act 71 of 2008: *Gihwala v Grancy Property Limited* 2016 ZASCA 35" 11.

[484] 2014 JDR 1292 (WCC).

[485] 116 ER 811 (1848) at 814.

[486] 1995 (1) SA 475 (A) at 483.

[487] R Cassim "Delinquent Directors under the Companies Act 71 of 2008: *Gihwala v Grancy Property Limited* 2016 ZASCA 35" 12.

[488] 2013 JDR 2001 (GNP).

reasoned that if section 162(5) of the Companies Act had retrospective effect the rights of directors to engage freely in economic activities and to be involved in business ventures at all levels would be infringed.[489] In the view of the court, this was not envisaged by Parliament.[490] The court accordingly held that any retrospective application of section 162(5) of the Companies Act would operate unfairly on directors. Consequently, in considering the application which had been brought under section 162(5)(c) of the Companies Act, the court declined to take into consideration the conduct of the relevant directors that had occurred prior to 1 May 2011.

It appears, however that the North Gauteng High Court, Pretoria overlooked the provisions of item 7(7) of Schedule 5 to the Companies Act which states:

> "A right of any person to seek a remedy in terms of this Act applies with respect to conduct pertaining to a pre-existing company and occurring before the effective date, unless the person had commenced proceedings in a court in respect of the same conduct before the effective date."

Section 162(5) of the Companies Act provides a specific remedy in the Companies Act as referred to in item 7(7) of Schedule 5, that is, a remedy to have a director declared delinquent,[491] and accordingly section 162(5) of the Act would apply with respect to conduct pertaining to a pre-existing company[492] if such conduct had occurred prior to the effective date of 1 May 2011, provided that no legal proceedings in respect of that conduct had been commenced before that date. This was affirmed in *Grancy Property Limited v Gihwala*[493] where the court found that the wording of item 7(7) of Schedule 5 to the Companies Act is clear that in an application under section 162 of the Companies Act past conduct of the relevant director may be taken into

[489] *Pride 73 Properties (Pty) Ltd v Theunis Christoffel Du Toit* 2013 JDR 2001 (GNP) para 43.

[490] *Pride 73 Properties (Pty) Ltd v Theunis Christoffel Du Toit* 2013 JDR 2001 (GNP) para 45.

[491] See *Grancy Property Limited v Gihwala* 2014 JDR 1292 (WCC) para 162.

[492] A pre-existing company is a company registered in terms of the Companies Act 61 of 1973; an existing company in terms of the Companies Act 61 of 1973 (other than an external company); a close corporation which converted to a company under the Companies Act, or a company which was deregistered in terms of the Companies Act 61 of 1973 and was subsequently registered in terms of the Companies Act 71 of 2008 (see s 1 of the Companies Act).

[493] 2014 JDR 1292 (WCC) para 163.

account, unless legal proceedings in respect thereof had already been commenced before 1 May 2011.[494]

It is submitted that even though the Supreme Court of Appeal in *Gihwala and Others v Grancy Property Limited and Others*[495] did not consider and did not apply the definition of retrospectivity laid down in *National Iranian Tanker Co v MV Pericles GC*,[496] the correct conclusion regarding the retrospectivity of section 162(5) of the Companies Act was nonetheless reached by the court. This is because item 7(7) of Schedule 5 to the Companies Act indicates that the legislature intended that conduct prior to 1 May 2011 could validly be considered in proceedings under section 162(5) of the Companies Act.

3.8 Prescription Period in Declaring a Director Delinquent or under Probation

It is not clear from the Companies Act how far back item 7(7) of Schedule 5 to the Companies Act extends in the context of considering an application to declare a director delinquent or to place him under probation. Item 7(7) of Schedule 5 simply states that the right of a person to seek a remedy in terms of the Companies Act applies with respect to conduct pertaining to a pre-existing company and "occurring before the effective date". In applying the remedy in section 162(5) of the Companies Act in *Gihwala v Grancy Property Limited*[497] the Supreme Court of Appeal took into consideration conduct of the directors which had occurred as far back as 2005. This raises the question whether there is a limit to the number of years before the effective date of 1 May 2011 the conduct in question may be considered in an application under section 162(5) or section 162(7) of the Companies Act. The answer to the converse question is equally unclear, that is, how many years after the conduct has occurred may an application under section 162(5) or section 162(7) of the Companies Act be instituted.

Under section 162(5)(*c*) of the Companies Act a court must make an order declaring a person a delinquent director if the relevant offence set out in the section was committed by the person

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[494] See further R Cassim "Delinquent Directors under the Companies Act 71 of 2008: *Gihwala v Grancy Property Limited* 2016 ZASCA 35" 13.

[495] 2017 (2) SA 337 (SCA).

[496] 1995 (1) SA 475 (A) at 483.

[497] 2017 (2) SA 337 (SCA).

"while a director". It is submitted that the words "while a director" indicate that the application may be brought at any time after the offence was committed provided that the offence was committed while the person was a director of the company. The only time limitation imposed in section 162 is that, in terms of sections 162(2), 162(3) and 162(4) of the Companies Act, an application to declare a director delinquent may be brought if the person in question was a director of the company within the twenty four months immediately preceding the application. Apart from this restriction, a prescription period has not been imposed under section 162(5)(*c*) of the Companies Act regarding the time period within which an application must be brought to declare a person a delinquent director. It is arguable that the Prescription Act 68 of 1969[498] would not apply in this instance because this statute applies primarily with regard to the acquisition of ownership by prescription,[499] the acquisition and extinction of servitudes by prescription,[500] and the prescription of debts,[501] while section 162 of the Companies Act relates to a declaration which affects the status of a person.

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[498] The Prescription Act 68 of 1969 deals with the effect of the effluxion of time on obligations. An obligation is extinguished or rendered unenforceable by the effluxion of time. The rationale of the Prescription Act 68 of 1969 is aimed at fairness towards a debtor. One of its main purposes is to protect a debtor from old claims against which it cannot effectively defend itself because of loss of records or witnesses caused by the lapse of time. The Act is designed to ensure finality and certainty in business affairs, and to promote efficiency by providing an incentive for the quick enforcement of claims (*Murray & Roberts Construction (Cape) (Pty) Ltd v Upington Municipality* 1984 (1) SA 571 (A) at 578; *Uitenhage Municipality v Molloy* 1998 (2) SA 735 (SCA) at 742; *De Jager en Andere v Absa Bank Bpk* 2001 (3) SA 537 (SCA) para 12; *Trinity Asset Management (Pty) Ltd v Grindstone Investments 132 (Pty) Ltd* 2018 (1) SA 94 (CC) para 35; Bradfield *Christie's Law of Contract in South Africa* 561; Van der Merwe et al *Contract: General Principles* 476). The Prescription Act 68 of 1969 lays down periods of prescription which apply to the acquisition of ownership, the acquisition and extinction of servitudes by prescription (acquisitive prescription) and the prescription of various categories of debt (extinctive prescription). See further on the Prescription Act 68 of 1969 Bradfield *Christie's Law of Contract in South Africa* 560-580; Du Bois et al *Wille's Principles of South African Law* 851-855 and Van der Merwe et al *Contract: General Principles* 475-487.

[499] See ss 1-5 of the Prescription Act 68 of 1969. Section 1 of the Prescription Act 68 of 1969 provides that a person shall become the owner of a thing which he has possessed openly and as if he were the owner thereof for an uninterrupted period of thirty years or for a period which, together with any periods for which such thing was so possessed by his predecessors in title, constitutes an uninterrupted period of thirty years.

[500] See ss 6-9 of the Prescription Act 68 of 1969. In terms of s 6 a person shall acquire a servitude by prescription if he has openly and as though he were entitled to do so, exercised the rights and powers which a person who has a right to such servitude is entitled to exercise, for an uninterrupted period of thirty years, or, in the case of a praedial servitude, for a period which, together with any periods for which such rights and powers were so exercised by his predecessors in title, constitutes an uninterrupted period of thirty years.

[501] See ss 10-16 of the Prescription Act 68 of 1969. In terms of s 10 a debt is extinguished by prescription after the lapse of the period which applies in respect of the prescription of such debt. For instance, a debt secured by a mortgage bond and a judgment debt prescribes after thirty years; a debt owed to the State prescribes after fifteen years; a debt arising from a bill of exchange or other negotiable instrument or from a notarial contract prescribes after six years, while any other debt prescribes after three years. A debtor is not legally bound to perform in terms of an obligation which has prescribed. Prescription begins to run as soon as the debt is due (s 12(1)). A debt is not regarded as being due until the creditor has knowledge of the identity of the debtor and of the facts from which the debt arises (s 12(3)). A creditor will however be deemed to have such knowledge if he could have acquired it by exercising reasonable care (s 12(3)) (see further *Makate v Vodacom (Pty) Ltd* [2016] ZACC 13 paras 82-86; *Off-beat Holiday Club and Another v Sanbonani Holiday Spa Shareblock Ltd and Others* 2017 (5) SA 9 (CC)

In terms of section 162(5)(*f*) of the Companies Act in assessing whether a person was a director of one or more companies that were convicted of an offence or subjected to an administrative fine or similar penalty, the assessment must be made within a period of five years. It should be noted that the legislature does not state that the assessment must be made in the previous five years, but "within a period of five years" which could be any period of five years at any time. This is accordingly not a time limitation on the application of section 162 of the Companies Act.

Regarding a probation order, section 162(7)(*a*) of the Companies Act provides that a court may make an order placing a person under probation if "while serving as a director" the person had contravened the provisions set out in section 162(7)(*a*).[502] Again, there is no statutory time limit imposed under section 162(7)(*a*). Section 162(7)(*b*) states that a court may make an order placing a person under probation if within "any" period of ten years after the effective date the person contravened the provisions set out in section 162(7)(*b*).[503] This means that under section 162(7)(*b*) the only conduct of the director that may be considered in the application to place him under probation is conduct which has occurred in any ten year period after 1 May 2011. There is, however, no prescription period imposed with regard to the lodging of the application, which may be brought with regard to "any" period of ten years after the effective date.

In contrast, a prescription period has been imposed under section 77(7) of the Companies Act in terms of which proceedings to recover any loss, damages or costs for which a person is or may be held liable in terms of section 77 of the Companies Act may not be commenced more than three years after the act or omission that gave rise to that liability. It is strange that the legislature did not impose a prescription period with regard to section 162 of the Companies Act when it imposed a prescription period with regard to the liability of a director under section 77 of the Companies Act, particularly since there is an overlap between some of the grounds of delinquency under section 162(5)(*c*) of the Companies Act and the grounds of liability under

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paras 43-49; *Fluxmans Incorporated v Levenson* [2017] 1 All SA 313 (SCA) paras 7-9; *Trinity Asset Management (Pty) Ltd v Grindstone Investments 132 (Pty) Ltd* 2018 (1) SA 94 (CC) paras 36-42 and Van der Merwe et al *Contract: General Principles* 481-483).

[502] See paras 3.5.1, 3.5.2 and 3.5.3 above where s 162(7)(*a*) is discussed.

[503] See para 3.5.4 above where s 162(7)(*b*) is discussed.

section 77 of the Companies Act. For instance, a breach of section 76(2)(*a*) and sections 77(3)(*a*), (*b*) and (*c*) of the Companies Act are grounds for a declaration of delinquency and at the same time are also grounds under which a director may be held liable for loss, damages or costs under section 77 of the Companies Act.[504] This means that one must recover loss, damages or costs from a director for a breach of section 77 of the Companies Act within three years after the act or omission that gave rise to that liability, but one is not limited by this three year prescription period with regard to an application to declare a director delinquent for the same action under section 162(5)(*c*) of the Companies Act. The failure of the legislature to explicitly provide for a prescription period in section 162 of the Companies Act would suggest that a prescription period does not apply to section 162 of the Companies Act. But it remains to be seen how courts will interpret these provisions.[505]

Sections 162(2)(*a*), 162(3)(*a*) and 162(4)(*a*) are further curious provisions of the Companies Act in this context. Under these provisions, an application to declare a director delinquent or to place him under probation may be brought if the person is currently a director of a company or was a director of that company within the twenty four months immediately preceding the application. An application to declare a director delinquent may be brought against a former director only if the former director was a director of the company within twenty four months immediately preceding the application. It is not clear why the legislature imposed a twenty four month prescription period with regard to bringing an application of delinquency or probation against a former director, but did not impose any prescription period at all with regard to bringing an application of delinquency or probation against a person who is currently still a director of the company in question. A person could well commit any of the offences set out in section 162(5) of the Companies Act and then simply resign from the company, or be removed as a director of the company in terms of section 71 of the Companies Act. If an application to declare him delinquent or to place him under probation is not lodged within twenty four months after his departure from the company, such a person is immune from such an action. More disconcerting is that it is possible that the misconduct of a director may only be discovered

[504] See ss 162(5)(*c*)(ii), 162(5)(*c*)(iii), 76(2)(*a*), 77(2)(*a*) and 77(3)(*a*), (*b*) and (*c*) of the Companies Act. These provisions are discussed in paras 3.4.4, 3.4.5 and 3.4.7 above.

[505] R Cassim "Delinquent Directors under the Companies Act 71 of 2008: *Gihwala v Grancy Property Limited* 2016 ZASCA 35" 15.

more than twenty four months after his resignation from a company, in which event he would at that stage be immune from a declaration of delinquency.[506]

The twenty four month limitation in sections 162(2)(*a*), 162(3)(*a*) and 162(4)(*a*) of the Companies Act strangely does not start to run when the applicant becomes aware of the misconduct of the director in question but starts to run as soon as the director in question ceases to be a director of the relevant company.[507] It is not clear whether the twenty four month prescription period is merely arbitrary or whether there is any policy underlying it. If so, it is not clear what the policy is and why a three-year prescription period was not adopted.

Proceedings under the UK Company Directors Disqualification Act 1986 for the disqualification of an unfit director of an insolvent company must be commenced within three years of the date on which the company of which that person is or was a director became insolvent.[508] It is only with the leave of the court that an application for the disqualification of an unfit director of an insolvent company may be made more than three years after the company becomes insolvent.[509] In *Secretary of State for Trade and Industry v Davies and Others*[510] the UK Court of Appeal, per Hobhouse LJ, asserted that to be a director represents, or may represent a person's means of livelihood and his ability to carry on his business activities, and if he has to defend proceedings which may disqualify him from being a director, he should know about this within a reasonable time and not be left in a state of uncertainty. Millett LJ emphasised that the requirement to proceed timeously against delinquent directors is imposed for two reasons. The first reason is for the protection of directors, so that they may be able to organise their affairs once the statutory time limit has passed free of the risk of future

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[506] See generally R Cassim "Delinquent Directors under the Companies Act 71 of 2008: *Gihwala v Grancy Property Limited* 2016 ZASCA 35" 15.

[507] By way of comparison, prescription on a debt begins to run as soon as the debt is due, but the debt is not regarded as being due until the creditor has knowledge of the identity of the debtor and the facts from which the debt arises (s 12(3) of the Prescription Act 68 of 1969). A creditor will be deemed to have such knowledge if he could have acquired it by exercising reasonable care (s 12(3) of the Prescription Act 69 of 1969). The object of s 12(3) of the Prescription Act 68 of 1969 is to excuse innocent inaction (*Minister of Finance and Others v Gore NO* 2007 (1) SA 111 (SCA) paras 12-19; Van der Merwe et al *Contract: General Principles* 481).

[508] This time period was two years but the Small Business, Enterprise and Employment Act of 2015 extended it to three years with effect from 1 October 2015 (see s 7(2) of the UK Company Directors Disqualification Act 1986 read with s 108 of the Small Business, Enterprise and Employment Act of 2015).

[509] Section 7(2) of the UK Company Directors Disqualification Act 1986.

[510] [1996] 4 All ER 289 at 302.

disqualification.[511] The second reason is to protect the public because it is "obviously wrong" in the public interest that a person who is unfit to be a director should be left free to be a director any longer than is necessary.[512] In *Re Probe Data Systems Ltd (No 3), Secretary of State for Trade and Industry v Desai*[513] Scott LJ in the UK Court of Appeal emphasised that a court must take four factors into account in considering whether to grant leave to commence disqualification proceedings after the statutory period (which at the time was two years) had passed. These factors are the length of the delay, the reasons for the delay, the strength of the case against the director and the degree of prejudice caused to the director by the delay.[514] In *Secretary of State for Trade and Industry v Davies and Others*[515] Millet LJ emphasised that the extension of the statutory period to apply for disqualification proceedings against directors must be exercised sparingly and with great caution.

To revert to the question posed earlier, how far before the effective date of 1 May 2011 may conduct of a director be considered for purposes of an application under section 162(5) or section 162(7) of the Companies Act? In the absence of any clear guidelines in the Companies Act and in light of the fact that, as long as he is still a director of the company in question, there is no prescribed statutory time limit for instituting an application to declare a director delinquent, it seems that there is no limit on how many years before the effective date of 1 May 2011 the misconduct of a director must have occurred before it may be taken into account for the purposes of an application under section 162(5) of the Companies Act.[516] Likewise with regard to a probation order, there is no statutory time limit prescribed, provided that the offence was committed while the person was serving as a director.

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[511] *Secretary of State for Trade and Industry v Davies and Others* [1996] 4 All ER 289 at 297.

[512] *Secretary of State for Trade and Industry v Davies and Others* [1996] 4 All ER 289 at 297. See further *Re Noble Trees Ltd* [1993] BCC 318 at 322 where the Chancery Division had proclaimed that it is wrong that a person whom the Secretary of State considers to be unfit to act as a director should be left free to be a director any longer than is necessary.

[513] [1992] BCC 110 at 118.

[514] These factors have been approved by several subsequent decisions. See for instance *Re Polly Peck International plc (In Administration) (No 3), Secretary of State for Trade and Industry v Ellis* [1993] BCC 890 at 893-894 and *Secretary of State for Trade and Industry v Davies and Others* [1996] 4 All ER 289 at 296. See further *CM Van Stillevoldt BV v El Carriers Inc* [1983] 1 All ER 699 at 704 where these factors were derived.

[515] [1996] 4 All ER 289 at 298.

[516] R Cassim "Delinquent Directors under the Companies Act 71 of 2008: *Gihwala v Grancy Property Limited* 2016 ZASCA 35" 16.

It is submitted that a statutory time limit of three years should be imposed with regard to applications to declare a director delinquent or to place him under probation. It is submitted further that the twenty four month prescription period imposed for a director who ceases to be a director of a company should be extended to three years, so as to have consistency and harmony with the three-year prescription period that applies to section 77 of the Companies Act, particularly since there is some overlap between the offences in section 77 and those set out in section 162(5)(*c*) of the Companies Act.[517] Imposing a three-year statutory time limit to apply to declare a director delinquent or to place him under probation would ensure that directors are not left in a state of uncertainty, and that they are able to organise their affairs once the statutory time bar has passed; free of the risk of a future delinquency or probation order. It would also ensure that a director who is delinquent is not left to be a director of a company for longer than necessary, thus protecting the public. In order to ensure that in those instances where an application to declare a director delinquent cannot be lodged within the three-year time period, it is submitted that, as is the case under section 7(2) of the UK Company Directors Disqualification Act 1986, with the leave of the court, an application to declare a director delinquent after the three-year period may be made. This would ensure that delinquent directors are not immune from applications to declare them delinquent after three years, but in order to bring such an application after three years, leave of the court must be sought. This would further serve to balance the public interest and the legitimate interests of the director.

3.9 Discretion of the Court in Making a Declaration of Delinquency and a Probation Order

The word "must" in section 162(5) of the Companies Act makes it clear that a court is obliged to make an order declaring a person a delinquent director if any of the grounds set out in that section are satisfied. A court does not have any discretion in this regard. In *Companies and Intellectual Property Commission v Cresswell and Others*[518] the High Court intimated that while sections 162(5)(*a*) and (*b*) do not give a court a discretion whether to grant a declaration of delinquency due to the word "must" in section 162, section 162(5)(*c*) "requires this court to

[517] R Cassim "Delinquent Directors under the Companies Act 71 of 2008: *Gihwala v Grancy Property Limited* 2016 ZASCA 35" 16.

[518] (21092/2015) [2017] ZAWCHC 38 (27 March 2017) para 26.

exercise a discretion in deciding whether to grant an order." The court did not suggest any reason why a discretion should apply in respect of section 162(5)(*c*). This view of the court is, with respect, questionable. It is submitted with respect that the word "must" in section 162(5) of the Companies Act applies to section 162(5)(*c*) of the Companies Act as well. Therefore a court does not in fact have a discretion under section 162(5)(*c*) either whether to grant a declaration of delinquency if the provisions of section 162(5)(*c*) are satisfied.

In *Gihwala and Others v Grancy Property Limited and Others*[519] the appellants had argued that section 162(5)(*c*)[520] of the Companies Act as read with section 162(6)(*b*)(ii) is unconstitutional because there is no discretion vested in the court to refuse to make a delinquency order or to moderate the period of such order to less than seven years. The court found that the appellants had not attacked section 162(5)(*c*) on the basis that it was irrational, which was detrimental to their argument regarding the constitutionality of section 162(5)(*c*) of the Companies Act.[521] The Supreme Court of Appeal had little difficulty in dismissing this argument on the ground that section 162(5) is a rational and proportionate response by the legislature to the problem of delinquent directors.[522] The court found it to be rational to remove a person from serving as a director on the ground that he was guilty of conduct falling within the categories specified in section 162(5)(*c*) of the Companies Act.[523]

A further basis on which the appellants argued that section 162(5) of the Companies Act is unconstitutional is that it infringed the right to choose a trade, occupation or profession (section 22 of the Constitution), the right of access to courts (section 34 of the Constitution) and the right to dignity (section 10 of the Constitution).[524] With regard to the constitutional challenge

[519] 2017 (2) SA 337 (SCA) para 140.

[520] It should be noted that this case specifically dealt with s 162(5)(*c*) of the Companies Act and not with s 162(5) in general.

[521] *Gihwala and Others v Grancy Property Limited and Others* 2017 (2) SA 337 (SCA) para 145. Legislation must serve a rational purpose and there must be a rational connection between the purpose of the legislation and the provision under consideration. The absence of such a rational connection would result in the provision being unconstitutional (*New National Party of South Africa v Government of the Republic of South Africa* 1999 (3) SA 191 (CC) paras 19 and 24; *Gihwala and Others v Grancy Property Limited and Others* 2017 (2) SA 337 (SCA) para 145).

[522] *Gihwala and Others v Grancy Property Limited and Others* 2017 (2) SA 337 (SCA) para 145.

[523] *Gihwala and Others v Grancy Property Limited and Others* 2017 (2) SA 337 (SCA) para 145.

[524] *Gihwala and Others v Grancy Property Limited and Others* 2017 (2) SA 337 (SCA) para 141.

on section 22 of the Constitution, the Supreme Court of Appeal[525] relied on the following dictum of the Constitutional Court in *Affordable Medicines Trust and Others v Minister of Health and Others*[526] in which Ngcobo J had stated the following:

> "But we live in a modern and industrial world of human interdependence and mutual responsibility. Indeed we are caught in an inescapable network of mutuality. Provided it is in the public interest and not arbitrary or capricious, regulation of vocational activity for the protection both of the persons involved in it and of the community at large affected by it is to be both expected and welcomed. These considerations are reflected in the text of s 22."

Based on the assumption in favour of the appellants that being a director of a company is an occupation, trade or profession (which the Supreme Court of Appeal said was by no means an obviously correct proposition), the court held that the appellants had not suggested that section 162(5) is either capricious or arbitrary.[527] On this ground the constitutional challenge on section 22 of the Constitution failed. The challenge under section 34 of the Constitution also failed. The court held that an errant director has an entirely fair hearing before a court, and that a court is involved in every stage of an enquiry under section 162(5).[528] The Supreme Court of Appeal found that the challenge under section 34 was in fact misconceived since it was not the absence of a fair hearing which was in issue but the consequences of an adverse decision.[529] The court held that this consequence cannot be challenged under section 34 of the Constitution on the ground that the delinquent director has been deprived of a right of access to court, but may only be challenged on the ground that section 162(5) is an irrational legislative response to the particular problem.[530] The constitutional challenge that section 162(5) infringed the right to dignity under section 10 of the Constitution was reduced to saying that the terms of section 162(5) of the Companies Act do not permit the court to take into account the individual director's circumstances and degree of blameworthiness.[531] The Supreme Court of Appeal

[525] *Gihwala and Others v Grancy Property Limited and Others* 2017 (2) SA 337 (SCA) para 146.

[526] 2006 (3) SA 247 (CC) para 60.

[527] *Gihwala and Others v Grancy Property Limited and Others* 2017 (2) SA 337 (SCA) para 146.

[528] *Gihwala and Others v Grancy Property Limited and Others* 2017 (2) SA 337 (SCA) para 147.

[529] *Gihwala and Others v Grancy Property Limited and Others* 2017 (2) SA 337 (SCA) para 147.

[530] *Gihwala and Others v Grancy Property Limited and Others* 2017 (2) SA 337 (SCA) para 147.

[531] *Gihwala and Others v Grancy Property Limited and Others* 2017 (2) SA 337 (SCA) para 150.

stated that section 162 of the Companies Act was not about the "individualisation of punishment" but about the appropriateness of the protective measures the legislature had prescribed to deal with delinquent directors.[532] The Supreme Court of Appeal held that the constitutional challenge on the infringement of the right to dignity could only be pursued by attacking the rationality of section 162 of the Companies Act, which the appellants had failed to do.[533] The Supreme Court of Appeal accordingly held that the court *a quo* had correctly rejected the attacks on the constitutionality of section 162(5) of the Companies Act.[534] The appeal against the delinquency orders was consequently dismissed.[535]

In terms of section 162(7) of the Companies Act a court has been given a discretion to decide whether or not to place a director under probation. This is made clear by the use of the word "may" in section 162(7) of the Companies Act. Regarding the disqualification of a director, a court has again been given a discretion, under section 69(11) of the Companies Act, to exempt a person from the application of any provision of section 69(8)(*b*) of the Companies Act which sets out the instances when a person would be disqualified from being a director. It is questionable why the court has been given a discretion whether to remove a director from office (under section 71(6) of the Companies Act), whether to place a director under probation (under section 162(7) of the Companies Act), and whether to disqualify a person from being a director (under section 69(11) of the Companies Act), but has not been given such a discretion under section 162(5) of the Companies Act, when the effect of all of these provisions is that the director in question is not permitted to serve as a director.[536]

It may be argued that the court was denied a discretion under section 162(5) of the Companies Act in light of the seriousness of the offences listed in that section. Fault in the form of intent

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[532] *Gihwala and Others v Grancy Property Limited and Others* 2017 (2) SA 337 (SCA) para 148.

[533] *Gihwala and Others v Grancy Property Limited and Others* 2017 (2) SA 337 (SCA) para 150.

[534] *Gihwala and Others v Grancy Property Limited and Others* 2017 (2) SA 337 (SCA) para 150.

[535] *Gihwala and Others v Grancy Property Limited and Others* 2017 (2) SA 337 (SCA) para 150. For a further discussion of the constitutional challenge of s 162 of the Companies Act in this case see R Cassim "Delinquent Directors under the Companies Act 71 of 2008: *Gihwala v Grancy Property Limited* 2016 ZASCA 35" 3-7 and J Du Plessis & Delport "'Delinquent Directors' and 'Directors under Probation': A Unique South African Approach Regarding Disqualification of Company Directors" 287-292.

[536] R Cassim "Delinquent Directors under the Companies Act 71 of 2008: *Gihwala v Grancy Property Limited* 2016 ZASCA 35" 17.

or gross negligence is required for an order in terms of section 162(5)(*c*) of the Companies Act.[537] As the Supreme Court of Appeal in *Gihwala and Others v Grancy Property Limited and Others*[538] stated, the categories of conduct listed in section 162(5)(*c*) of the Companies Act deal with instances of serious misconduct constituting a gross abuse of the office of a director of a company. The lack of a discretion may also serve to promote consistency and certainty with regard to declaring delinquent directors who are in breach of section 162(5) of the Companies Act.[539] Nevertheless, the fact that a court has not been given a discretion whether or not to remove a director from office under section 162 of the Companies Act results in a clear interference by the judiciary with the internal affairs of a company.[540] It further has the effect that under section 162(5) of the Companies Act courts are not empowered to consider any relevant mitigating factors in declaring directors delinquent. For instance, courts are not empowered to consider the remorse shown by the director, the need to balance the personal hardship to the director against the public interest and the need for the protection of the public from any repetition of the conduct, the potential of the director to reform, or the likelihood of the director refraining from any future misconduct in exercising his functions and duties.

It should, however, be noted that with regard to the ground of delinquency in section 162(5)(*f*) which may be raised by an organ of state only,[541] a court has some discretion whether or not to grant a declaration of delinquency since the order will be granted only if "the court is satisfied that the declaration of delinquency is justified". In determining whether the declaration of delinquency is justified a court must have regard to the nature of the contravention(s), and the "person's conduct in relation to the management, business or property" of any company, close corporation or juristic person at the time. This wording mirrors section 206C of the Australian Corporations Act of 2001, discussed below.

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[537] Delport *Henochsberg on the Companies Act 71 of 2008* 566.

[538] 2017 (2) SA 337 (SCA) paras 143-144.

[539] Griffin argues that the value of a mandatory disqualification order is that it promotes consistency and certainty in respect of a positive requirement on the part of the courts to disqualify directors in circumstances where their conduct in the management of a company is considered to have been unfit (Griffin "The Disqualification of Unfit Directors and the Protection of the Public Interest" 210).

[540] See further chapter 2, paras 6 and 7 and para 3.10 below where the interference by the judiciary in the internal affairs of a company has been discussed in more detail.

[541] This ground of delinquency is discussed in para 3.4.10 above.

Section 206C(1)(b) of the Australian Corporations Act of 2001 states that a court "may" disqualify a person from managing corporations for a period that the court considers appropriate if a civil penalty provision in section 1317E has been contravened and if the court "is satisfied that the disqualification is justified." In determining whether the disqualification is justified, section 206C(2)(a) requires a court to have regard to the "person's conduct in relation to the management, business or property" of any corporation. A court may however also take into account any other issues that it considers appropriate in the circumstances.[542] Thus the matters that may be considered by the court are not limited to the director's conduct in relation to the management of the company.[543] As discussed[544] the grounds listed in section 1317E are very similar to the grounds of delinquency listed in section 162(5)(*c*) of the Companies Act. Yet the Companies Act does not give courts a discretion under section 162(5)(*c*) whether or not to declare a director delinquent if these provisions are contravened, while under section 206C of the Australian Corporations Act of 2001 a court is given a high level of discretion under similar grounds to determine whether or not to disqualify a person from managing a company. The Australian Corporations Act of 2001 further gives a court a discretion whether to disqualify a director from managing corporations in respect of all the other grounds of disqualification that may be raised by ASIC in a court application.[545]

The UK Company Directors Disqualification Act 1986 also confers on the court a discretion whether or not to grant a disqualification order against a director.[546] The only instance when disqualification is mandatory under the UK Company Directors Disqualification Act 1986 is under section 6 of this Act, which relates to the disqualification of unfit directors of insolvent companies.

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[542] See s 206C(2)(b) of the Australian Corporations Act of 2001.

[543] Austin & Ramsay *Ford, Austin and Ramsay's Principles of Corporations Law* para 7.191 at 266.

[544] See para 3.4.4 above.

[545] See s 206D(1) (involvement in two or more failed corporations in the previous seven years), s 206E(1) (court power of disqualification with regard to repeated contraventions of the Australian Corporations Act of 2001) and s 206EAA (court's power of disqualification with regard to disqualification under a law of a foreign jurisdiction).

[546] See s 2 (disqualification on conviction of indictable offence), s 3 (disqualification for persistent breaches of companies legislation), s 4 (disqualification for fraud in winding-up of a company) and s 5 (disqualification on summary conviction) which all state that a court "may" make a disqualification order.

Under section 8.09(a) of the MBCA the courts likewise have a discretion whether to remove a director from office, even if the grounds to do so have been satisfied. This is made clear from the use of the words "may remove a director from office" in section 8.09(a) of the MBCA. Similarly, the DGCL[547] as well as the corporate legislation of the USA States which permit the judicial removal of directors, confer a discretion on a court whether or not to remove a director from office.[548]

It is evident from the above comparisons that section 162(5) of the (South African) Companies Act is far stricter than the equivalent provisions in the foreign jurisdictions reviewed in that, save for the ground of delinquency in section 162(5)(*f*), the South African courts have not been given any discretion to decide whether or not to grant a declaration of delinquency and thus remove a director from office.

3.10 Interference by the Judiciary with the Internal Affairs of a Company

Section 162 of the (South African) Companies Act does not contain provisions designed to minimise the interference by the judiciary in the internal affairs of a company. In contrast, section 8.09 of the MBCA is designed to interfere as little as possible with the usual mechanisms of corporate governance.[549] For instance, under section 8.09(a) of the MBCA not only has a court been conferred a discretion whether or not to remove a director from office based on a contravention of any of the grounds listed in that provision (which are similar to the grounds set out in section 162(5)(*c*) of the Companies Act), but it may do so only if, considering the director's course of conduct and the inadequacy of other available remedies, removal would

[547] Section 225(c) of the DGCL states that a court "may" remove a director from office if the grounds set out in that section have been satisfied. These grounds are a conviction of a felony in connection with the duties of a director or a breach of the duty of loyalty in connection with the duties of such director.

[548] The relevant provisions of the corporate legislation of the respective USA States which permit the judicial removal of a director state that a court "may" remove from office a director if the grounds set out in the respective provisions of such statutes have been satisfied. See for example s 10-809(A) of the Arizona Revised Statutes; s 10A-2-8.09(a) of the Alabama Business and Nonprofit Entities Code; s 10.06.463 of the Alaska Corporations Code; s 304 of the California Corporations Code; s 33-743(a) of the Connecticut General Statutes; s 29-306.09(a) of the District of Columbia Code; s 30-29-809(1) of the Idaho Code; s 490.809(1) of the Iowa Code; s 450.1514(1) of the Michigan Business Corporation Act; s 1726(c) of the Pennsylvania Business Corporation Law; s 33-8-109(a) of the South Carolina Code of Laws; s 47-1A-809 of the South Dakota Business Corporation Act; s 48-18-109(a) of the Tennessee Code; s 23B.08.090(1) of the Washington Business Corporation Act and s 17-16-809(a) of the Wyoming Business Corporation Act.

[549] *Model Business Corporation Act with Official Comments and Reporter's Annotations* 8-95.

be in the best interest of the corporation. A court is thus required to consider whether any remedies other than removal would be adequate and further whether removal of the director concerned would be in the best interests of the company, before removing a director from office.

Notably, section 8.09(a) of the MBCA states that a court may remove a director from office or "may order other relief". Several other USA States permit a court to order other relief instead of removing a director from office.[550] Section 225(c) of the DGCL goes further in that it states that a court may remove a director from office if judicial removal is necessary to avoid irreparable harm to the corporation. The section also states that a court may make such orders as are necessary to effect the removal of a director. The legislation of many of the USA States which permit judicial removal state that a court may remove a director from office only if the removal is in the best interest of the corporation.[551] These provisions serve to ensure that a court does not unduly interfere with the internal affairs of a company.

In sharp contrast, under section 162 of the (South African) Companies Act, as discussed above, a court has no discretion whether or not to remove a director from office if any of the grounds under that provision are satisfied. A court is not required to consider whether any other remedies are adequate before declaring a director delinquent and hence removing him from office. The judicial removal of a director from office is not a remedy of last resort. A court is also not required to consider whether declaring a director delinquent is in the best interest of the company. A court moreover is not given any discretion to grant any other relief, save for making the declaration of delinquency subject to any conditions that the court considers appropriate.[552] It is clear that section 162(5)(*c*) of the (South African) Companies Act is much

[550] See for example ss 33-743(a) and (d) of the Connecticut General Statutes; ss 29-306.09(a)(2) and (d) of the District of Columbia Code; ss 30-29-809(1)(b) and (4) of the Idaho Code; ss 490.809(1)(b) and (4) of the Iowa Code; s 47-1A-809 of the South Dakota Business Corporation Act and ss 17-16-809(a)(ii) and (d) of the Wyoming Business Corporation Act. These provisions provide that a court may remove a director only if, considering the director's course of conduct and the inadequacy of other available remedies, removal would be in the best interest of the corporation, and further, that the equitable powers of the court to order other relief is not limited.

[551] See for example s 10A-2-8.09(a) of the Alabama Business and Nonprofit Entities Code; s 10-809(A)(2) of the Arizona Revised Statutes; s 8.35(b) of the Illinois Business Corporation Act of 1983; s 450.1514(1) of the Michigan Business Corporation Act; s 33-8-109(a) of the South Carolina Code of Laws; s 48-18-109(a)(2) of the Tennessee Code and s 23B.08.090(1) of the Washington Business Corporation Act.

[552] See s 162(6) of the Companies Act.

stricter than the equivalent provisions in the foreign jurisdictions considered that have influenced the Companies Act.

In *Gihwala and Others v Grancy Property Limited and Others*[553] the Supreme Court of Appeal proclaimed that the fact that foreign legislation gives courts a wider discretion to remove directors from office does not render section 162(5)(*c*) of the Companies Act constitutionally problematic, and that the provision remains a rational one. It is imperative to note, however, that section 5(2) of the Companies Act states that a court interpreting or applying the Companies Act may consider foreign company law to the extent appropriate. It would have been useful and instructive for the Supreme Court of Appeal to have considered the equivalent provisions of the foreign jurisdictions discussed above, in ascertaining the rationality of section 162(5)(*c*) of the Companies Act.[554]

It is submitted that the approach adopted to the removal of a director under section 8.09 of the MBCA and the equivalent provisions under the DGCL and the corporate legislation of the USA States that permit the judicial removal of a director is commendable and has the effect of limiting the extent of the judicial interference in the internal affairs of the company.[555] As discussed, the threshold for the misconduct of a director before a court will remove him from office is set much higher in the MBCA and the legislation of several USA States compared to section 162 of the (South African) Companies Act, where the threshold for misconduct before a court will remove a director from office is set much lower. The reason for the high threshold under the MBCA is in recognition of the primacy of the voting rights of the shareholders who elected the director to office, and the notion that the exercise of shareholders' voting power should not easily be undone by a court.[556]

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[553] 2017 (2) SA 337 (SCA) para 145.

[554] See also R Cassim "Delinquent Directors under the Companies Act 71 of 2008: *Gihwala v Grancy Property Limited* 2016 ZASCA 35" 19 for a discussion of this issue.

[555] See chapter 2, para 6 where the impact of the court's power to remove a director from office is discussed, and chapter 2, para 7 where suggestions are made to maintain the balance of powers with regard to the removal of a director from office by the court.

[556] Cox & Hazen *Corporations* 171.

While the removal of directors by the judiciary is important and appropriate in instances when the shareholders or the board of directors are unable to remove a director from office (as discussed in paragraph 6 of chapter 2), at the same time the removal of directors by the judiciary impacts on the internal structure of the company, and alters the composition of the board of directors elected by the shareholders to represent their interests. As discussed,[557] in light of section 7(*i*) of the Companies Act, which states that one of the purposes of the Companies Act is to balance the rights and obligations of shareholders and directors within companies, there must be a balance between the removal of a director by a court and the shareholders' or board of directors' privilege to remove a director from office. It is submitted that in order to strike a proper balance and to limit judicial interference in the internal affairs of a company, section 162 of the Companies Act should incorporate the following provisions based on the legislation of foreign jurisdictions with regard to the judicial removal of directors from office:

- Courts should have a discretion whether or not to declare directors delinquent and hence remove them from office;
- Courts should be required to consider whether the declaration of delinquency and removal of the director would be in the best interests of the company;
- Courts should consider whether any other remedies besides a declaration of delinquency and removal of the director from office are adequate; and
- In addition to imposing any conditions ancillary to a declaration of delinquency or probation, courts should have the power to order any other relief under section 162 of the Companies Act.

It is submitted that if these considerations formed part of the remedy of the judicial removal of directors as contained in section 162 of the Companies Act, due consideration would be given by the courts to the inherent right of shareholders to remove directors and to the principle of non-interference in the internal affairs of the company.[558]

[557] See chapter 2, para 7.

[558] See chapter 2, para 7 where some of these factors are discussed.

3.11 Application To Suspend Or Set Aside A Delinquency Order Or Probation Order

Under section 162(11)(*a*) of the Companies Act, a delinquent director may, at any time more than three years after the order of delinquency was made, apply to court to suspend the order of delinquency and to substitute it for an order of probation, with or without conditions. A person who is subsequently placed under a probation order by way of substitution of the delinquency order may apply to court at any time more than two years thereafter for an order setting aside the probation order.[559] A person who was originally placed under a probation order may apply to court for the probation order to be set aside after at least two years have elapsed since the probation order was made.[560]

It follows from the above that even though, in terms of section 162(6)(*b*)(ii) of the Companies Act,[561] a delinquency order may be imposed on a director for a period of seven years or longer, a director may apply to court to reduce this period by first applying to court after three years for the suspension of the delinquency order and substitution thereof with a probation order, and thereafter applying to court, after two years, to set aside the substituted probation order. The implication of section 162(11) of the Companies Act is that in effect the minimum period of a delinquency order and a probation order, assuming that the application under section 162(11) of the Companies Act is successful, is in fact three years and two years respectively. Section 162(11) of the Companies Act serves to alleviate the severity of a delinquency order and a probation order.

Under section 17 of the UK Company Directors Disqualification Act 1986 a disqualified person may apply for leave to act as a director.[562] In terms of this provision a court may waive the

[559] Section 162(11)(*b*)(i) of the Companies Act.

[560] Section 162(11)(*b*)(ii) of the Companies Act.

[561] In terms of s 162(6)(*b*)(ii) of the Companies Act a declaration of delinquency in terms of ss 162(5)(*c*) to (*f*) subsists for seven years from the date of the order or such longer period as determined by the court at the time of making the declaration, subject to ss 162(11) and (12). Section 162(6)(*b*)(ii) is discussed in para 3.6.2 above.

[562] The relevant sections in this regard are s 17(1) read with s 1(1)(a) of the UK Company Directors Disqualification Act 1986. Section 1(1)(a) defines a disqualification order as one which provides that the person subject to it shall not act in certain ways, including being a director of a company or taking part in its management, without the leave of the court. Section 17(1) deals with the procedure governing such an application and the court to whom the application is to be made. In *Secretary of State for Trade and Industry v Collins & Ors* [2000] BCC 998 at 1003 the UK Court of Appeal commented that even though applications in terms of s 17 of the UK Company Directors Disqualification Act 1986 are generally known as "section 17 applications" this is a misnomer since the application is properly regarded as made under s 1 of the UK Company Directors Disqualification Act 1986.

disqualification of a director to a certain extent and permit a disqualified director to act as a director of specific companies.[563] A court has a discretion whether or not to grant the application. Should the court grant leave to the applicant to act as a director it may do so subject to conditions.

The application by a disqualified director in terms of section 17 of the UK Company Directors Disqualification Act 1986 for leave to act as a director may be equated to an application by a director in terms of section 162(11) of the (South African) Companies Act for his delinquency order to be suspended. If an application in terms of section 17 of the UK Company Directors Disqualification Act 1986 is successful, the applicant would be empowered to act as a director of a company subject to the conditions imposed by the court. Likewise, if an application in terms of section 162(11) of the (South African) Companies Act is successful, the applicant's delinquency order would be suspended and replaced with a probation order, with or without conditions. The effect of a probation order is that the person may serve as a director but subject to the extent permitted by the probation order.[564] It follows that the effect of a successful application in terms of section 17 of the UK Company Directors Disqualification Act 1986 and in terms of section 162(11) of the (South African) Companies Act is that a person may act as a director but only to the extent permitted by the court and subject to the conditions imposed by the court. In light of the similarities between section 17 of the UK Company Directors Disqualification Act 1986 and section 162(11) of the (South African) Companies Act this chapter draws on the jurisprudence in the UK under section 17 of the UK Company Directors Disqualification Act 1986, which may provide guidance to interpreting section 162(11) of the (South African) Companies Act.

Under section 206G(1) of the Australian Corporations Act of 2001 a court may grant leave to a person who is disqualified from managing corporations, to manage corporations, to manage a particular class of corporations, or to manage a particular corporation. Such leave may not be granted if the person was disqualified by ASIC.[565] If the application is successful, the court

[563] See Milman "Partial Disqualification Orders" 224.

[564] Section 69(5) of the Companies Act. See para 3.6.1 above for a discussion on the effect of a probation order.

[565] Under s 206F(1)(a) of the Australian Corporations Act of 2001 ASIC may disqualify a person from managing corporations for up to five years if, within seven years before ASIC notifies the person that they may be disqualified (1) the person has been an officer of two or more corporations and (ii) while the person was an officer, or within twelve months after the person ceased to be an officer of those corporations, each of the corporations

may permit the applicant to manage corporations, to manage a particular class of corporations, or to manage a particular corporation.[566] The applicant is required to lodge a notice with ASIC at least twenty one days before commencing the proceedings for leave to manage a corporation.[567] If the order granting leave to manage a particular corporation or corporations is granted it may allow unrestricted access to direct a particular company or companies or it may be made subject to conditions as determined by the court.[568] In light of the similarities between section 206G of the Australian Corporations Act of 2001 and section 162(11) of the (South African) Companies Act, the jurisprudence in Australia on section 206G of the Australian Corporations Act of 2001 may provide further guidance to interpreting section 162(11) of the (South African) Companies Act.[569]

Section 162(11) of the Companies Act does not make provision for any third party to intervene in the application to suspend or set aside a delinquency order or a probation order. Even though a very wide range of persons has been conferred with *locus standi* in terms of sections 162(2), (3) and (4) of the Companies Act to apply to court for an order declaring a director delinquent or under probation, the (South African) Companies Act has not conferred on such persons any standing to intervene in the proceedings in terms of section 162(11) to suspend or set aside the delinquency order or probation order.[570] In contrast, section 17(5) of the UK Company Directors Disqualification Act 1986 imposes a duty on the Secretary of State to appear on an application of a person for leave to act as a director, and to call the attention of the court to any relevant matters.[571] This may be done by giving evidence himself or calling witnesses to do

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was wound up and a liquidator lodged a report under s 533(1) of the Australian Corporations Act of 2001 about the corporation's inability to pay its debts.

[566] Section 206G(1) of the Australian Corporations Act of 2001.

[567] Section 206G(2) of the Australian Corporations Act of 2001.

[568] Section 206G(3) of the Australian Corporations Act of 2001.

[569] While the MBCA and some States in the USA provide for the judicial removal of directors, they do not contain a provision akin to that contained in s 162(11) of the (South African) Companies Act, on which directors may rely to apply to court for the suspension of their disqualification orders, as is the case in the UK and Australia.

[570] The *locus standi* to institute an application under s 162 of the Companies Act is discussed in para 3.3 above.

[571] In *Secretary of State for Trade and Industry v Collins & Ors* [2000] BCC 998 the Secretary of State appealed to the UK Court of Appeal against the granting of leave in terms of s 17 of the UK Company Directors Disqualification Act 1986 to an applicant to act as a director. The UK Court of Appeal remarked that in the ordinary case it would expect the Secretary of State to accept the determination of the judge to grant leave to an applicant to manage a company since the discretion to do so vests in the judge considering the application. But in an unusual case, as in the one before the UK Court of Appeal, the Secretary of State was of the view that the court had erred by granting leave. In such a case, the UK Court of Appeal held, it is open to the Secretary of State, who

so.[572] In Australia, ASIC may intervene in proceedings in terms of section 206G of the Australian Corporations Act of 2001 for leave to manage a corporation or corporations, and it is empowered to oppose the application as well.[573] The fact that section 162(11) of the Companies Act does not empower any person to intervene in the proceedings has the effect of weakening the power conferred on those persons with *locus standi* in terms of sections 162(2), (3) and (4) to apply to court to have a director declared delinquent or placed under probation. This is because a court may suspend or set aside the delinquency order or probation order under section 162(11) of the Companies Act without any input from the person that had initially successfully applied to court to have the director declared delinquent or placed under probation.

3.11.1 Application of Section 162(11) of the Companies Act

Section 162(11) of the Companies Act may be relied on by a director who has been declared delinquent by a court or who is subject to an order of probation.[574] This provision does not apply to directors who have been declared delinquent in terms of sections 162(5)(*a*) or (*b*) of the Companies Act, that is, on account of (i) having consented to act as a director or having acted in the capacity of a director while ineligible or disqualified, or (ii) on account of having acted as a director while under a probation order in a manner that contravened that probation order.[575] In such instances, the declaration of delinquency subsists for such person's lifetime and may not be suspended or set aside.

Section 162(11) of the Companies Act may not be invoked unless the applicant has served at least three years of the delinquency order. With regard to a probation order, the provision may be invoked only after a period of two years has passed since the order was made. As

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had obtained the disqualification order, to appeal against the decision on leave (at 1008). This case was the first appeal to come to the UK Court of Appeal in respect of an order granting leave in terms of s 17 of the UK Company Directors Disqualification Act 1986.

[572] Section 17(5) of the UK Company Directors Disqualification Act 1986.

[573] Section 1330 of the Australian Corporations Act of 2001.

[574] Section 162(11) of the Companies Act.

[575] Section 162(11) of the Companies Act provides that a person who has been declared delinquent in terms of s 162(6)(*a*) of the Companies Act may not apply to court to suspend the order of delinquency and substitute it with an order of probation. Section 162(6)(*a*) refers to a declaration of delinquency in terms of ss 162(5)(*a*) and (*b*), and states that such a declaration is unconditional and subsists for the lifetime of the person declared delinquent.

indicated,[576] a probation order may be imposed for a period not exceeding five years, as determined by the court.[577] In the event that a probation order of two years or less is imposed on a director, the provisions of section 162(11) of the Companies Act would not come to the assistance of a director. He would have no choice but to serve the full period of his probation order.

In contrast, the UK Company Directors Disqualification Act 1986 does not specify any time period after which an applicant may apply for leave to act as a director. In fact, a person who faces the possibility of a disqualification order is encouraged to immediately seek leave in terms of section 17 of the UK Company Directors Disqualification Act 1986 to act as a director. In *Secretary of State for Trade and Industry v Collins & Ors*[578] the UK Court of Appeal stated as follows:

> "[I]t is highly desirable that a person who faces the possibility of a disqualification order but who in the event of such an order wishes to seek leave should make that application early enough so that the same judge should consider both the application for disqualification and the application for leave."

This does not mean that an applicant may not apply for leave to act as a director after a number of years have passed since the disqualification order was made. In *Hennelly v Secretary of State for Trade and Industry*[579] a director had been disqualified to act as such for a period of eight years. He successfully applied for leave to act as a director, in terms of section 17 of the UK Company Directors Disqualification Act 1986, after a period of five years had elapsed. In *Re Westmid Packing Services Ltd Secretary of State for Trade and Industry v Griffiths and Others*[580] the UK Court of Appeal emphasised that when a court knows or expects that an application under section 17 of the UK Company Directors Disqualification Act 1986 will be

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[576] See para 3.6.1 above.

[577] Section 162(9)(*b*) of the Companies Act.

[578] [2000] BCC 998 at 1010.

[579] [2004] EWHC 34 (Ch). The applicant had been disqualified as a director for a period of eight years in terms of s 6 of the UK Company Directors Disqualification Act 1986. He had been disqualified because of his conduct in relation to five companies, of which he had been the sole effective director. All five companies had gone into insolvent liquidation with large debts. Together the five companies owed approximately ten million pounds to creditors and approximately five million pounds to the Crown. All five companies also had a history of the late filing of returns.

[580] [1998] 2 All ER 124 at 131.

made immediately after the making of a disqualification order or soon thereafter, and the court is inclined to grant such leave, it should not impose the minimum period of disqualification since the power to grant leave under section 17 is irrelevant to determining the proper period of disqualification.

Setting aside a delinquency order is a two-stage process under section 162(11) of the (South African) Companies Act. The applicant must first apply to have the delinquency order suspended and substituted with an order of probation, and thereafter, after a period of at least two years, he may apply for the probation order to be set aside.[581] It is submitted that the mandatory two-stage approach adopted under the Companies Act is commendable because it affords a court time and opportunity to monitor and assess the conduct of the delinquent director during the period that the order is substituted with a probation order. If a court is not satisfied with the conduct of the delinquent director during this period, it may decline to set aside the substituted probation order. Monitoring the delinquent director's conduct during the suspension of the delinquent order is critical in light of the fact that a delinquency order is aimed at protecting companies and corporate stakeholders against directors who have proven themselves unable to manage the company's business or who have neglected their duties and obligations as company directors.[582] It is submitted that a two-stage process to have a delinquency order set aside facilitates this object.

3.11.2 Discretion of the Court to Suspend or Set Aside the Delinquency Order or Probation Order

A court has a discretion whether or not to grant the application to suspend the delinquency order or to set aside the probation order. This is made clear by section 162(12) of the Companies Act, which states that in considering an application in section 162(11) "the court may" grant the order if "the court is satisfied" that the requirements in section 162(12)(*b*) are met.

Neither the UK Company Directors Disqualification Act 1986 nor the Australian Corporations Act of 2001 provide explicit statutory guidance to the courts on the manner in which they

[581] Section 162(11)(*a*) and (*b*) of the Companies Act.

[582] *Msimang NO and Another v Katuliiba and Others* [2013] 1 All SA 580 (GSJ) para 29; *Gihwala and Others v Grancy Property Limited and Others* 2017 (2) SA 337 (SCA) para 144. The purpose of a delinquency order is discussed in para 3.2 above.

should exercise their discretion to grant leave to a disqualified director to act as a director. Accordingly in these jurisdictions the courts' "discretion [is] unfettered by any statutory condition or criterion".[583] The courts in these jurisdictions have accordingly developed criteria for determining whether to grant such leave, and are guided by case law with regard to the overall approach to be adopted.[584] In contrast, the (South African) Companies Act has, in section 162(12), usefully provided statutory criteria to be considered by the courts in exercising their discretion whether to suspend an order of delinquency or to set aside an order of probation. The criteria are that (i) any conditions attached to the delinquency order or probation order must be satisfied; (ii) the court must be satisfied that the applicant has demonstrated satisfactory progress towards rehabilitation; and (iii) the court must be satisfied that there is a reasonable prospect that the applicant would be able to serve successfully as a director of the company in the future.[585]

In *Re Tech Textiles Ltd, Secretary of State for Trade and Industry v Vane*[586] the Chancery Division, per the Honourable Mrs Justice Arden, remarked that in exercising its discretion under section 17(1) of the UK Company Directors Disqualification Act 1986 whether to grant leave to a director to act as a director, the end which a disqualification order seeks to achieve is particularly relevant. The starting point, the court opined, is to bear in mind that the purpose of a disqualification order is protective. The court stated as follows:

> "Leave, however, in my view, is not to be too freely given. Legislative policy requires the disqualification of unfit directors to minimise the risk of harm to the public, and the courts must not by granting leave prevent the achievement of this policy objective. Nor would the court wish anyone dealing with the director to be misled as to the gravity with which it views the order that has been made."[587]

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[583] *Re Dawes and Henderson (Agencies) Ltd* [2000] 2 BCC 204 at 211.

[584] Belcher "What Makes a Director Fit: An Analysis of the Workings of Section 17 of the Company Directors Disqualification Act 1986" 387 and 400.

[585] These criteria are discussed below in paras 3.11.3 and 3.11.4.

[586] [1998] 1 BCLC 259 at 267.

[587] *Re Tech Textiles Ltd, Secretary of State for Trade and Industry v Vane* [1998] 1 BCLC 259 at 267. See further *Re Britannia Homes Centres Ltd, Official Receiver v McCahill* [2001] 2 BCLC 63 at 71; *Hennelly v Secretary of State for Trade and Industry* [2004] EWHC 34 (Ch) para 65; Walters "Leave to Act as a Company Director following Disqualification" 240 and Davies & Worthington *Gower Principles of Modern Company Law* 240 where it was emphasised that in granting leave to a disqualified director to act as a director the purpose of the UK Company Directors Disqualification Act 1986 must not be undermined, and that a cautious approach should be adopted by courts.

Griffin also submits that since section 17 of the UK Company Directors Disqualification Act 1986 has the effect of permitting a director with a dubious past history in the management of a company to partly escape the consequences of his past indiscretions, granting leave to the director to manage a corporation must be done with caution.[588]

It is of interest that a concern has been raised by the UK Courts of Appeal that in some instances leave is in fact granted too easily by the courts of first instance. For instance in *Re Westmid Packing Services Ltd Secretary of State for Trade and Industry v Griffiths and Others*[589] the UK Court of Appeal expressed the view that the directors concerned had been "fortunate" in that the court of first instance had granted leave to them under section 17 of the UK Company Directors Disqualification Act 1986. The UK Court of Appeal stated:[590]

> "The appellants may have been dazzled, manipulated and deceived by [their fellow director] but they were in breach of their own duties in allowing this to happen. They can count themselves fortunate to have received the minimum period of disqualification and to have had the benefit of immediate orders under s 17 of the Act."

Similarly, in *Secretary of State for Trade and Industry v Collins & Ors*[591] the UK Court of Appeal found that it was "very doubtful" that it would have granted leave to the applicant under section 17 of the UK Company Directors Disqualification Act 1986, and that the applicant had been "fortunate"[592] that leave had been granted by the court of first instance.

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[588] Griffin *Company Law Fundamental Principles* 360.

[589] [1998] 2 All ER 124 at 131.

[590] *Re Westmid Packing Services Ltd Secretary of State for Trade and Industry v Griffiths and Others* [1998] 2 All ER 124 at 131.

[591] [2000] BCC 998 at 1012.

[592] [2000] BCC 998 at 1015. Even though the UK Court of Appeal doubted that it would have granted leave to the applicant to manage a company, it did not overturn the decision of the court *a quo*. It found that the discretion whether or not to grant leave was that of the judge of the court *a quo* and that it was not open to the UK Court of Appeal to interfere with the judge's exercise of his discretion unless he had misdirected himself about material considerations, or had come to a plainly erroneous conclusion (at 1012 and 1015). Since it had not been shown to the satisfaction of the UK Court of Appeal that the judge in the court *a quo* had been plainly wrong, the court dismissed the appeal by the Secretary of State (at 1014). Belcher reviewed the statistics between 1 November 2001 and 12 January 2010 reflecting instances when UK courts granted leave to directors in terms of s 17 of the UK Company Directors Disqualification Act 1986. Belcher argues that there is evidence of leniency in the granting of leave which suggests that leave may be granted by the UK courts too often (Belcher "What Makes a Director Fit: An Analysis of the Workings of Section 17 of the Company Directors Disqualification Act 1986" 389).

In considering an application under section 17 of the UK Company Directors Disqualification Act 1986, a court will generally have regard to two factors in particular: (i) the protection of the public; and (ii) the need for the applicant to be a director.[593] The courts balance the need for a director to act as such against the protection of the public from the conduct that had led to the disqualification order.[594] With regard to the second factor of "need", in *Secretary of State for Trade and Industry v Collins & Ors*[595] the UK Court of Appeal stated that there are two distinct needs which must be considered. The first is the need of the disqualified person to earn a living and the second is the need of the company to have the work done for the purposes of its business.[596] Each factor carries some weight, but the second factor is more influential in an application in terms of section 17 of the UK Company Directors Disqualification Act 1986.[597] With regard to the need for the company to have the work done for the purposes of its business, a further distinction must be made between a case where the company simply needs to have the job done by somebody and a case where the company needs to have the job done by the particular applicant.[598] The UK Court of Appeal stated that the argument for leave to act as a director is more cogent where the company needs to have the job done by the particular applicant.[599] In *Harris v Secretary of State for Business, Innovation and Skills*[600] the Chancery Division made it clear that convenience and need are not the same things.

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[593] *Re Cargo Agency Ltd* [1992] BCC 388 at 393; *Re Gibson Davies Ltd* [1995] BCC 11; *Re Grayan Building Services Ltd* [1995] Ch 241 at 253-254; *Secretary of State for Trade and Industry v Palfreman* [1995] BCC 193 at 195; *Re Tech Textiles Ltd, Secretary of State for Trade and Industry v Vane* [1998] 1 BCLC 259 at 267; *Secretary of State for Trade and Industry v Barnett* [1998] 2 BCLC 64 at 68-70; *Re Dawes and Henderson (Agencies) Ltd* [2000] 2 BCC 204 at 210; *Secretary of State for Trade and Industry v Collins & Ors* [2000] BCC 998 at 1003; *Re Britannia Homes Centres Ltd, Official Receiver v McCahill* [2001] 2 BCLC 63 at 71-74; *Hennelly v Secretary of State for Trade and Industry* [2004] EWHC 34 (Ch) para 63; *Secretary of State for Trade and Industry v Swan (No 2)* [2005] EWHC 2479 para 10; *Harris v Secretary of State for Business, Innovation and Skills* [2015] BCC 283 at 297; French, Mayson & Ryan *Mayson, French & Ryan on Company Law* 721; Hannigan *Company Law* 378; Belcher "What Makes a Director Fit: An Analysis of the Workings of Section 17 of the Company Directors Disqualification Act 1986" 402.

[594] *Hennelly v Secretary of State for Trade and Industry* [2004] EWHC 34 (Ch) para 63.

[595] [2000] BCC 998 at 1003.

[596] *Secretary of State for Trade and Industry v Collins & Ors* [2000] BCC 998 at 1003.

[597] *Secretary of State for Trade and Industry v Collins & Ors* [2000] BCC 998 at 1003.

[598] *Secretary of State for Trade and Industry v Collins & Ors* [2000] BCC 998 at 1003.

[599] *Secretary of State for Trade and Industry v Collins & Ors* [2000] BCC 998 at 1003.

[600] [2015] BCC 283 at 299.

Turning to Australian law, in exercising its discretion under section 206G of the Australian Corporations Act 2001 whether to grant leave to an applicant to manage a corporation, the Australian courts generally take into account the following factors: (i) the nature of the offence; (ii) the nature of the applicant's involvement in the offence; (iii) the applicant's general character; (iv) the structure of the companies in which the applicant may be a director; and (v) the assessment of the risk of those connected with the company and the public involved in the applicant assuming a position on the board.[601] The importance of protecting the public has been emphasised on the ground that those who have dealings with the company are entitled to find that they are dealing with persons of integrity and that the funds of the company are not dissipated by dishonest activities.[602] In the leading case of *Re Magna Alloys & Research Pty Ltd*[603] the Supreme Court of New South Wales stated as follows with regard to section 122 of the Companies Act, 1961 (the predecessor to section 206G of the Australian Corporations Act of 2001):

> "It is designed to protect the public and to prevent the corporate structure from being used to the financial detriment of investors, shareholders, creditors and persons dealing with the company. In its operation it is calculated to act as a safeguard against the corporate structure being used by individuals in a manner which is contrary to proper commercial standards."

In exercising their discretion to grant leave to an applicant to act as a director of a corporation in terms of section 206G of the Australian Corporations Act of 2001, the Australian courts also

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[601] These factors were first laid down in *Re Magna Alloys & Research Pty Ltd* (1975) 1 ACLR 28353 at 28354 and were adopted by subsequent courts. See for instance *Re Zim Metal Products Pty Ltd* (1977) ACLC 29556 at 29557-29559 (decided under s 122 of the Companies Act 1961 (Victoria), the equivalent provision to s 206G of the Australian Corporations Act of 2001); *In Re Marsden* (1981) 29 SASR 454 at 459-460; *Re Minimix Industries Ltd* (1982) 1 ACLC 511 at 512; *Re Hamilton-Irvine* (1990) 8 ACLC 1067 at 1071; *Murray v Australian Securities Commission* (1994) 12 ACLC 11 at 13-14; *Re Jarret* [1999] FCA 503 para 7; *Adams v Australian Securities & Investments Commission* [2003] FCA 557 para 8 and *Re Chapman* [2006] NSWSC 99 paras 7-10. For a further discussion of these factors see J Cassidy "Disqualification of Directors Under the Corporations Law" 228-234 and Austin & Ramsay *Ford, Austin and Ramsay's Principles of Corporations Law* para 7.191 at 279.

[602] *Re Minimix Industries Ltd* (1982) 1 ACLC 511 at 512. See further *Re Magna Alloys & Research Pty Ltd* (1975) 1 ACLR 28353 at 28354; *Re Van Reesema* (1975) 11 SASR 28249 at 28255; *Re Zim Metal Products Pty Ltd* (1977) ACLC 29556 at 29557; *Zuker v Commissioner for Corporate Affairs* [1980] ACLC 34334 at 34338; *In Re Marsden* (1981) 29 SASR 454 at 459; *Re Hamilton-Irvine* (1990) 8 ACLC 1067 at 1070; *Re C & J Hazell Holdings Pty Ltd and Related Companies* [1991] TASSC 11 paras 4-5; *Murray v Australian Securities Commission* (1994) 12 ACLC 11 at 13; *Hosken v Australian Securities and Investments Commission* [1998] TASSC 101 para 15; *Re Jarret* [1999] FCA 503 para 7 and *Re Chapman* [2006] NSWSC 99 paras 7 to 11 where the respective courts stressed the importance of protecting the public in considering whether to grant leave to a disqualified applicant to manage a corporation.

[603] (1975) 1 ACLR 28353 at 28354.

take into account the hardship on the company if leave were to be denied.[604] In *Re C & J Hazell Holdings Pty Ltd and Related Companies*[605] the Supreme Court of Tasmania held that there was substance in the contention that if the applicant (who had been convicted of contravening traffic legislation) were not granted leave to act as a director of various companies, the group would suffer detriment and the security of the employees would be weakened. The court found that while these matters are by no means decisive "they are material considerations".[606] The court subsequently granted the applicant's request for leave to act as a director of various companies.

Since the disqualification order contemplates that there will be hardship to the offender, hardship is not generally a compelling factor that is taken into account by Australian courts in exercising their discretion under section 206G of the Australian Corporations Act of 2001.[607] In *Re Van Reesema*[608] the Supreme Court of South Australia gave little weight to the suggestion made on behalf of the applicant that hardship to him should be taken into account when

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[604] *Re Zim Metal Products Pty Ltd* (1977) ACLC 29556 at 29559; *Zuker v Commissioner for Corporate Affairs* [1980] ACLC 34334 at 34340; *Re Minimix Industries Ltd* (1982) 1 ACLC 511 at 513; *Re Hamilton-Irvine* (1990) 8 ACLC 1067 at 1074; *Hosken v Australian Securities and Investments Commission* [1998] TASSC 101 para 15; J Cassidy "Disqualification of Directors Under the Corporations Law" 232-233. For example, in *Murray v Australian Securities Commission* (1994) 12 ACLC 11 the applicant was convicted of aiding and abetting an accountant to falsify books of a company whilst he was a director of the company. In light of the hardship that would be caused to the existing directors, the shareholders, the employees and customers of the company if the applicant were not granted leave to act as a director of the corporation, the Supreme Court of Western Australia exercised its discretion in favour of the applicant (at 14). The court held that the risk to the public could be minimised in this case by the imposition of appropriate conditions (at 14). One condition imposed by the court was that the company should be subject to audits during the period while the applicant was a director (at 14).

[605] [1991] TASSC 11 para 13.

[606] *Re C & J Hazell Holdings Pty Ltd and Related Companies* [1991] TASSC 11 para 13.

[607] *Re Van Reesema* (1975) 11 SASR 28249 at 28256; *Murray v Australian Securities Commission* (1994) 12 ACLC 11 at 14; *Adams v Australian Securities & Investments Commission* [2003] FCA 557 para 8; *Re Chapman* [2006] NSWSC 99 para 9; J Cassidy "Disqualification of Directors Under the Corporations Law" 232-233; Austin & Ramsay *Ford, Austin and Ramsay's Principles of Corporations Law* para 7.191 at 279. In *Adams v Australian Securities & Investments Commission* [2003] FCA 557 the Federal Court of Australia refused to grant leave to an applicant to manage a corporation even though a mere seven months of the original five year period of disqualification remained. The applicant had been convicted of defrauding the Commonwealth of sales tax revenue. The court was not persuaded by the director's evidence that it was essential that he be appointed a director of five companies in order for those companies to enter into a significant transaction (paras 25 and 32).

[608] (1975) 11 SASR 28249 at 28255. This case was decided under s 122 of the Companies Act 1962 (South Australia), which was the equivalent section to what is now s 206G of the Australian Corporations Act of 2001. In terms of s 122(2) of the Companies Act 1962 (South Australia) a person who was convicted of an offence in connection with the promotion, formation or management of a corporation or an offence involving fraud or dishonesty could apply to court for leave to act as a director to take part in the management of a company.

exercising its discretion whether to grant leave to him to act as a director on the ground that any hardship was "self created" and that it was envisaged by the statute.

While the factors referred to above are generally taken into account by the courts in Australia in exercising their discretion under section 206G of the Australian Corporations Act of 2001, they are not exhaustive.[609] The Supreme Court of Victoria stated in *Zuker v Commissioner for Corporate Affairs*[610] that these statements of principle do not seek to set out all the matters which a judge must take into account in determining whether to grant leave to an applicant to act as a director. They serve only to fix the area of enquiry.[611] Following the stance adopted in the UK, the Supreme Court of Victoria in *Zuker v Commissioner for Corporate Affairs*[612] cautioned that leave of the court to act as a director is not to be granted lightly.

It is submitted that in exercising its discretion in terms of section 162(12) of the (South African) Companies Act, South African courts should, as the UK courts do, in respect of their equivalent provision, bear in mind that the section is a protective remedy in the public interest.[613] Thus, in considering whether to suspend a delinquency order or to set aside a probation order, the courts must exercise caution. They should not, by suspending or setting aside the relevant order, prevent the achievement of this objective. The protection of the public includes all relevant interest groups, such as shareholders, employees, investors, customers, creditors and all those with whom the company will do business.[614] The protection of the public in this context is not explicitly specified in section 162(12) as a factor to be taken into account by a court in considering an application in terms of section 162(11) of the Companies Act. It is however

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[609] *Adams v Australian Securities & Investments Commission* [2003] FCA 557 para 8. In *Re Chapman* [2006] NSWSC 99 para 9 the Supreme Court of New South Wales agreed that these factors are not exhaustive.

[610] [1980] ACLC 34334 at 34339.

[611] In *Re C & J Hazell Holdings Pty Ltd and Related Companies* [1991] TASSC 11 para 5 the Supreme Court of Tasmania approved of this statement.

[612] [1980] ACLC 34334 at 34340.

[613] *Msimang NO and Another v Katuliiba and Others* [2013] 1 All SA 580 (GSJ) para 29; *Gihwala and Others v Grancy Property Limited and Others* 2017 (2) SA 337 (SCA) para 144; *Lewis Group Limited v Woollam* 2017 (2) SA 547 (WCC) para 40. See para 3.2 above where the purpose of s 162 of the Companies Act is discussed.

[614] *Re Minimix Industries Ltd* (1982) 1 ACLC 511 at 512; *Re Tech Textiles Ltd, Secretary of State for Trade and Industry v Vane* [1998] 1 BCLC 259 at 268; *Murray v Australian Securities Commission* (1994) 12 ACLC 11 at 13; *Secretary of State for Trade and Industry v Collins & Ors* [2000] BCC 998 at 1011; *Hennelly v Secretary of State for Trade and Industry* [2004] EWHC 34 (Ch) para 63.

submitted that the purpose of a court in considering whether the applicant has demonstrated satisfactory progress towards rehabilitation and whether there is a reasonable prospect that the applicant would be able successfully to serve as a director in the future, is to ensure that the applicant does not pose a risk to the public if the delinquency order were to be suspended or if the probation order were to be set aside. It follows that a court would implicitly take into account the protection of the public in exercising its discretion in terms of section 162(12) of the Companies Act, even if this factor is not explicitly specified in the provision.

It is further submitted that in accordance with the approach adopted in the UK and Australia, the hardship on the applicant should not weigh too heavily as a factor to be considered by a court in exercising its discretion in terms of section 162(12) of the Companies Act. As Zelling J asserted in the Supreme Court of South Australia in *Re Van Reesema*,[615] the protection of the public outweighs any hardship to the applicant since such hardship is self created.

3.11.3 Conditions

In *Re Brian Sheridan Cars Ltd Official Receiver v Sheridan*[616] the Chancery Division found that the approach of courts in the UK is not to tolerate imperfect compliance with conditions attached to a disqualification order. A similar approach has been adopted with regard to applications in terms of section 162(11) of the South African Companies Act. Section 162(12)(*a*) of the Companies Act prohibits a court from granting the order applied for under section 162(11) of the Companies Act unless the applicant has satisfied any conditions that were attached to the original order, or which are imposed on him when the court suspended the delinquency order and substituted it with a probation order. If an applicant has not satisfied such conditions, his application to suspend the delinquency order or to set aside the probation order would not be granted. A court does not have any discretion in this regard. It is submitted that section 162(12)(*a*) highlights the importance of the conditions imposed by a court on a delinquency order and a probation order. The monitoring of conditions, the determination of the conditions, the type of conditions and the breach of the conditions are discussed below.

[615] (1975) 11 SASR 28249 at 28256.

[616] [1996] 1 BCLC 327 at 342.

3.11.3.1 Monitoring of Conditions

An applicant must, in his application under section 162(11) of the Companies Act, prove that he has satisfied the conditions that were attached to the delinquency order or the probation order. For instance, if a court had imposed as a condition to the delinquency order that the director must undertake a designated programme of remedial education or carry out a designated programme of community service, the applicant must prove to the court that he has complied with this condition. It is advisable for directors who have had a delinquency order or probation order imposed on them to ensure that they retain evidence of compliance with the conditions imposed by the court. This would facilitate their application under section 162(11) of the Companies Act, should they decide to utilise this provision once the applicable period of time has elapsed.

The UK Court of Appeal in *Secretary of State for Trade and Industry v Collins & Ors*[617] cautioned against courts imposing conditions which are of such a nature that they are too easily disregarded and almost impossible to police. The court's concern was that a breach of a condition might well not come to light unless and until the company or another company managed by the disqualified director "has come to grief",[618] by which stage it would be too late to secure the intended protection for the public.

Since the compliance by the applicant with the conditions imposed by the court is fundamentally important in order to protect the public, it is advisable for a court to appoint someone to monitor whether the applicant does in fact comply with such conditions. This was done in *Hennelly v Secretary of State for Trade and Industry*[619] where the Chancery Division appointed the finance director of the company to provide quarterly reports to the Department of Trade and Industry on the level of compliance by the disqualified director with the conditions imposed by the court. Appointing someone to monitor the compliance by the applicant of the

[617] [2000] BCC 998 at 1018.

[618] *Secretary of State for Trade and Industry v Collins & Ors* [2000] BCC 998 at 1019. Hannigan also opines that there is little policing of disqualification orders in the UK once they have been put in place (Hannigan *Company Law* 386). Enforcement action is likely to arise only when the conduct of the disqualified director has been brought to the attention of the Secretary of State in some way. For instance, when another venture in which the disqualified director is involved collapses, or when a member of the public complains (Hannigan *Company Law* 386).

[619] [2004] EWHC 34 (Ch) para 68. The applicant had been a director of five companies and each of them had a history of the late filing of returns and a failure to pay money owed to the Crown.

conditions imposed by the court would facilitate an application under section 162(11) of the (South African) Companies Act since the appointed person would be in a position to report to the court on the extent of the applicant's compliance with the conditions imposed by the court.

An alternative suggestion to monitor compliance with the conditions by a director would be to require the director to lodge an affidavit with the court after a specified period of time confirming that he has complied with the conditions laid down by the court. Such a requirement was imposed in *Re Brian Sheridan Cars Ltd Official Receiver v Sheridan*[620] where the Chancery Division imposed a condition to the effect that within twenty one days of the date of the court order, the director must lodge an affidavit with the court confirming that all the conditions laid down by the court had been satisfied. Such a condition, the Chancery Division asserted, would serve to concentrate the mind of the director on the necessity to comply strictly with the terms of the court order.[621]

Another suggestion to monitor the compliance by the director would be to provide a copy of the court order and conditions imposed on the director on all parties affected by any failure of the director to comply with the conditions imposed. Such parties could be the shareholders and creditors of the company and, if applicable, the company's bank and the South African Revenue Services. It is submitted that if the fact that a delinquent director is functioning as a director under the terms of a suspended delinquency order were to be publicised to relevant parties, this would limit the risk of the director failing to fully comply with the conditions imposed by a court on him.

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[620] [1996] 1 BCLC 327 at 343.

[621] *Re Brian Sheridan Cars Ltd Official Receiver v Sheridan* [1996] 1 BCLC 327 at 346. The applicant in this case had been disqualified under s 6 of the UK Company Directors Disqualification Act 1986 for a period of three years. The court *a quo* had permitted him to continue to act as a director of certain companies for twelve months subject to specific conditions. The director had not complied strictly with the conditions relating to the appointment of auditors to the company and to the service of the court's judgment on various interested parties. He applied to court for leave to continue to act as a director of the company for a further period, with retrospective effect. The Chancery Division found that the director had been unacceptably casual in his attitude to complying with the conditions imposed on him. However since the two companies in respect of which the director had been granted leave to act as a director had, through his efforts, traded successfully, the court granted leave to the director to continue to act as such for a further year. But because of the non-compliance by the director with the conditions imposed on him by the court *a quo*, the Chancery Division refused to back date the new court order, as requested by the applicant. It also imposed a new condition that the applicant lodge an affidavit with the court within twenty one days confirming that every condition laid down by the court had been satisfied.

3.11.3.2 Determination of the Conditions

Section 162(11) of the Companies Act leaves it unclear whether, in his application to suspend the delinquency order and substitute it with a probation order, it is the applicant that must request the court to determine the conditions that should be imposed, or whether the court would of itself determine what these conditions should be.[622]

The approach adopted in the UK with regard to the imposition of conditions, as affirmed in *Re Tech Textiles Ltd, Secretary of State for Trade and Industry v Vane*[623] is that in many instances the applicant proposes in his application for leave in terms of section 17 of the UK Company Directors Disqualification Act 1986 the conditions that a court may put in place in order to protect the public. Bristoll states that most applicants offer fairly standard conditions drawn from the Secretary of State's guidelines which are tailored to the facts of their case.[624] In other instances the court sets the conditions itself.[625] Often the conditions of leave are a combination of those proposed by the applicant and those imposed by the court.[626]

For example, in *Re Gibson Davies Ltd*[627] the applicant applied to court in terms of section 17 of the UK Company Directors Disqualification Act 1986 for leave to act as a director. He proposed ten conditions that a court could consider imposing if it decided to grant the application. The Chancery Division duly granted the application for leave for the applicant to act as a director, subject to the ten conditions that were proposed by him.[628] In *Harris v Secretary of State for Business, Innovation and Skills*[629] the applicant had also proposed

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[622] J Du Plessis & Delport "'Delinquent Directors' and 'Directors under Probation': A Unique South African Approach Regarding Disqualification of Company Directors" 283.

[623] [1998] 1 BCLC 259 at 268.

[624] Bristoll "Permission to Act whilst Disqualified" 52. The guidelines issued by the Secretary of State include a list of information which should generally be included in an application for leave to act as a director, although the evidence must be tailored to the facts of the particular case (for a discussion of the Secretary of State's guidelines see Bristoll "Permission to Act whilst Disqualified" 53).

[625] Belcher "What Makes a Director Fit: An Analysis of the Workings of Section 17 of the Company Directors Disqualification Act 1986" 404.

[626] Belcher "What Makes a Director Fit: An Analysis of the Workings of Section 17 of the Company Directors Disqualification Act 1986" 404.

[627] [1995] BCC 11.

[628] *Re Gibson Davies Ltd* [1995] BCC 11 at 17-18.

conditions to the court which it could consider imposing if his application for leave to act as a director were granted. The court granted the applicant's application in respect of one company on the basis of the conditions imposed by him, but imposed its own additional conditions with regard to his appointment as a director of the second company. This was done in order to minimise the risk of harm to the public.[630] A similar approach is adopted by the courts in Australia with regard to the consideration of applications under section 206G of the Australian Corporations Act of 2001. In *Hosken v Australian Securities and Investments Commission*[631] the Supreme Court of Tasmania granted leave to the applicant to manage a corporation but imposed its own conditions with which it required the applicant to comply.

While the decision whether to impose conditions as well as the type of conditions to be proposed is in the discretion of the court that is considering the application under section 162(11) of the (South African) Companies Act, it is submitted that, in accordance with the approach adopted in the UK and Australia, it would be advisable for an applicant to propose appropriate conditions that a court may consider imposing, should it exercise its discretion to suspend the delinquency order. This would guide the court on the conditions to be imposed should the application succeed, in order to guard against a recurrence of the applicant's misconduct. A court may also be more inclined to suspend a delinquency order if the applicant is able to demonstrate that the conditions proposed by him would serve to protect the public from a recurrence of his misconduct.

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[629] [2015] BCC 283.

[630] *Harris v Secretary of State for Business, Innovation and Skills* [2015] BCC 283 at 295. These conditions are discussed in para 3.11.3.3 below.

[631] [1998] TASSC 101. This case was decided under s 229 of the Australian Corporations Act, 1989. This section was substantially in the same terms as s 206G of the Australian Corporations Act of 2001. In terms of s 229 of the Australian Corporations Act, 1989 where a person had been convicted of various offences he was disqualified from managing a corporation for a period of five years save with the leave of the court. The applicant in this case had been convicted of offences involving the improper use of his position as an officer of the corporation and for incurring a debt by the company at a time when it was improper to do so. The court granted leave to the applicant to manage the corporation subject to various conditions. Some of the conditions were that an accountant be appointed to supervise the business of the company, conditions restricting the amount of money that could be spent by the company without the prior consent of the accountant, and a condition that the applicant provide the accountant, on a monthly basis, with a list of all receipts and payments of the company and copies of all bank statements.

3.11.3.3 Type of Conditions

It is useful to examine the sort of conditions imposed by courts in the UK and Australia on disqualified directors to act as directors. This may provide guidance to South African courts on the appropriate conditions to impose in the event of a delinquency order being suspended in terms of section 162(12) of the (South African) Companies Act.

Some of the conditions generally imposed by courts in the UK in the context of an application in terms of section 17 of the UK Company Directors Disqualification Act 1986, are to appoint a third party to provide control or supervision over the director, to limit the roles which the director may undertake, conditions regarding the composition of the board of directors in the particular company, and conditions relating to accounting controls.[632] Examples of such conditions are that an independent chartered accountant or solicitor approved by the court acts as a co-director;[633] a director's loan owed by the company to the applicant not be repaid unless all the creditors of the company are first paid;[634] the applicant not be granted any security over the company's assets;[635] conditions relating to the countersigning of cheques;[636] conditions restricting the total emoluments that may be paid by the company to the applicant,[637] and an undertaking that the company would convene monthly board meetings and that these would be attended by a representative of the auditors.[638]

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[632] See *Re Gibson Davies Ltd* [1995] BCC 11 at 17-18; *Re Tech Textiles Ltd, Secretary of State for Trade and Industry v Vane* [1998] 1 BCLC 259 at 268; *Re Dawes and Henderson (Agencies) Ltd* [2000] 2 BCC 204 at 213; Hicks "Director Disqualification: Can it Deliver?" 447; Belcher "What Makes a Director Fit: An Analysis of the Workings of Section 17 of the Company Directors Disqualification Act 1986" 404; Bristoll "Permission to Act whilst Disqualified" 52 and Hannigan *Company Law* 378.

[633] *Re Majestic Recording Studios Ltd and Others* [1989] BCLC 1 at 7; *Secretary of State for Trade and Industry v Palfreman* [1995] BCC 193 at 196; *Re Brian Sheridan Cars Ltd Official Receiver v Sheridan* [1996] 1 BCLC 327 at 337; *Hennelly v Secretary of State for Trade and Industry* [2004] EWHC 34 (Ch) para 67.

[634] *Re Gibson Davies Ltd* [1995] BCC 11 at 17.

[635] *Re Gibson Davies Ltd* [1995] BCC 11 at 17; *Harris v Secretary of State for Business, Innovation and Skills* [2015] BCC 283 at 292.

[636] *Re Gibson Davies Ltd* [1995] BCC 11 at 17; *Re Tech Textiles Ltd, Secretary of State for Trade and Industry v Vane* [1998] 1 BCLC 259 at 272.

[637] *Re Gibson Davies Ltd* [1995] BCC 11 at 17; *Harris v Secretary of State for Business, Innovation and Skills* [2015] BCC 283 at 292.

[638] *Re Chartmore Ltd* [1990] BCLC 673 at 676; *Re Tech Textiles Ltd, Secretary of State for Trade and Industry v Vane* [1998] 1 BCLC 259 at 272; *Hennelly v Secretary of State for Trade and Industry* [2004] EWHC 34 (Ch) para 67.

In some instances UK courts have imposed conditions which are unusual and very specific to the offences committed by the applicant. Thus in *Harris v Secretary of State for Business, Innovation and Skills*[639] the applicant had applied for leave to be a director of three companies, which he claimed were inter linked. Some of the conditions which the applicant proposed to the court, in the context of his application in terms of section 17 of the UK Company Directors Disqualification Act 1986, were that without the court's permission he would not act as a director of any other company, he would not borrow money from the companies or accept security over their assets, and that he would receive only a board-approved salary.[640] The court granted his application for leave to be a director of one of the companies. In relation to the second company the court imposed additional specific conditions in order to minimise the risk of harm to the public. These conditions were that the applicant convert his loan into preference shares, an annual review of the company's assets and liabilities be undertaken by experienced, independent auditors, and that no dividends be paid that would have the effect of reducing the company's distributable profits to less than fifty thousand pounds.[641] The court did not grant the applicant's application with regard to the third company on the ground that his need to be reappointed as a director of that company was outweighed by the risks accompanying such an appointment.[642]

Turning to Australia, some of the conditions imposed by courts in terms of section 206G of the Australian Corporations Act of 2001 in granting leave to an applicant to manage a corporation, are conditions relating to the financial authority of the applicant,[643] and the appointment of an independent person to supervise the business of the company while the applicant was involved

[639] [2015] BCC 283.

[640] *Harris v Secretary of State for Business, Innovation and Skills* [2015] BCC 283 at 292.

[641] *Harris v Secretary of State for Business, Innovation and Skills* [2015] BCC 283 at 294.

[642] *Harris v Secretary of State for Business, Innovation and Skills* [2015] BCC 283 at 299-300.

[643] *Hosken v Australian Securities and Investments Commission* [1998] TASSC 101 para 15. The Supreme Court of Tasmania imposed conditions restricting the amount of money that could be spent by the company without the prior consent of the accountant who was appointed to supervise the business of the company.

in management.[644] In *Re Minimix Industries Ltd*[645] the Australian High Court granted leave to the applicant to be employed as a manager of a corporation on condition that he had no authority to sign cheques on the company's bank account for the remainder of his disqualification period. In *Re Chapman*[646] the Supreme Court of New South Wales granted the applicant's application in terms of section 206G of the Australian Corporations Act of 2001 to be a director subject to the condition that he could not be the sole signatory on any account maintained by the company with any bank or financial institution. A further example of a condition imposed by an Australian court (the Federal Court of Australia), provided in *Re Jarret*,[647] is that as a condition of permitting the disqualified applicant to be a director of a company, a registered auditor be appointed as the auditor of the company, and, in addition the company lodge audited accounts with ASIC while the applicant was acting as a director of the company. In *Re Hamilton-Irvine*[648] the Supreme Court of Norfolk Island (Australia) granted leave to the applicant to act as a director but only under the scrutiny of a chartered secretary or a registered auditor. The court ordered the applicant to personally bear the costs of retaining the services of the chartered secretary or the registered auditor.[649]

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[644] *Hosken v Australian Securities and Investments Commission* [1998] TASSC 101 para 15. The Supreme Court of Tasmania appointed an accountant to supervise the business of the company.

[645] (1982) 1 ACLC 511 at 513. This case was decided under s 188A, a section which was introduced by the 1980 Amendment Act. Section 188A was substantially in the same terms as s 206G of the Australian Corporations Act of 2001. In terms of s 188A, where a person had been convicted of any offence in connection with the promotion, formation or management of a company he was disqualified from being a director of a company for a period of five years save with the leave of the court, which could be given on such terms and conditions as the court considered fit. The applicant's offences in this case related to procuring goods by the use of a false name, a false address and valueless cheques.

[646] [2006] NSWSC 99 paras 18-19. The applicant had been automatically disqualified to act as a director in terms of s 206B(4) of the Australian Corporations Act of 2001 on the ground that he had executed a personal insolvency agreement under part X of the Bankruptcy Act 1966.

[647] [1999] FCA 503 para 9. The applicant in this case had been convicted of failing to act honestly in the exercise of his powers and discharge of his duties as a director with intent to deceive and defraud. The applicant had concealed the true nature of equitable interests which he held in a group of companies, and had in addition concealed the true reasons for payments made to a third party which were disguised as being genuine foreign exchange hedging transactions.

[648] (1990) 8 ACLC 1067 at 1075.

[649] *Re Hamilton-Irvine* (1990) 8 ACLC 1067 at 1075. The applicant had been convicted of charges in relation to the import of cargo into Norfolk Island. The court required the chartered secretary or the registered auditor to report periodically to the Controller of Customs whether the company had complied with the relevant provisions of the customs legislation. In *Hosken v Australian Securities and Investments Commission* [1998] TASSC 101 para 15 the Supreme Court of Tasmania affirmed that the power exists to require an applicant to bear the costs of the services of an independent scrutineer of the company.

It is submitted that the nature of the conditions to be imposed on a suspension of a delinquency order should be determined by the nature of the particular case. Courts must of course impose conditions that are enforceable and realistic.[650] It is evident that the conditions imposed by courts in the UK and Australia are specifically tailored to protect the public from the nature of the misconduct committed by the director, and to ensure that the public would be protected if the director were permitted to act as a director again or to manage a company. It is submitted that the South African courts should likewise impose conditions on the suspension of a delinquency order which relate specifically to the misconduct committed by the director, which had resulted in the original delinquency order being granted. The conditions imposed should ensure that the public would be protected if the delinquency order were suspended. For instance, if a director were declared delinquent because he had signed documents on behalf of the company despite knowing that he had lacked the authority to do so,[651] a condition that a court could appropriately impose, should it decide to suspend the declaration of delinquency, is that the director may not sign any documents, including cheques on the company's bank account, on behalf of the company. This would ensure that during the suspension of the delinquency order the risk of the director committing the same offence again would be minimised.

3.11.3.4 Breach of Conditions

Under the UK Company Directors Disqualification Act 1986 if a person contravenes a disqualification order (and by implication contravenes the conditions of a disqualification order) he commits both a criminal offence and a civil offence. In terms of section 13 of the UK Company Directors Disqualification Act 1986 if a person acts in contravention of a disqualification order he is liable on conviction on indictment to imprisonment for not more than two years or a fine, or both, and on summary conviction to imprisonment for more than six months or a fine not exceeding the statutory maximum, or both. Accordingly, the sanction for breach of a condition is severe in that the person would be acting in breach of a

[650] *Hennelly v Secretary of State for Trade and Industry* [2004] EWHC 34 (Ch) para 70.

[651] This is a ground of delinquency in terms of s 162(5)(*c*)(iv)(*bb*) of the Companies Act read with s 77(3)(*a*) of the Companies Act.

disqualification order and would commit a criminal offence.[652] In addition, a breach of a disqualification order in the UK exposes the director to potential personal liability.[653] Sections 15(1) and 15(2) of the UK Company Directors Disqualification Act 1986 state that a disqualified person involved in the management of a company in contravention of a disqualification order is personally liable, jointly and severally with the company, for the debts of the company incurred at that time.

It is of interest that Griffin states that the criminal sanction of imprisonment of two years or a fine, or both, is much too lenient in that it may encourage disqualified directors to continue to act in a managerial position in contravention of the terms of the disqualification order.[654] His concern is that a disqualified director may regard the financial reward of participating in a managerial capacity in a company as outweighing the risk of detection and the possibility of imprisonment or a fine.[655] Griffin suggests that a breach of a disqualification order (and by implication, a breach of the conditions of a disqualification order) should be punished by a criminal sanction of a minimum term of imprisonment of one year and a fine and a maximum term of imprisonment of five years and a fine.[656]

The (South African) Companies Act is silent on the consequences of a director failing to comply with the conditions imposed on him while his delinquency order is suspended. It is submitted that the word "suspended" in section 162(11) of the Companies Act implies that the "suspension" of the delinquency order may be revoked, and that the original delinquency order may be reinstated. On this basis, it is arguable that if a director were to breach any of the conditions imposed on him in terms of section 162(11) of the Companies Act, the original delinquency order could be reinstated in full. The director would thus have to serve out the full term of the original delinquency order imposed on him. If a director breaches the conditions

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[652] *Re Brian Sheridan Cars Ltd Official Receiver v Sheridan* [1996] 1 BCLC 327 at 346; *Secretary of State for Trade and Industry v Collins & Ors* [2000] BCC 998 at 1018; Griffin "The Disqualification of Unfit Directors and the Protection of the Public Interest" 220; Hannigan *Company Law* 378.

[653] *Re Brian Sheridan Cars Ltd, Official Receiver v Sheridan* [1996] 1 BCLC 327 at 346; Davies & Worthington *Gower Principles of Modern Company Law* 239.

[654] Griffin "The Disqualification of Unfit Directors and the Protection of the Public Interest" 228.

[655] Griffin "The Disqualification of Unfit Directors and the Protection of the Public Interest" 228.

[656] Griffin "The Disqualification of Unfit Directors and the Protection of the Public Interest" 228.

imposed on him while under a probation order, he must in terms of section 162(5)(*b*) of the Companies Act be declared a delinquent director.[657]

The delinquency remedy under the (South African) Companies Act is a civil remedy.[658] It follows that the breach of a delinquency order or of a suspended delinquency order would be a civil, and not a criminal, offence. Nevertheless, if a delinquency order were suspended by a court and the conditions attached to it were thereafter breached by a director, it is submitted that the director ought to be severely punished by a court. The suspension of a delinquency order is an indulgence granted by a court to a delinquent director. Any conditions attached to the suspension of a delinquency order must be scrupulously observed and fully respected and complied with by a director. As the Chancery Division in *Re Brian Sheridan Cars Ltd Official Receiver v Sheridan*[659] emphasised, it is of "cardinal importance" that any conditions imposed by a court on a disqualified director are strictly observed. It is not clear from the (South African) Companies Act whether a court would be empowered to extend the delinquency period to a term longer than the original period of delinquency, in the event of a director breaching the conditions of a suspended delinquency order. This must be clarified by the legislature by amending legislation.

3.11.4 The Statutory Requirements in Considering a Section 162(11) Application

Section 162(12)(*b*) of the Companies Act provides statutory guidance to the courts in exercising their discretion in considering an application in terms of section 162(11), as follows:

> "On considering an application contemplated in subsection (11), the court may-
> (a) . . .
> (b) grant an order if, having regard to the circumstances leading to the original order, and the conduct of the applicant in the ensuing period, the court is satisfied that –
> (i) the applicant has demonstrated satisfactory progress towards rehabilitation; and

[657] Section 162(5)(*b*) of the Companies Act states that a court must make an order declaring a person a delinquent director if, while under a probation order, the person acted as a director in a manner that contravened the probation order. If a director were to breach the conditions imposed to a probation order, this would arguably constitute a breach of the probation order itself.

[658] In *Grancy Property Limited v Gihwala* 2014 JDR 1292 (WCC) para 155 the Western Cape Division, Cape Town affirmed that the innovation in s 162 of the Companies Act is that it introduces a new civil remedy for those harmed by the conduct of delinquent directors.

[659] [1996] 1 BCLC 327 at 346.

(ii) there is a reasonable prospect that the applicant would be able to serve successfully as a director of a company in the future."

The word "and" in section 162(12)(*b*)(i) makes it clear that both the requirements in section 162(12)(*b*)(i) and 162(12)(*b*)(ii) must be satisfied before a court may consider suspending or setting aside a delinquency order or probation order. The applicant bears the onus of convincing a court that the requirements in section 162(12)(*b*) of the Companies Act have been fulfilled. These requirements are discussed below.

3.11.4.1 The Circumstances Leading to the Original Order

This factor requires a court to consider the reason why the director was initially declared delinquent or placed under probation. The importance of considering the circumstances leading to the original order is also a factor which is taken into account by courts in the UK in considering whether or not to grant leave in terms of section 17 of the UK Company Directors Disqualification Act 1986. In *Re Barings plc and Others (No 3), Secretary of State for Trade and Industry v Baker and Others*[660] the Chancery Division stated that the improprieties that had led to and had required the making of a disqualification order must be kept clearly in mind when considering whether to grant leave in terms of section 17 of the UK Company Directors Disqualification Act 1986. The court asserted as follows:

> "The court in considering whether or not to grant leave should, in particular, pay attention to the nature of the defects in company management that led to the disqualification order and ask itself whether, if leave were granted, a situation might arise in which there would be a risk of recurrence of those defects."[661]

In *Secretary of State for Trade and Industry v Collins & Ors*[662] the UK Court of Appeal emphasised that in considering whether to grant leave to a disqualified director to act as a director, due weight must be given to the seriousness of the conduct which had led to the disqualification order. In *Re Tech Textiles Ltd, Secretary of State for Trade and Industry v Vane*[663] the Chancery Division regarded the misappropriation of assets and acting knowingly

[660] [1999] 1 All ER 1017 at 1020.

[661] *Re Barings plc and Others (No 3), Secretary of State for Trade and Industry v Baker and Others* [1999] 1 All ER 1017 at 1024.

[662] [2000] BCC 998 at 1017.

[663] [1998] 1 BCLC 259 at 268.

in breach of duty as factors that would weigh more heavily against an applicant in terms of an application under section 17 of the UK Company Directors Disqualification Act 1986. In *Re Barings plc and Others (No 3), Secretary of State for Trade and Industry v Baker and Others*[664] the Chancery Division stated that some of the factors that UK courts consider to "loom very large" in an application in terms of section 17 of the UK Company Directors Disqualification Act 1986 are if the conduct of the director involved dishonesty, if the company had been allowed to continue trading while it was insolvent, and if a director had been withdrawing excessive amounts of remuneration in anticipation of the collapse of the company and in effect living off the company's creditors. In *Hennelly v Secretary of State for Trade and Industry*[665] the Chancery Division affirmed that a heavier burden of convincing the court to grant an application for leave to act as a director fell on the applicant in light of the gravity of the allegations against him. The Chancery Division was however persuaded to grant leave to the applicant to be appointed a director, in terms of section 17 of the UK Company Directors Disqualification Act 1986, because he had been disqualified for serious mismanagement and for want of commercial probity, but not for dishonesty.[666] The presence of dishonesty generally makes it unlikely that leave in terms of section 17 of the UK Company Directors Disqualification Act 1986 would be granted.[667]

In considering an application in terms of section 206G(1) of the Australian Corporations Act of 2001 for leave to manage a corporation, Australian courts also take into account the nature

[664] [1999] 1 All ER 1017 at 1020.

[665] [2004] EWHC 34 (Ch) para 62. The applicant had been disqualified to act as a director because five companies of which he had been the sole effective director had gone into insolvent liquidation with large debts. Together the five companies owed approximately ten million pounds to creditors and approximately five million pounds to the Crown. All five companies also had a history of the late filing of returns.

[666] [2004] EWHC 34 (Ch) para 74. For a discussion of this case see Goddard "Leave to Act and the Disqualified Director: *Re Hennelly's Utilities Ltd*" 222-223.

[667] *Secretary of State for Trade and Industry v Barnett* [1998] 2 BCLC 64 at 72; Goddard "Leave to Act and the Disqualified Director: *Re Hennelly's Utilities Ltd*" 222; Bristoll "Permission to Act whilst Disqualified" 51.

of the offence committed by the applicant.[668] In *Re Magna Alloys & Research Pty Ltd*[669] the Supreme Court of New South Wales remarked that in a case which involves dishonesty in the handling of money a court would be particularly reluctant to grant leave to an applicant to manage a corporation because it would not want to afford the person "an opportunity of renewing his depredations". Where the offence pertains to promoting or conducting company affairs, a company is less likely to grant leave to the applicant to manage a company.[670] In *Re Van Reesema*[671] the Supreme Court of South Australia declined to grant leave to an applicant to manage two companies on the ground that the offences involved dishonesty and a degree of premeditation.[672] On the other hand, where the offence is not connected with the conduct of a company's affairs, Australian courts are more likely to grant leave to an applicant to manage a corporation.[673] For example in *Re Zim Metal Products*[674] the applicant had been convicted of an offence of having received stolen goods knowing or believing them to have been stolen. One of the factors which persuaded the Supreme Court of Victoria to grant leave to the applicant to take part in the management of the company was that the offences did "not really arise out of

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[668] *Re Magna Alloys & Research Pty Ltd* (1975) 1 ACLR 28353 at 28354; *Re Van Reesema* (1975) 11 SASR 28249 at 28256; *Re Zim Metal Products Pty Ltd* (1977) ACLC 29556 at 29559; *Zuker v Commissioner for Corporate Affairs* [1980] ACLC 34334 at 34340; *In Re Marsden* (1981) 29 SASR 454 at 459; *Re C & J Hazell Holdings Pty Ltd and Related Companies* [1991] TASSC 11 para 4; *Murray v Australian Securities Commission* (1994) 12 ACLC 11 at 13; *Re Chapman* [2006] NSWSC 99 paras 9 and 13; J Cassidy "Disqualification of Directors Under the Corporations Law" 229; Austin & Ramsay *Ford, Austin and Ramsay's Principles of Corporations Law* para 7.191 at 279.

[669] (1975) 1 ACLR 28353 at 28355. In this case the applicant had been convicted of conspiring to offer agents valuable consideration in the nature of a secret commission. Even though the Supreme Court of New South Wales found that the offence was "reprehensible" (at 28356) it granted leave to the applicant to be involved in the management of the company. The court was persuaded to grant leave to the applicant based on the fact that the offence did not involve dishonesty in the handling of money. The court found that the offence was of such a character and had occurred in such circumstances that it believed that the offence was unlikely to be repeated by the applicant (at 28355).

[670] *Re Van Reesema* (1975) 11 SASR 28249 at 28256; J Cassidy "Disqualification of Directors Under the Corporations Law" 229.

[671] (1975) 11 SASR 28249 at 28256.

[672] The offences committed by the applicant were that while he was a director and involved in the management of investment companies, he had received money on trust from public investors contrary to various laws; he had falsely told such investors that their moneys had been secured over certain property; he had falsified documents, and he had represented such documents to be court judgments as a means of extracting the payment of overdue debts.

[673] *Re Zim Metal Products Pty Ltd* [1977] ACLC 29556 at 29559 (decided under s 122 of the Companies Act 1961 (Victoria), the equivalent provision to s 206G of the Australian Corporations Act of 2001); *Re Minimix Industries Ltd* (1982) 1 ACLC 511 at 512; *Re C & J Hazell Holdings Pty Ltd and Related Companies* [1991] TASSC 11 para 13; J Cassidy "Disqualification of Directors Under the Corporations Law" 230.

[674] [1977] ACLC 29556.

or relate to the management or conduct of the company."[675] The court found that the offences had occurred on the premises of the company but were related more to the fact that the applicant was doing work at the company than to the fact that he was a director of the company.[676] In a similar vein, in *Re Minimix Industries Ltd*[677] the applicant's offences related to procuring goods by the use of a false name, a false address and valueless cheques. The court found that these offences were not connected in any way to the applicant's position in the company.[678] This factor influenced the company in its decision to grant leave to the applicant to manage the corporation. In *Re C & J Hazell Holdings Pty Ltd and Related Companies*[679] the applicant had been convicted of infringing certain offences in terms of traffic legislation. As a consequence of the conviction the applicant was disqualified from being a director. In granting the applicant's application for leave to act as a director of various companies the Supreme Court of Tasmania held that there was no risk that the applicant's reinstatement as a director would pose any danger to shareholders, employees, competitors, customers or anyone including Government departments with whom he or any of the companies was likely to have dealings.[680]

In accordance with the approach adopted by the UK courts, it is submitted that in considering the circumstances leading to the original delinquency or probation order, a court should take into account the gravity of the misconduct which led to the original order. A heavier burden of convincing the court to grant an application in terms of section 162(11) of the Companies Act should lay on an applicant who has committed a more serious offence which resulted in the original order. For instance, if the applicant had intentionally inflicted harm upon the company, as opposed to doing so by gross negligence[681] this factor should weigh more heavily against the applicant since an intentional infliction of harm is more serious than an infliction of harm by gross negligence.

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[675] *Re Zim Metal Products Pty Ltd* [1977] ACLC 29556 at 29559.

[676] *Re Zim Metal Products Pty Ltd* [1977] ACLC 29556 at 22559.

[677] (1982) 1 ACLC 511.

[678] *Re Minimix Industries Ltd* (1982) 1 ACLC 511 at 512.

[679] [1991] TASSC 11.

[680] *Re C & J Hazell Holdings Pty Ltd and Related Companies* [1991] TASSC 11 para 10.

[681] This ground of delinquency is set out in s 162(5)(*c*)(iii) of the Companies Act.

It is further submitted that in considering the circumstances leading to the original order, in accordance with the approach adopted in Australia, a distinction should be made between offences which are connected with the conduct of a company's affairs and those which are unrelated to the company's affairs. The grounds of delinquency listed in sections 162(5)(*b*),[682] (*c*)[683] and (*f*)[684] of the Companies Act relate to offences committed by a director while he was a director of the company and relate to the company's affairs. The grounds of delinquency referred to in sections 162(5)(*d*)[685] and (*e*)[686] of the Companies Act do not necessarily relate to offences committed by a director in connection with the conduct of the company's affairs. If for example an applicant were declared delinquent on the basis that he had twice been personally convicted of an offence in terms of legislation which does not relate to his position as a director in a company, it is submitted that this factor should be taken into account by a court, in favour of the applicant, in considering whether to suspend the delinquency order in terms of section 162(12) of the Companies Act.

3.11.4.2 The Conduct of the Applicant in the Ensuing Period

This element of section 162(12)(*b*) of the Companies Act relates to the manner in which the applicant has conducted himself from the time that the delinquency order or probation order was made to the time of the application under section 162(11) of the Companies Act. The term "conduct" is a broad one. The Companies Act provides no guidance on whether a court should only take into account the applicant's conduct in relation to his dealing with companies, or whether his conduct generally is to be taken into account. In the absence of any statutory guidance on this point, it is submitted that a court should take into account both the conduct of the applicant in relation to his dealings with companies, as well as the general conduct of the

[682] This offence relates to acting as a director in a manner that contravenes a probation order.

[683] These offences relate to a director grossly abusing his position, taking personal advantage of information or an opportunity, intentional or gross negligence, infliction of harm upon the company, committing gross negligence, wilful misconduct or breach of trust and fraudulent conduct. See para 3.4 above where the grounds of delinquency are discussed in detail.

[684] This offence relates to being a director of one or more companies which were convicted of an offence or subjected to an administrative fine or similar penalty.

[685] This offence relates to a director being personally subject to a compliance notice or similar enforcement mechanism for substantially similar conduct in terms of any legislation.

[686] This offence relates to a director being at least twice personally convicted of an offence or subjected to an administrative fine or similar penalty, in terms of any legislation.

applicant which may demonstrate progress of rehabilitation and the applicant's prospects of being able to serve successfully in the future as a director of a company.

In considering an application in terms of section 17 of the UK Company Directors Disqualification Act 1986, a director's conduct in relation to his dealings with companies is taken into account by the UK courts. In *Re Tech Textiles Ltd, Secretary of State for Trade and Industry v Vane*[687] the Chancery Division remarked, in relation to this factor, that if a director had acted as a director whilst the disqualification proceedings were pending, it would be relevant for the court to determine whether the company or companies had carried on business satisfactorily. Relevant factors to consider are whether the companies were trading profitably, whether they had complied with their obligations under the relevant company legislation, fiscal legislation and other applicable legislation, and whether the companies had paid their liabilities in full.[688]

Australian courts likewise, in considering whether or not to grant leave to a disqualified director to act as a director, take into account the conduct of the applicant in the period from the time of the disqualification order to the time of the application for leave to act as a director.[689] This factor has been particularly persuasive in cases where leave has been successfully granted to an applicant to act as a director.[690] For example, in granting leave to the applicant to act as a director in *Zuker v Commissioner for Corporate Affairs*,[691] the Supreme Court of Victoria attached much significance to the applicant's good behaviour since the time of his disqualification to act as a director. The court regarded the applicant's good behaviour as "strong positive reasons"[692] for exercising its discretion in the applicant's favour. In *In Re*

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[687] [1998] 1 BCLC 259 at 269.

[688] In *Re Tech Textiles Ltd, Secretary of State for Trade and Industry v Vane* [1998] 1 BCLC 259 at 269.

[689] *Re Van Reesema* (1975) 11 SASR 28249; *Re Zim Metal Products Pty Ltd* [1977] ACLC 29556 at 29558; *Zuker v Commissioner for Corporate Affairs* [1980] ACLC 34334 at 34340; *In Re Marsden* (1981) 29 SASR 454 at 466; *Hosken v Australian Securities and Investments Commission* [1998] TASSC 101 para 15; *Re Chapman* [2006] NSWSC 99 para 9.

[690] J Cassidy "Disqualification of Directors Under the Corporations Law" 231.

[691] [1980] ACLC 34334 at 34340.

[692] *Zuker v Commissioner for Corporate Affairs* [1980] ACLC 34334 at 34340. The applicant had been convicted of conspiring with certain persons to utter forged documents purporting to be genuine Federal Reserve Notes of the USA with intent to defraud. After his release from prison five years later, the applicant applied for leave to act as a director of a small, family tannery business. His application was successful. The tannery business was thereafter sold, and the applicant sought leave again to take part in the management of the purchaser's business.

Marsden[693] the applicant had been convicted of the offences of breaching his duty to act honestly and failing to exercise due diligence and care in the discharge of his powers as a director. The applicant had misappropriated a portion of the company's funds and had attempted to cover this up by means of a false auditor's report to the shareholders and the stock exchange. The fact that the applicant had subsequently been involved in the management of two companies for a period of twelve months without any complaint persuaded the Supreme Court of South Australia to grant leave to the applicant to act as a director.[694]

In considering an application in terms of section 162(11) of the (South African) Companies Act it is submitted that, following the approach adopted in the UK and Australia, a court should take into account whether the applicant has successfully acted as a director of any other companies while the original delinquency or probation proceedings were pending, and thereafter. It should assess whether the companies were trading profitably, whether they had complied with their obligations under the relevant company legislation, income tax and other applicable legislation, whether the companies had paid their liabilities in full and whether there had been any complaints against the applicant during the period that he had been acting as a director of a company. Of course, if the delinquency order had prohibited the applicant from acting as a director of any company at all, these factors would not be relevant to the applicant's application in terms of section 162(11) of the Companies Act. In such event, it is submitted that a court should take into account the applicant's general conduct in the ensuing period and consider whether his general conduct was respectable. For instance, dishonest conduct by an applicant in the period since the delinquency order or probation order was made would be a relevant factor for a court to take into account in considering an application in terms of section 162(11) of the Companies Act. If the applicant had tried to mislead the court in his application in terms of section 162(11), this would be a factor that ought to weigh heavily against the applicant. For example, in *Re Van Reesema*,[695] one of the grounds on which the Supreme Court

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The application was brought under s 122 of the Companies Act 1961 (Victoria) (the equivalent section to what is now s 206G of the Australian Corporations Act of 2001).While the court believed that the gravity of the crime was a matter to be taken into account, the applicant's good behaviour since his release from prison and the fact that he had been acting as a director of the tannery business for the previous twelve months without complaint, influenced the court to grant the applicant's application.

[693] (1981) 29 SASR 454.

[694] *In Re Marsden* (1981) 29 SASR 454 at 466.

[695] (1975) 11 SASR 28249 at 28252.

of South Australia refused to grant leave to a disqualified director to manage a corporation was that his affidavit in court had been misleading and "less than frank". In *Re Zim Metal Products Pty Ltd*[696] the Supreme Court of Victoria emphasised that had it been satisfied that the applicant had sought to mislead the court in his application to act as a director, it would "be difficult to conceive of circumstances which would warrant the court granting him the leave he now seeks."

In order for a court to assess the conduct of the applicant in the ensuing period, a reasonable period of time must have elapsed since the delinquency or probation order was made. In *Re Zim Metal Products Pty Ltd*[697] the Supreme Court of Victoria found that the period of time from the disqualification order to the time of the application for leave to act as a director, which was one month, was too short for it to attach much weight to the applicant's conduct. Since an application in terms of section 162(11) of the (South African) Companies Act to suspend an order of delinquency or to set aside an order of probation may not be made until at least three years or two years have respectively passed, it is submitted that this would be sufficient time for a court to assess the conduct of the applicant in the ensuing period, and to determine whether it indicates that the applicant has made satisfactory progress towards rehabilitation.

3.11.4.3 Rehabilitation of the Director

This factor in section 162(12)(*b*)(i) of the Companies Act requires a court to determine whether, based on the circumstances leading to the original order and the conduct of the applicant in the ensuring period, the court is satisfied that the applicant has demonstrated satisfactory progress towards rehabilitation. The Companies Act does not define the term "rehabilitation" in the context of section 162(12)(*b*)(i), nor does it provide any guidance on the factors a court should take into account to assess whether the applicant has made satisfactory progress towards "rehabilitation". This means that courts would have to develop criteria or standards for determining whether the applicant has demonstrated satisfactory progress towards "rehabilitation". In terms of section 162(12)(*b*)(i) of the Companies Act, the applicant need not have been fully rehabilitated for a court to suspend a delinquency order or set aside a probation order – he merely needs to demonstrate "satisfactory progress" towards

[696] [1977] ACLC 29556 at 29558.

[697] [1977] ACLC 29556 at 29558.

rehabilitation.

As discussed,[698] the term "rehabilitation" is akin to the term "reformation,"[699] which term was found by the High Court of Australia in *Rich v Australian Securities and Investments Commission*[700] to resemble sentencing principles under the criminal law.[701] In criminal law the concept of being rehabilitated means that the offender has learnt new values, he has reformed and is now fit to take his place in society.[702] The term "rehabilitation" or "reformation" connotes positive impressions of the betterment of individuals.[703] In criminal law rehabilitation seeks to modify behaviour by changing the moral outlook of the offender.[704] The notion of whether an offender is rehabilitated or has reformed focuses attention on the offender as an individual, as opposed to the offence itself or the harm caused by the offence.[705] In the penal context the rehabilitation of a criminal is achieved either while the offender is incarcerated in prison, through rehabilitation programmes, or through making the completion of some rehabilitation programme a condition of the suspension of a punishment of imprisonment.[706]

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[698] See para 3.2 above.

[699] *S v Nkambule* [1993] 1 All SA 485 (A) at 491; Terblanche *Guide to Sentencing in South Africa* 163. Ashworth states that in the criminal law context the term "reform" which is used as a synonym for "rehabilitation", tends to be written more fully as "reformation of character", thereby indicating the true target of methods employed to reform an offender (see Ashworth "Rehabilitation" in Von Hirsh, Ashworth & Roberts *Principled Sentencing: Readings on Theory and Policy* 2).

[700] [2004] 220 CLR 129 para 52.

[701] J Du Plessis and Delport also maintain that the term "rehabilitation" used in s 162(12)(*b*)(i) of the Companies Act sounds like a criminal-law issue (J Du Plessis & Delport "'Delinquent Directors' and 'Directors under Probation': A Unique South African Approach Regarding Disqualification of Company Directors" 284).

[702] *S v Nombewu* 1996 (12) BCLR 1635 (E) at 1647; Gillies *Criminal Law* 7; Terblanche *Guide to Sentencing in South Africa* 163; Ashworth "Rehabilitation" in Von Hirsh, Ashworth & Roberts *Principled Sentencing: Readings on Theory and Policy* 2; Easton & Piper *Sentencing and Punishment: The Quest for Justice* 112; Kemp et al *Criminal Law in South Africa* 23.

[703] Bronitt & McSherry *Principles of Criminal Law* 22; Kemp et al *Criminal Law in South Africa* 23.

[704] Bronitt & McSherry *Principles of Criminal Law* 22; Ashworth "Rehabilitation" in Von Hirsh, Ashworth & Roberts *Principled Sentencing: Readings on Theory and Policy* 2 and 4.

[705] Ashworth *Sentencing and Criminal Justice* 86.

[706] Gillies *Criminal Law* 7; Terblanche *Guide to Sentencing in South Africa* 163; Ashworth "Rehabilitation" in Von Hirsh, Ashworth & Roberts *Principled Sentencing: Readings on Theory and Policy* 6; Ashworth *Sentencing and Criminal Justice* 86.

The notion of rehabilitation is thus based on the premise that the delinquent may be re-educated to become a useful member of society.[707]

The completion of rehabilitation programmes in the penal context is relevant as evidence of a reduced need for public protection from the offender.[708] If an applicant is rehabilitated or reformed the implication is that he is unlikely to commit the misconduct again. In *Re Grayan Building Services Ltd*[709] the UK Court of Appeal stressed that the question of whether a director has shown himself unlikely to offend again is highly material to whether he should be granted leave to act as a director. It is imperative to guard against a recurrence of the misconduct by the director in order to protect the public from the misconduct that had led to the original order.

In *Grancy Property Limited v Gihwala*[710] the Western Cape Division, Cape Town stated that an applicant would most probably not be able to demonstrate satisfactory progress towards rehabilitation in a period shorter than three years. An applicant under section 162(11) of the Companies Act would have to present evidence to the court over a period of at least three years demonstrating that he has made satisfactory progress towards rehabilitation. The applicant could, for instance, present evidence to the court showing that he has complied satisfactorily with all the conditions imposed by the court on the order of delinquency. While the compliance with the conditions imposed by a court is one of the factors that a court would take into account in considering the application to suspend or set aside the order of delinquency or probation,[711] compliance with the conditions imposed by a court may also serve to demonstrate that an applicant has made satisfactory progress towards rehabilitation. For instance, compliance by an applicant with a condition that he undertakes a designated programme of remedial education relevant to his conduct as a director, or that he carries out a designated programme of

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[707] *S v Nombewu* 1996 (12) BCLR 1635 (E) at 1647; Ashworth "Rehabilitation" in Von Hirsh, Ashworth & Roberts *Principled Sentencing: Readings on Theory and Policy* 2; Ashworth *Sentencing and Criminal Justice* 86; Easton & Piper *Sentencing and Punishment: The Quest for Justice* 112; Kemp et al *Criminal Law in South Africa* 23.

[708] *S v Matthee* 1971 (3) SA 769 (A) at 771; *S v Nkambule* [1993] 1 All SA 485 (A) at 491; Ashworth "Rehabilitation" in Von Hirsh, Ashworth & Roberts *Principled Sentencing: Readings on Theory and Policy* 6.

[709] [1995] Ch 241 at 254.

[710] 2014 JDR 1292 (WCC) para 195.

[711] Section 162(12)(*a*) of Companies Act, discussed in para 3.11.3 above.

community service[712] may indicate to a court that the applicant has made progress towards rehabilitation, and that there is a reduced need for public protection from the applicant. As suggested,[713] courts ought to make more effective use of their power to impose appropriate ancillary conditions to declarations of delinquency so as to facilitate the rehabilitation of delinquent directors.

If an applicant were permitted to be a director of another company he would be able to present evidence to the court of his conduct as a director in the other company during the delinquency order that demonstrates his progress towards rehabilitation. Likewise, if the applicant were under a probation order and was permitted to act as a director subject to the conditions imposed by the court, he could again present evidence to the court of his conduct as a director during the probation order that demonstrates his progress towards rehabilitation.

Presenting evidence of rehabilitation would be more challenging in the case of an applicant who has been absolutely prohibited from being a director of any company during the delinquency period. Such an applicant may present evidence to the court demonstrating that his conduct in the previous three years in a position other than a director, indicates that he is on the path towards rehabilitation. For instance, if the applicant were appointed as a manager of a company (in the position of an employee, as opposed to a director) and has satisfactorily complied with all his duties without any complaint from any party, this would indicate satisfactory progress towards rehabilitation. Alternatively, if the applicant had successfully carried on a business as a sole trader (with unlimited liability) during the delinquency period, this may serve as evidence to a court that the applicant has made satisfactory progress towards rehabilitation. It would be important for an applicant who intends to apply to court for his delinquency order or probation order to be suspended or set aside to ensure that during the period of delinquency or probation, he takes steps towards rehabilitation, and that he is able to present the court with sufficient evidence demonstrating satisfactory progress towards his rehabilitation.

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[712] These conditions may be imposed by a court to a delinquency order or a probation order in terms of ss 162(10)(*a*) and (*b*) of the Companies Act.

[713] See para 3.6.3 above and R Cassim "Delinquent Directors under the Companies Act 71 of 2008: *Gihwala v Grancy Property Limited* 2016 ZASCA 35"at 25.

3.11.4.4 Reasonable Prospect of Serving Successfully as a Director in the Future

This factor requires the court to consider whether the applicant is likely to be a future risk to the public, as opposed to focusing on the director's past misconduct. The court would have to determine whether, based on the circumstances leading to the original order and the conduct of the applicant in the ensuing period, it is satisfied that there is a "reasonable prospect" of the applicant being able to serve successfully as a director of a company in the future. It is not clear what a "reasonable prospect" would comprise since the Companies Act does not define this term in the context of section 162(12)(*b*)(ii). Its meaning has been left to the courts to determine.

In *Southern Palace Investments 265 (Pty) Ltd v Midnight Storm Investments 386 Ltd*[714] the Western Cape Division, Cape Town examined the meaning of the phrase "reasonable prospect" in section 131(4)(*a*) in the context of business rescue proceedings.[715] The court stated that a "reasonable prospect" indicates that something less is required than a reasonable probability.[716] In *Oakdene Square Properties (Pty) Ltd and Others v Farm Bothasfontein (Kyalami) (Pty) Ltd and Others*[717] the Supreme Court of Appeal agreed with this interpretation of the phrase "reasonable prospect". It proclaimed that the concept of a "reasonable prospect" is a lesser requirement than a "reasonable probability" but more than a mere *prima facie* case or an arguable possibility.[718] The Supreme Court of Appeal placed emphasis on the fact that the prospect must be "reasonable", which it said means that it must be a prospect based on

[714] 2012 (2) SA 423 (WCC).

[715] Section 131(4)(*a*) of the Companies Act deals with a court order to commence business rescue proceedings. In terms of s 131(1) an affected person may apply to court for an order placing a company under supervision and commencing business rescue proceedings. After considering the application a court may make an order placing the company under supervision and commencing business rescue proceedings if it is satisfied that (i) the company is financially distressed; (ii) the company has failed to pay over any amount in terms of an obligation or in terms of a public regulation or contract with respect to employment matters; or (iii) it is otherwise just and equitable to do so for financial reasons, and there is a "reasonable prospect" for rescuing the company (s 131(4)(*a*)).

[716] *Southern Palace Investments 265 (Pty) Ltd v Midnight Storm Investments 386 Ltd* 2012 (2) SA 423 (WCC) para 21. In *Nedbank Ltd v Bestvest 153 (Pty) Ltd; Essa and Another v Bestvest 153 (Pty) Ltd and Others* 2012 (5) SA 497 (WCC) para 39 the court agreed with this interpretation of the phrase "reasonable prospect".

[717] 2013 (4) SA 539 (SCA) para 29.

[718] *Oakdene Square Properties (Pty) Ltd and Others v Farm Bothasfontein (Kyalami) (Pty) Ltd and Others* 2013 (4) SA 539 (SCA) para 29.

reasonable grounds – a mere speculative suggestion would not suffice.[719] In *Prospec Investments (Pty) Ltd v Pacific Coast Investments 97 Ltd and Another*[720] the Free State High Court, Bloemfontein asserted that a "prospect" means an expectation, which may or may not come true, and therefore signifies a possibility. A possibility is reasonable if it rests on a ground that is objectively reasonable.[721] Consequently, the court reasoned, a "reasonable prospect" means no more than a possibility that rests on an objectively reasonable ground or grounds.[722] In *Koen and Another v Wedgewood Village Golf & Country Estate (Pty) Ltd and Others*[723] the Western Cape High Court, Cape Town stated that a cogent evidential foundation must be placed before the court to support the existence of a reasonable prospect that the desired object can be achieved. In *Tyre Corporation Cape Town (Pty) Ltd and Others v GT Logistics (Pty) Ltd (Esterhuizen and Another Intervening)*[724] the Western Cape Division, Cape Town affirmed that the existence of a "reasonable prospect" is a factual question, albeit involving a value judgment.

While the interpretation of a "reasonable prospect" as propounded by the Supreme Court of Appeal and various High Courts was advocated in the context of business rescue proceedings, it may provide some guidance in interpreting the phrase "reasonable prospect" in section 162(12)(*b*)(ii) of the Companies Act.[725] Applying the interpretation of a "reasonable prospect" in the context of section 131(4)(*a*) of the Companies Act to section 162(12)(*b*)(ii) of the Companies Act, in an application to suspend a delinquency order or to set aside a probation order, the applicant would have to satisfy a court that based on objectively reasonable grounds, there is a possibility that he would be able to serve successfully as a director of a company in the future. While vague averments and mere speculative suggestions would not suffice, an

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[719] *Oakdene Square Properties (Pty) Ltd and Others v Farm Bothasfontein (Kyalami) (Pty) Ltd and Others* 2013 (4) SA 539 (SCA) para 29. In *Koen and Another v Wedgewood Village Golf & Country Estate (Pty) Ltd and Others* 2012 (2) SA 378 (WCC) para 20 and *Prospec Investments (Pty) Ltd v Pacific Coast Investments 97 Ltd and Another* 2013 (1) SA 542 (FB) para 11 the respective High Courts also stated that vague averments and mere speculative suggestions would not suffice to establish that there is a "reasonable prospect".

[720] 2013 (1) SA 542 (FB) para 12.

[721] *Prospec Investments (Pty) Ltd v Pacific Coast Investments 97 Ltd and Another* 2013 (1) SA 542 (FB) para 12.

[722] *Prospec Investments (Pty) Ltd v Pacific Coast Investments 97 Ltd and Another* 2013 (1) SA 542 (FB) para 12.

[723] 2012 (2) SA 378 (WCC) para 17.

[724] 2017 (3) SA 74 (WCC) para 76.

[725] See J Du Plessis & Delport "'Delinquent Directors' and 'Directors under Probation': A Unique South African Approach Regarding Disqualification of Company Directors" 284.

applicant need not go so far as to establish a reasonable probability that he would be able to serve successfully as a director of a company in the future. Based on the evidential foundation put before the court by the applicant, the court would have to make a value judgment whether the applicant would be able to serve successfully as a director in the future.

In those instances where the delinquency order completely excludes the applicant from being a director of any company it would be challenging for a director to be able to present to court evidence of a reasonable prospect of him being able to serve successfully as a director in the future.[726] If the declaration of delinquency permits a director to serve as a director of another company, he would have to present evidence to the court of having successfully served on the board of directors of the other company or companies. He may for instance present to the court affidavits from his fellow board members attesting to his ability to successfully serve as a director of such companies.

4. CONCLUSIONS AND RECOMMENDATIONS

Sections 71(6) and 162 of the Companies Act empower a court to remove a director from office. Under section 71(6) the court's power to remove a director from office is a direct power,[727] while under section 162 the court's power to do so is an indirect power.[728] Under section 71(6) of the Companies Act a court is empowered to remove a director from office only if the board of directors has voted not to remove the director from office and a disgruntled director or holder of voting rights in the election of that director applies to court for the board's decision to be reviewed. Under section 162 of the Companies Act a court is empowered to remove a director from office if a person with *locus standi* applies to court to have the director declared delinquent, which has the effect of removing the director from office. An application by a person with *locus standi* may also be made to place the director under probation, which has the effect that the director may not serve as a director except to the extent permitted by the probation order. The UK Company Directors Disqualification Act 1986 and the Australian Corporations Act of 2001 have likewise empowered courts to disqualify directors under various

[726] J Du Plessis & Delport "'Delinquent Directors' and 'Directors under Probation': A Unique South African Approach Regarding Disqualification of Company Directors" 284.

[727] See para 2 above.

[728] See para 3.1 above.

grounds, which has the effect that such persons are removed from office.[729] In contrast, the MBCA and the corporate legislation of various USA States have conferred on courts a direct power to remove directors from office.[730]

This chapter examined the powers of review conferred on a court under a section 71(6) court application. It found that the court's powers are not confined to the procedure in which the decision was made but extend to considering the merits of the decision.[731] For this reason it was argued that the court's review powers under section 71(6) may be described as a "substantive" or a "wide review".[732] Alternatively, the powers may be construed to be a special statutory power of review.[733] Compounding the wide review powers conferred on the court is the fact that a court is empowered to remove the director from office and is not required to remit the matter to the board of directors so that the board may reconsider the matter and make a new decision.[734]

It was noted that a shareholder may make an allegation under section 71(3) of the Companies Act but is not necessarily empowered to institute a review application under section 71(6) of the Companies Act because only a holder of voting rights entitled to be exercised in the election of the particular director, has been granted *locus standi* to institute a section 71(6) review application.[735] It was argued that it is anomalous to provide a shareholder with the right to make an allegation against a director under section 71(3) but not to provide him with a remedy to apply to court to review the board's decision not the remove the director from office.[736] A director who voted in favour of the removal of the director is also empowered to launch a section 71(6) review application.[737]

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[729] See para 3.1 above.

[730] See para 3.1 above.

[731] See para 2.2 above.

[732] See para 2.2 above.

[733] See para 2.2 above.

[734] See para 2.2 above.

[735] See para 2.1 above.

[736] See para 2.1 above.

[737] See para 2.1 above.

It was noted that there is no time limit in which a director or a shareholder is required to apply to court under section 71(6) to review the board's decision not to remove the director from office.[738] In order to bring the matter to a finality and in order to have consistency with the time limit of twenty business days prescribed in section 71(5) of the Companies Act (for a director to challenge his removal from office by the board of directors), it was argued that a time limit of twenty business days ought to be imposed in section 71(6) of the Companies Act.[739] It was suggested that the period of twenty business days should commence from the date of the board's decision not to remove the director from office.[740]

It was further noted that section 71(7) of the Companies Act has excluded the common law discretion conferred on courts with regard to the making of a costs order.[741] Courts therefore have no discretion to make a costs order with regard to a section 71(6) review application because costs must in all instances be awarded against the applicant, save where the court reverses the board's decision not to remove the director from office. It was argued that courts should be conferred a discretion to make an appropriate costs order under section 71(6) so as to strike the right balance in ensuring, on the one hand, that directors and holders of voting rights are not discouraged from instituting *bona fide* and genuine review applications and that, on the other hand, they do not institute vexatious and frivolous review applications.[742] It was argued that section 71(7) of the Companies Act should be deleted and replaced with a provision conferring on a court the discretion to "make any order it considers appropriate on the costs".[743] Alternatively, it was argued that the approach adopted by the High Court in *Lynmar Investments (Pty) Ltd v South African Railways and Harbours*[744] ought to be adopted to the award of a cost order under section 71(7) of the Companies Act in that courts should still have a residual

[738] See para 2.3 above.

[739] See para 2.3 above.

[740] See para 2.3 above.

[741] See para 2.4 above.

[742] See para 2.4 above.

[743] See para 2.4 above.

[744] 1975 (3) SA 905 (D) at 911.

discretion, if valid reasons and justice so require, to depart from the rule in section 71(7) of the Companies Act.[745]

This chapter argued further that section 71(6) offends the principle of non-interference by courts in the internal affairs of the company.[746] It argued that in certain instances such as illegality, oppressive conduct or fraudulent conduct by the board of directors in failing to remove a director from office, judicial interference is justified.[747] However, in order to ensure that in other instances a court does not unduly interfere in the internal affairs of the company, it was argued in this chapter that before a court exercises its discretion to remove a director from office under a section 71(6) review application, it should give due consideration to the reasons why the board of directors did not remove the director from office, whether the board of directors had complied with its fiduciary duties in not removing the director from office, and whether it had acted openly and transparently and in the best interests of the company in not removing the director from office.[748]

It was suggested in this chapter that while section 162 of the Companies Act may have a protective purpose, there is also a penal element to the section in that declaring a director delinquent inevitably involves a substantial and significant interference with the individual's freedom.[749] It furthermore carries a stigma and reputational damage for the director.[750] For this reason it was argued that declaring a director delinquent must not be done without due and proper consideration by a court.[751] In many respects, section 162 of the Companies Act is much wider, stricter and far-reaching than the equivalent provisions in the UK, Australia and the USA. Some examples of this are as follows:

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[745] See para 2.4 above.

[746] See para 2.5 above.

[747] See para 2.5 above.

[748] See para 2.6 above.

[749] See para 3.2 above.

[750] See para 3.2 above.

[751] See para 3.2 above.

- The range of persons who have *locus standi to* apply to court to remove a director from office are much wider under section 162 of the Companies Act compared to the equivalent provisions under the UK Company Directors Disqualification Act 1986, the Australian Corporations Act of 2001, the MBCA, the DGCL and the corporate legislation of many other USA States. Section 162 of the Companies Act permits a single shareholder and a single director to institute a section 162 application.[752] The UK Company Directors Disqualification Act 1986 does not confer this power on directors, and permits shareholders to institute an application to disqualify a director in limited instances only.[753] The Australian Corporations Act of 2001 does not empower a director or a shareholder to apply to court to disqualify a director.[754] Likewise, the MBCA, the DGCL and the applicable legislation in the majority of the USA States which permit the judicial removal of directors do not empower a single director or a single shareholder to apply to court to remove a director.[755] Instead, the application must be brought by the corporation or derivatively in the right of the corporation.[756] None of the foreign jurisdictions referred to above confer *locus standi* on a company secretary, prescribed officer, trade union or employee representative to apply to court to remove a director, as section 162 of the (South African) Companies Act does.[757] It was argued in this chapter that it is important to guard against abuse by this wide group of persons with *locus standi* to declare a director delinquent.[758] It was further contended that section 162 of the (South African) Companies Act does not contain safeguards or filters to guard against vexatious and frivolous applications.[759] It was submitted that if shareholders were to institute delinquency proceedings by means of the derivative action this would have the advantage of curbing the abuse of section 162.[760]

[752] See para 3.3.1.1 above.

[753] See para 3.3.1.1 above.

[754] See para 3.3.1.1 above.

[755] See para 3.3.1.1 above.

[756] See paras 3.3.1.1 and 3.3.1.2 above.

[757] See para 3.3.1.3 above.

[758] See para 3.3.4 above.

[759] See para 3.3.4 above.

[760] See paras 3.3.1.2 and 3.3.4 above.

- In general the grounds to declare a director delinquent and hence remove him from office are much wider and far-reaching under section 162 of the (South African) Companies Act, and the threshold of misconduct set lower, compared to the equivalent provisions in foreign legislation. Some examples of this are as follows:

    - Under section 8.09(a) of the MBCA a director may be judicially removed from office if he intentionally inflicted harm on the corporation. Under section 162(5)(*c*)(iii) of the (South African) Companies Act mere gross negligence in inflicting harm upon the company would suffice for a director to be declared delinquent. It would also suffice under section 162(5)(*c*)(iii) of the (South African) Companies Act if the director inflicted the harm not on the corporation, but on a subsidiary of the corporation.[761]

    - Under section 8.09(a) of the MBCA for a director to be judicially removed from office there must have been some fraudulent conduct by him with respect to the company or its shareholders. In contrast, under section 162(5)(*c*)(iv)(*bb*) read with section 77(3)(*c*) of the (South African) Companies Act, for a director to be judicially removed from office, the fraudulent conduct may extend not only to a shareholder of the company, but also to a creditor or an employee of the company. Even if the fraudulent conduct does not extend to a shareholder, a creditor or employee, a court may nevertheless declare a director delinquent under section 162(5)(*c*)(iv)(*bb*) read with section 77(3)(*c*) of the (South African) Companies Act if the conduct had another fraudulent purpose.[762]

    - Under section 162(5)(*c*)(i) of the (South African) Companies Act a director may be declared delinquent if he has grossly abused the position of director. In contrast, under section 8.35(b) of the Illinois Business Corporation Act of 1983 in order for a director to be judicially removed from office on the ground of gross abuse of the position of director, the gross abuse must have been to the detriment of the corporation. It is irrelevant under section 162(5)(*c*)(i) of the

[761] See para 3.4.5 above.

[762] See para 3.4.7 above.

(South African) Companies Act whether or not the director's gross abuse of his position was to the detriment of the company.[763]

- Under section 6 of the UK Directors Disqualification Act 1986 a director may be declared to be "unfit" to be concerned in the management of the company provided that the company became insolvent while he was a director or subsequently. A breach of a fiduciary duty is a relevant factor to determine whether a director is unfit to be concerned in the management of the company. In contrast, under section 162(5)(*c*) of the (South African) Companies Act a breach of the fiduciary duties in section 76(2)(*a*) of the Companies Act would suffice to declare a director delinquent, regardless of whether or not the company has become insolvent.[764]

- In terms of section 162(5)(*e*) of the (South African) Companies Act a court must make an order declaring a person a delinquent director if the person has at least twice been personally convicted of an offence or subjected to an administrative fine or penalty in terms of any legislation. In contrast, the equivalent provision in section 206E of the Australian Corporations Act of 2001 confines this ground of disqualification to a contravention of the Australian Corporations Act of 2001 – it does not extend to a contravention of *any* legislation, as is the case under the more far-reaching section 162(5)(*e*) of the (South African) Companies Act.[765] "Legislation" is defined broadly in section 162(1) of the (South African) Companies Act.[766] The implication is that an applicant with *locus standi* may institute an application to declare a director delinquent if the director has twice been subject to an administrative fine under that legislation notwithstanding that the legislation in issue has no connection to the director's position as a director or to his functions as a director.[767] It is submitted that this ground is unnecessarily wide.

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[763] See para 3.4.3 above.

[764] See para 3.4.11 above.

[765] See para 3.4.9 above.

[766] See para 3.4.8 above.

[767] See para 3.4.9 above.

- While the grounds for the judicial removal of a director are wider under section 162 of the (South African) Companies Act and the threshold for the misconduct of a director set lower compared to the laws of the foreign jurisdictions compared, section 162(5) of the (South African) Companies Act does not list as a ground of delinquency a conviction of a foreign offence, as is the case under section 5A(3) of the UK Company Directors Disqualification Act 1986 and under section 206EAA(3) of the Australian Corporations Act of 2001, which empowers ASIC to apply to court to disqualify a director who has been disqualified under the law of a foreign country.[768] The specified list of grounds of delinquency in section 162(5) of the (South African) Companies Act is a closed one, unlike some USA States (such as New York, Rhode Island and Pennsylvania) which give courts the power to remove directors from office for any proper cause.[769]

- Under section 162 of the (South African) Companies Act courts do not have a discretion to determine the minimum period of the declaration of delinquency.[770] In contrast, the UK Company Directors Disqualification Act 1986 does not, in most instances, prescribe a minimum period of disqualification, but instead it prescribes maximum periods of disqualification.[771] It is only with regard to a disqualification of unfit directors of insolvent companies, in terms of section 6 of the UK Company Directors Disqualification Act 1986, that a minimum period of disqualification (of two years) has been prescribed.[772] Courts in the UK, unlike South African courts, are accordingly given a discretion in most instances to determine the minimum period of disqualification of a director. The Australian Corporations Act of 2001 gives courts a high degree of discretion to determine the disqualification period of directors. Courts in Australia are empowered to disqualify directors for the period that they consider appropriate.[773] Section 8.09(a) of the MBCA and the legislation of most of the USA States which

[768] See para 3.4.11 above.

[769] See para 3.4.11 above.

[770] See para 3.6.2 above.

[771] See para 3.6.2 above.

[772] See para 3.6.2 above.

[773] See para 3.6.2 above.

permit the judicial removal of directors likewise confer on courts a discretion to determine the period of time for which a director will be removed from office.[774] Section 162 of the (South African) Companies Act is therefore much stricter than the equivalent provisions in foreign legislation because courts do not have any discretion to deviate from the minimum period of delinquency prescribed by the (South African) Companies Act.[775]

- There is no prescription period imposed on instituting an application to declare a director delinquent or placing him under probation under section 162 of the (South African) Companies Act.[776] In contrast, under the UK Company Directors Disqualification Act 1986 legal proceedings to apply for the disqualification of an unfit director of an insolvent company must be commenced within three years of the date on which the company of which that person is or has been a director became insolvent.[777] It is only with the leave of the court that an application for the disqualification of an unfit director of an insolvent company may be made more than three years after the company becomes insolvent.[778] It was argued that in South African law a statutory time limit of three years should be imposed with regard to launching applications to declare a director delinquent or to place him under probation.[779] It was submitted further that the twenty four month prescription period imposed on a director who ceases to be a director of a company should be extended to three years, so as to have consistency and harmony with the three-year prescription period imposed by section 77 of the (South African) Companies Act, particularly since there is some overlap between the offences in section 77 and those set out in section 162(5)(*c*) of the (South African) Companies Act.[780] Imposing a three-year statutory time limit to apply to declare a director delinquent or to place him under probation would ensure that directors are not left in a

[774] See para 3.6.2 above.

[775] See para 3.6.2 above.

[776] See para 3.8 above.

[777] See para 3.8 above.

[778] See para 3.8 above.

[779] See para 3.8 above.

[780] See para 3.8 above.

state of uncertainty, and that they are able to organise their affairs once the statutory time limit has passed free of the risk of future delinquency proceedings being instituted against them.[781] It would also ensure that a director who is delinquent is not left to be a director for longer than necessary, thus protecting the public.[782] In order to ensure that in those instances where an application to declare a director delinquent or to place him under probation is not able to be lodged with the three-year time period, it was submitted that, as is the case under section 7(2) of the UK Company Directors Disqualification Act 1986, with the leave of the court, an application to apply to court to declare a director delinquent or to place him under probation after the three-year period may be made.[783] This would ensure that delinquent directors are not protected from applications to declare them delinquent after three years, but in order to bring such an application after three years, the leave of the court must be sought.[784] It will further serve to balance the public interest and the legitimate interests of the director.[785]

- Unlike the UK Company Directors Disqualification Act 1986, the Australian Corporations Act of 2001, the MBCA, the DGCL and the corporate legislation of various USA States, section 162 of the (South African) Companies Act does not confer on courts any discretion whether or not to declare a director delinquent.[786] It was argued that it is anomalous that a court has been given a discretion whether to remove a director from office (under section 71(6) of the Companies Act), whether to place a director under probation (under section 162(7) of the Companies Act) and whether to disqualify a person from being a director (under section 69(11) of the Companies Act) but has not been given a discretion under section 162(5) whether to declare a director delinquent when the effect of all of these provisions is that the director in question is not permitted

[781] See para 3.8 above.

[782] See para 3.8 above.

[783] See para 3.8 above.

[784] See para 3.8 above.

[785] See para 3.8 above.

[786] See para 3.9 above.

to serve as a director.[787] It was contended that the absence of such a discretion results in an interference by the judiciary in the internal affairs of a company.[788]

- Section 162 of the (South African) Companies Act does not contain provisions designed to minimise the interference by the judiciary in the internal affairs of the company.[789] In contrast, not only does section 8.09(a) of the MBCA confer a discretion on a court to remove a director from office, but it also requires a court to consider whether any remedies other than removal would be adequate, and, further, to consider whether removal would be in the best interests of the company.[790] Moreover, in terms of section 8.09(a) of the MBCA, a court is empowered to remove a director from office or to order other relief.[791] As discussed, the laws of several USA States also provide that a court may remove a director from office only if the removal is in the best interests of the corporation.[792] Section 225(c) of the DGCL goes even further in that it provides that a court may remove a director from office if judicial removal is necessary to avoid irreparable harm to the corporation.[793] These provisions serve to ensure that a court does not unduly interfere with the internal affairs of a company.

- It was contended[794] that section 162 of the (South African) Companies Act should incorporate the following provisions of the legislation of foreign jurisdictions in order to limit the extent of the judicial interference in the internal affairs of a company:

    - Courts should have a discretion whether or not to declare directors delinquent and hence remove them from office;

[787] See para 3.9 above.

[788] See para 3.9 above.

[789] See para 3.10 above.

[790] See para 3.10 above.

[791] See para 3.10 above.

[792] See para 3.10 above.

[793] See para 3.10 above.

[794] See para 3.10 above.

- Courts should be required to consider whether the declaration of delinquency and removal of the director would be in the best interests of the company;
- Courts should consider whether any other remedies besides a declaration of delinquency and removal of the director from office are adequate; and
- In addition to being able to grant any conditions ancillary to a declaration of delinquency or probation, courts should have the power to order any other relief under section 162 of the Companies Act.

Finally, this chapter discussed the provisions of section 162(11) of the Companies Act, in terms of which a delinquent director or a director under probation may apply to court, after three years or two years respectively, for the delinquency order or probation order to be suspended or set aside.[795] A court has a discretion whether or not to grant the application.[796] Courts are however bound by the statutory guidelines provided in section 162(12) of the Companies Act in exercising their discretion whether or not to grant the application in terms of section 162(11).[797]

Some challenges that may be faced by an applicant under section 162(11) were identified. Such challenges would include demonstrating to a court satisfactory progress towards rehabilitation, over a period of at least three years, and convincing a court that there is a reasonable prospect of being able to serve successfully as a director in the future.[798] These challenges are augmented if a director had been absolutely prohibited from being a director of any company for the duration of the delinquency order.[799] The circumstances leading to the original delinquency order or probation order,[800] and the director's conduct in the ensuing period would also be taken into account by a court.[801] Consequently a director must present to a court evidence of any

[795] See para 3.11 above.

[796] See para 3.11.2 above.

[797] See para 3.11.4 above.

[798] See para 3.11.4.3 above.

[799] See para 3.11.4.3 above.

[800] See para 3.11.4.1 above.

[801] See para 3.11.4.2 above.

favourable conduct in the ensuring period.[802] If the director has not satisfied any conditions that were imposed on him by the court at the time the original delinquency or probation order was made, his application to suspend the delinquency order or to set aside the probation order would be refused by a court.[803]

The following recommendations were made with regard to interpreting, applying and enhancing section 162(11) of the Companies Act:

- In exercising its discretion whether or not to grant the application in terms of section 162(11) of the (South African) Companies Act a court should, in accordance with the approach adopted in the UK and Australia, bear in mind that section 162 of the Companies Act is a protective remedy in the public interest; suspending or setting aside a delinquency order or a probation order must not frustrate the achievement of this object.[804] This is important in order to accord with the purpose of the Companies Act in section 7(*j*) of encouraging the efficient and responsible management of companies.

- In accordance with the approach adopted in the UK and Australia, the hardship on the applicant should not weigh too heavily as a factor to be considered by the court.[805]

- Courts should ensure that the conditions imposed on a suspended delinquency order are capable of being monitored and are not easily disregarded by a director.[806] This is important to ensure the protection of the public.[807] Suggestions were made on how the conditions could be monitored.[808] Appointing someone to monitor the compliance with the conditions would facilitate an application under section 162(11) since the appointed person would be in a position to report to the court on the extent of the applicant's

[802] See para 3.11.4.2 above.

[803] See para 3.11.2 above.

[804] See para 3.11.2 above.

[805] See para 3.11.2 above.

[806] See para 3.11.3.1 above.

[807] See para 3.11.3.1 above.

[808] See para 3.11.3.1 above.

compliance with the conditions imposed by the court.[809] Monitoring the conditions imposed on a delinquency order or a probation order accords with the purpose of the Companies Act of encouraging the efficient and responsible management of companies, as contained in section 7(*j*) of the Companies Act.

- It would be advisable for the applicant to propose to the court appropriate conditions which it may consider imposing, should it exercise its discretion to suspend the delinquency order.[810] This would guide the court on the conditions to be imposed on the applicant in order to guard against a recurrence of the applicant's misconduct.[811] It may also serve to convince a court to grant the application in terms of section 162(11) of the Companies Act if the conditions proposed by the applicant would serve to protect the public from a recurrence of his misconduct.[812]

- The conditions to be imposed by a court on a suspended delinquency order should be specifically tailored to the misconduct committed by the director which had resulted in the original delinquency order being granted.[813] This would ensure that during the suspension of the delinquency order the risk of the director committing the same offence again would be minimised.[814]

- It was suggested that if an applicant breaches any of the conditions imposed by the court during the suspended delinquency order, the original delinquency order should be reinstated in full.[815] It is not clear from the legislation whether or not a court may extend the delinquency period if the conditions are breached by the applicant.[816] This should be clarified by the legislature by amending legislation.

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[809] See para 3.11.3.1 above.

[810] See para 3.11.3.2 above.

[811] See para 3.11.3.2 above.

[812] See para 3.11.3.2 above.

[813] See para 3.11.3.3 above.

[814] See para 3.11.3.3 above.

[815] See para 3.11.3.4 above.

[816] See para 3.11.3.4 above.

- In considering the circumstances leading to the original delinquency or probation order in terms of section 162(12)(*b*) of the (South African) Companies Act, in accordance with the approach adopted in the UK and Australia, a court should take into account the gravity of the misconduct which had led to the original order.[817] A distinction should also be drawn between offences that are connected with the conduct of the company's affairs and those that are unrelated to the company's affairs (following the approach adopted in Australia).[818]

- Clarity is required on the meaning of the term "conduct" as used in section 162(12)(*b*) of the Companies Act.[819] It was suggested that in considering the conduct of the applicant in the ensuing period, a court should take into account both the specific conduct of the applicant in relation to his dealing with companies as well as his general conduct which may demonstrate progress towards rehabilitation.[820]

- The meaning of the term "rehabilitation" as used in section 162(12)(*b*)(i) of the Companies Act should be clarified.[821] It was suggested that guidance on the meaning of these terms may be sought in the criminal law context, where the term "rehabilitation" is used in sentencing proceedings.[822] In the criminal law context, the term "rehabilitation" connotes positive impressions of the betterment of the offender, and connotes that the offender has learnt new values, has reformed and is now fit to take his place in society.[823]

- Certainty is also required on the meaning of the phrase "reasonable prospect" of serving successfully as a director in the future, as used in section 162(12)(*b*)(ii) of the Companies Act. The Companies Act does not define this term in the context of section 162(12)(*b*)(ii). Its meaning has been left to the courts to determine.[824] Since the phrase "reasonable

[817] See para 3.11.4.1 above.

[818] See para 3.11.4.1 above.

[819] See para 3.11.4.2 above.

[820] See para 3.11.4.2 above.

[821] See para 3.11.4.3 above.

[822] See para 3.11.4.3 above.

[823] See para 3.11.4.3 above.

[824] See para 3.11.4.4 above.

prospect" is used in the context of business rescue proceedings in section 131(4)(*a*) of the Companies Act, reference to the numerous judicial decisions on section 131(4)(*a*) would provide useful guidance on the meaning of the phrase in section 162(12)(*b*)(ii) of the Companies Act.[825] Drawing on the interpretation of the phrase "reasonable prospect" in the context of business rescue proceedings, it is submitted that the phrase "reasonable prospect" in section 162(12)(*b*)(ii) of the Companies Act means a possibility based on objectively reasonable grounds, that the director will be able to serve successfully as a director in the future. While vague averments and mere speculative suggestions would not suffice, an applicant need not go so far as to establish a reasonable probability that he would be able to serve successfully as a director of a company in the future.

[825] See para 3.11.4.4 above.

CHAPTER 7 REMEDIES WITH REGARD TO THE REMOVAL OF DIRECTORS FROM OFFICE BY THE BOARD OF DIRECTORS

1. INTRODUCTION

This chapter examines the remedies which may be relied on by a (former) director who has been removed from office by the board of directors. The focus of this chapter is on these remedies under both the (South African) Companies Act and at common law but where relevant, this chapter draws on the remedies with regard to the removal of directors from office under the UK Companies Act of 2006 and the Australian Corporations Act of 2001.[1] Some improvements to the existing remedies are proposed.

Prior to the board of directors voting on the removal of the director, a director is entitled to protest his proposed removal from office. Under section 71(4)(*b*) of the Companies Act, a

[1] Some of the statutory remedies in the UK and Australia for a removal of a director from office are similar to those in the (South African) Companies Act. A comparison with these jurisdictions is therefore useful since guidance may be obtained from these jurisdictions in interpreting and applying the relevant remedies contained in the (South African) Companies Act. This approach is justified by s 5(2) of the (South African) Companies Act which provides that to the extent appropriate, a court interpreting or applying the Companies Act may consider foreign law. The MBCA and the law of the various States in the USA do not contain comparable remedies for the removal of a director. This is because the MBCA does not make provision for the board of directors to remove a director from office (see chapter 3, para 2.4 where the removal of directors under the MBCA is discussed). Most States in the USA, including the State of Delaware, have not conferred on the board of directors the power to remove fellow board members (see chapter 3, para 2.4 where the removal of directors in the State of Delaware and various States in the USA is discussed). Of those few States in the USA which permit the board of directors to remove directors from office, the legislation does not make provision for remedies on which directors may rely to contest their removal from office. For this reason this chapter focuses on the remedies for the removal of a director by the board of directors in the UK and Australia, but not the USA.

director must be given a reasonable opportunity to make a presentation to the board meeting before the resolution is put to the vote. The presentation is discussed in chapter 3.[2]

The consequences of the board of directors removing a director from office in breach of the board's fiduciary duties are discussed in chapter 4.[3] It must be pointed out that such a director may have a remedy under section 218(2) of the Companies Act for any loss or damages suffered by him as a result of the contravention of the Companies Act.[4]

Section 158 of the Companies Act provides guidance to a court in determining any matter brought before it in terms of the Act. The section is titled "Remedies to promote purpose of the Act" and it states as follows:

> "When determining a matter brought before it in terms of this Act, or making an order contemplated in this Act –
> (a) a court must develop the common law as necessary to improve the realisation and enjoyment of rights established by this Act;
> (b) the Commission, the Panel, the Companies Tribunal or a court –
> (i) must promote the spirit, purpose and objects of this Act; and
> (ii) if any provision of this Act, or other document in terms of this Act, read in its context, can be reasonably construed to have more than one meaning, must prefer the meaning that best promotes the spirit and purpose of this Act, and will best improve the realisation and enjoyment of rights."

It is submitted that some of the important underlying purposes of the Companies Act which the courts should take into account in adjudicating on a remedy sought by a director who has been removed from office, are as follows: (i) to encourage transparency;[5] (ii) to promote compliance with the Bill of Rights as provided in the Constitution, in the application of company law;[6] (iii) to balance the rights and obligations of shareholders and directors within companies;[7] (iv) to

[2] See chapter 3, para 8.4.

[3] See chapter 4, para 4.

[4] See chapter 4, para 4.3 for a discussion of the liability of directors under s 218(2) of the Companies Act.

[5] Section 7(*b*)(iii) of the Companies Act states that one of the purposes of the Companies Act is to encourage transparency and high standards of corporate governance as appropriate, given the significant role of enterprises within the social and economic life of the nation. This provision is discussed in chapter 3 paras 6.1.2.1 and 8.3 and chapter 7, para 3.

[6] Section 7(*a*) of the Companies Act. This provision is discussed in chapter 3, para 9.

[7] Section 7(*i*) of the Companies Act. This provision is discussed in chapter 2, paras 7 and 8, chapter 3, paras 3, 9 and 10 and chapter 6, para 3.10.

encourage the efficient and responsible management of companies;[8] and (v) to provide a predictable and effective environment for the efficient regulation of companies.[9] As discussed,[10] the "spirit" and "objects" of the Companies Act have not been defined.[11] The *Memorandum on the Objects of the Companies Bill, 2008* sets out specific objectives and goal statements of the new Companies Act, being simplification, flexibility, corporate efficiency, transparency and predictable regulation.[12] These considerations should also be taken into account by courts when adjudicating on a remedy instituted by a director who has been removed from office by the board of directors.

2. SECTION 71(5) REVIEW

Under section 71(5) of the Companies Act a director who has been removed by the board of directors may apply within twenty business days to court to review the determination of the board.[13] Section 71(5) of the Companies Act also applies to the review of a decision of the Companies Tribunal to remove a director from office.[14] If a director appointed by a person named in or determined in terms of the Memorandum of Incorporation as contemplated in section 66(4)(*a*)(i) of the Companies Act[15] is removed by the board of directors, section 71(5) also confers on this person the power to apply to court to review the board's decision. This strengthens the power conferred on a person named in or determined in terms of the Memorandum of Incorporation to ensure that the director appointed by him is not improperly removed from office. These are the only persons who have *locus standi* to institute a review

[8] Section 7(*j*) of the Companies Act. This provision is discussed in chapter 3, paras 8.3 and 9, chapter 6, para 4 and chapter 7, paras 2.3 and 6.

[9] Section 7(*l*) of the Companies Act. This provision is discussed in chapter 3, para 9.

[10] See chapter 3, para 9.

[11] See Delport *Henochsberg on the Companies Act 71 of 2008* 550.

[12] *Memorandum on the Objects of the Companies Bill, 2008*, Companies Bill [B 61D-2008] para 1.

[13] The period of twenty business days given to a director to apply to court to review the determination of the board in terms of s 71(5) of the Companies Act is discussed further in chapter 4, para 4.1.

[14] Section 71(8)(*c*) provides that s 71(5), read with the changes required by the context, applies to the determination of the matter of the removal of a director by the Companies Tribunal. The review of a decision by the Companies Tribunal is discussed in chapter 3, para 9.

[15] In terms of s 66(4)(*a*)(i) of the Companies Act a company's Memorandum of Incorporation may provide for the direct appointment and removal of a director by any person who is named in or determined in terms of the Memorandum of Incorporation.

application in terms of section 71(5) of the Companies Act. Section 71(5) does not confer *locus standi* on a shareholder to institute a review application under section 71(5). In contrast to section 71(6),[16] section 71(5) also does not confer standing on a holder of voting rights entitled to be exercised in the election of that director.

Unlike section 71(7) of the Companies Act which requires the applicant in a section 71(6) review to compensate the company and any other party for the costs incurred in relation to the application (unless the court reverses the decision of the board), section 71(5) is silent on the payment of the costs of a section 71(5) review application.[17] Presumably, the common law civil procedure rule that costs follow the event would be followed.[18] As discussed above,[19] the courts may in their discretion depart from this principle as each case must be decided on its own facts. The issue in essence is a matter of fairness to both sides.[20] On this basis, a successful applicant in a section 71(5) review application could be awarded costs in his favour and an unsuccessful applicant may be required to pay the costs of the other party or parties to the review application.

As discussed,[21] section 71(5) does not specify when the period of twenty business days would commence. Presumably the period of twenty business days would commence from the date that the board of directors makes the decision to remove the director from office. In the interests of clarity, it is submitted that section 71(5) should specify when the time period of twenty business days commences. During the twenty business day period the director who was removed from

[16] Section 71(6) of the Companies Act, which deals with a review in circumstances where the board of directors decides not to remove a director from office, is discussed in chapter 6, para 2. The *locus standi* to apply to court to review the board's decision is discussed in chapter 6, para 2.1.

[17] See chapter 6, para 2.4 where the provisions of s 71(7) of the Companies Act are discussed.

[18] See chapter 6, para 2.4 where this rule is discussed.

[19] See chapter 6, para 2.4.

[20] See for instance *Gelb v Hawkins* 1960 (3) SA 687 (A) at 694; *Transvaal and Orange Free State Chamber of Mines v General Electric Co* 1967 (2) SA 32 (T) at 72; *Ward v Sulzer* 1973 (3) SA 701 (A) at 706; *Nieuwoudt v Joubert* 1988 (3) SA 84 (SE) at 88; *Joubert T/A Wilcon v Beacham and Another* 1996 (1) SA 500 (C) at 502; *Malangu v De Jager* 1996 (3) SA 235 (LCC) at 246-247*; McDonald t/a Sport Helicopter v Huey Extreme Club* 2008 (4) SA 20 (C) at 22 and *Antoy Investments v Rand Water Board* (159/2007) [2008] ZASCA 10 (20 March 2008) para 9. In *Ward v Sulzer* 1973 (3) SA 701 (A) at 706 the Appellate Division stated that, "[i]n awarding costs the Court has a discretion, to be exercised judicially upon a consideration of all the facts; and, as between the parties, in essence it is a matter of fairness to both sides."

[21] See chapter 4, para 4.1.

office by the board of directors is suspended from office.[22] A vacancy would not arise on the board until the twenty business day period to file a review application expires, or a court grants an order on a section 71(5) review application, whichever occurs later.[23] It follows that once the board of directors removes a director from office, it may not fill the vacancy until the expiry of the period of twenty business days or until the court grants an order on a section 71(5) review application if such an application is instituted.

Section 1726(d) of the Pennsylvania Business Corporation Law provides that if a director has been suspended or removed for cause and the suspension or removal is thereafter rescinded by the shareholders, by the board or by the final judgment of a court, an act of the board of directors done during this period will not be impugned or invalidated. Drawing on section 1726(d) of the Pennsylvania Business Corporation Law, it is submitted that section 70(2) of the (South African) Companies Act should incorporate a provision to the effect that any acts of the board during the period of suspension of a director who is later reinstated by a court under a section 71(5) review, may not be impugned or invalidated. The rationale of section 1726(d) of the Pennsylvania Business Corporation Law could not be ascertained, but it is submitted that such a provision would ensure that there will be a minimal disruption to the running of the company if the suspended director were to be reinstated to the board by a court. Such a provision would also remove any doubt whether decisions taken by the board of directors in the absence of the suspended director, once he is reinstated to the board, remain valid. It would furthermore ensure that any decisions taken by the board of directors in the absence of the suspended director would not be subject to challenge by third parties when the suspended director is reinstated to the board. The provision would also accord with the purpose of the Companies Act in section 7(*j*) of encouraging the efficient and responsible management of companies.

Section 71(5) of the Companies Act is silent on two specific matters. First, the powers of a court under a section 71(5) review application are uncertain in that it is not clear whether a court would be empowered to review the substance and merits of the board's decision to remove a director from office, or whether it is empowered to only review the procedural aspects of the decision. Secondly, the provision does not specify the orders that a court may make under

[22] Section 70(2) of the Companies Act.

[23] Section 70(2) of the Companies Act.

section 71(5) of the Companies Act if it finds that a director was improperly removed by the board of directors. These matters are next discussed.

2.1 Powers of the Court

As discussed in chapter 6, a distinction is drawn between an appeal and a review.[24] It was submitted that a "review" under section 71(6) of the Companies Act may be construed to be a substantive or wide review because the provision empowers a court to review the substance and merits of the board's decision not to remove a director from office.[25] It was submitted further that the "review" under section 71(6) may also be construed to be a special statutory power of review since the powers given to courts under a section 71(6) review extend further than a review of the procedural aspects of the decision, and combine aspects of both a review and an appeal.[26]

In contrast, it is not clear from the wording of section 71(5) whether a court is empowered to review the substance and merits of the board's decision to remove a director from office, or whether it may enquire only into the procedural correctness of the decision. As discussed, a review involves an enquiry into the procedural aspects of a decision.[27] Since section 71(5) uses the word "review" and there are no indications in the provision pointing towards a court being empowered to review the substance and merits of the decision, on a strict reading of section 71(5) a court reviewing the decision of the board of directors to remove a director from office is empowered only to enquire into the procedural correctness of the decision.[28] The procedural elements would be whether the board had fully and correctly complied with the requirements set out in section 71(4) of the Companies Act. These requirements relate to the notice of the meeting, giving the director in question the reasons for the proposed removal resolution and providing him with a reasonable opportunity to make a presentation to the board of directors

[24] See chapter 6, para 2.2 for a discussion on the difference between an appeal and a review.

[25] See chapter 6, para 2.2.

[26] See chapter 6, para 2.2.

[27] See chapter 6, para 2.2.

[28] In contrast, an indication in s 71(6)(*b*) of the Companies Act that a court is empowered to review the substance and merits of the board's decision, is that the section states that a court may remove the director from office if it is "satisfied" that the director is ineligible, disqualified, incapacitated or has been negligent or derelict (see further chapter 6, para 2.2).

before the resolution is voted on.[29] On this basis a court is not empowered to take into account, on a section 71(5) review, whether the board of directors had acted in breach of its fiduciary duties in removing a director from office.

It is submitted that, in order for there to be consistency with section 71(6) of the Companies Act, a court should be empowered, under a section 71(5) review, to enquire into the merits of the board's decision to remove a director from office. As is the case with the review power under section 71(6) of the Companies Act,[30] the review power under section 71(5) is also a statutory power of review. A statutory power of review confers on the court powers of both appeal and review with the additional power, if required, of receiving new evidence and of entering into and deciding the whole matter *de novo*.[31] It is consequently arguable that since the review power conferred on a court in section 71(5) of the Companies Act is a statutory power of review, a court is empowered to consider both the procedural aspects of the decision as well as the substance and merits of the decision to remove a director from office.

It is of particular importance that a court be empowered under a section 71(5) review to consider the substance and merits of the board's decision to remove a director in order to ensure that the board has not acted with ulterior motives and thereby in breach of its fiduciary duty. It would be anomalous if a court were to review a decision of the board of directors to remove a director from office where the board had acted in breach of its fiduciary duties only to find that it is powerless to set aside that decision because the relevant procedures had been duly complied with by the board of directors. Conferring on a court the power to consider, in a section 71(5) review, the merits of the board's decision to remove a director from office is a significant and essential safeguard against the abuse of the board's power of removal of a fellow director. Clarity is however required on the court's review powers under section 71(5) of the Companies Act.

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[29] The procedural requirements for the board of directors to remove a director from office are discussed in chapter 3, para 8.

[30] See chapter 6, para 2.2 where the statutory review power is discussed.

[31] *Nel and Another NNO v The Master (Absa Bank Ltd and Others Intervening)* 2005 (1) SA 276 (SCA) para 23. See further *Simelane v Minister of Justice and Constitutional Development* 2009 (5) SA 485 (C) para 10; *Al-Kharafi & Sons v Pema and Others NNO* 2010 (2) SA 360 (W) paras 22-23; *Tongaat Paper Co (Pty) Ltd v The Master and Others* 2011 (2) SA 17 (KZP) para 27 and *Van Zyl and Others NNO v The Master, Western Cape High Court and Another* 2013 (5) SA 71 (WCC) para 19.

Assuming that a court is empowered to consider the merits of the board's decision under a section 71(5) review, the director concerned would have to prove that he was improperly removed from office on the basis that the alleged grounds for his removal were not satisfied. For instance, the affected director would bear the onus of proving, on a balance of probabilities, that the board of directors had made its decision to remove him from office with ulterior motives and in breach of its fiduciary duties. It is submitted that a mere suspicion in this regard would not be sufficient.[32] This may be difficult for the affected director, particularly considering that the board may frame the grounds for his removal as neglect of his functions or having been derelict in the performance of his functions, or that he failed to meet any other broadly expressed or subjective standard.[33]

2.2 Permissible Court Orders

Unlike section 71(6)(*b*) of the Companies Act which sets out the court's powers on a section 71(6) review application,[34] section 71(5) is silent on the orders that a court may make on a review in setting aside the board's decision to remove a director from office.

It is not clear whether a court would be empowered to reinstate a director to office under section 71(5) of the Companies Act if it finds that the director was improperly removed. In *PG Group (Pty) Ltd v Mbambo NO & Others*[35] the Labour Court cast doubt on whether an executive director is entitled to reinstatement because of the dual capacities in which he holds office. While reinstatement may be more difficult with regard to executive directors, it was indicated above[36] that this does not mean that a court would not order reinstatement in appropriate circumstances. It is submitted that a court ought to have the power to order an improperly

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[32] R Cassim "Contesting the Removal of a Director by the Board of Directors under the Companies Act" 154.

[33] Austin & Ramsay *Ford, Austin and Ramsay's Principles of Corporations Law* para 7.240 at 289.

[34] In terms of s 71(6)(*b*) a court may either confirm the determination of the board of directors not to remove the director from office, or it may remove the director from office if it is satisfied that the director is ineligible or disqualified, incapacitated, or has been negligent or derelict.

[35] [2005] 1 BLLR 71 (LC) para 29, discussed in chapter 5, para 2.2 above.

[36] The reinstatement of executive directors and the circumstances in which an executive director may be reinstated as an employee are discussed in chapter 5, para 2.2.

removed director to be reinstated to the board of directors, where this would be appropriate, and that section 71(5) should be amended to indicate this.

It is also not clear whether a court is empowered under section 71(5) of the Companies Act to order compensation to be paid to a director who was improperly removed, and if so, the basis upon which the compensation would be calculated. Such compensation is not to be confused with damages or compensation for loss of office which may be claimed by a director under section 71(9) of the Companies Act. Damages or compensation for loss of office under section 71(9) of the Companies Act arise from a breach of contract by the company (discussed in paragraph 3 below), while compensation which may be payable under section 71(5) would arise from the improper removal of a director from office by the board of directors under section 71(3) of the Companies Act. It is submitted that, where appropriate, a court ought to order compensation to be paid to a director who was improperly removed from office by the board of directors under section 71(3) of the Companies Act. If a court were to order compensation to be paid under section 71(5) of the Companies Act, one form of compensation it could order is that the improperly removed director be compensated for the loss of board fees during his suspension from office in terms of section 70(2) of the Companies Act.[37] Clarity, perhaps by legislative amendment, is required on the orders that a court may make under section 71(5) of the Companies Act.[38]

3. APPLICATION FOR DAMAGES OR OTHER COMPENSATION FOR LOSS OF OFFICE IN TERMS OF SECTION 71(9) OF THE COMPANIES ACT

Section 71(9) of the Companies Act states as follows:

> "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."

[37] Under s 70(2) of the Companies Act if the board of directors has removed a director from office a vacancy on the board would not arise until the later of the expiry of the time for filing a review application in terms of s 71(5) or the granting of an order by the court on such an application, but the director is suspended from office during that time.

[38] See chapter 3, para 8.6 for a discussion of the court's power under s 71(5) of the Companies Act to award compensation and to order reinstatement of a director in instances where the prescribed procedures to remove him from office were not followed.

The right to claim compensation or damages in respect of the termination of his appointment as a director or of any appointment terminating as a consequence of being removed as a director was conferred on directors under section 220(7) of the Companies Act 61 of 1973.[39] Section 71(9) of the Companies Act preserves this right. A distinction must however be drawn between a director's role as a director and his role as an employee. Section 71(9) relates to a director's loss of office as a director of the company and to the loss of any other office as a consequence of being removed as a director. If an executive director's contract of employment is breached as a result of his removal from office, he would have a separate claim for damages or other compensation under the LRA. This is discussed in chapter 5.[40]

For a director to have a remedy under section 71(9) of the Companies Act his removal from office must constitute a breach of contract on the part of the company.[41] A director must have a contract with the company or it must be stated in the Memorandum of Incorporation of the company that the company will not for a specified period of time terminate his office of directorship, or any appointment terminating with the termination of his office as a director. Thus where a company has appointed a director for a fixed period in terms of a contract or in terms of the Memorandum of Incorporation and that period has not expired at the time the director is removed from office, the affected director is entitled to claim damages or other compensation from the company for a breach of that contract by the company.[42] The director's contract with the company or the Memorandum of Incorporation may also provide that the director will be entitled to a contractual termination payment upon termination of his service

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[39] Section 220(7) of the Companies Act 61 of 1973 provided as follows:

> "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 or as derogating from any power to remove a director which may exist apart from this section."

[40] See chapter 5, para 2.2.

[41] See Blackman et al *Commentary on the Companies Act* 8-285; Griffin *Company Law Fundamental Principles* 287; Dignam *Hicks & Goo's Cases and Materials on Company Law* 338; French, Mayson & Ryan *Mayson, French & Ryan on Company Law* 447; Davies & Worthington *Gower Principles of Modern Company Law* 382-383; Worthington *Sealy & Worthington's Text, Cases and Materials in Company Law* 303-304.

[42] *Southern Foundries (1926) Ltd v Shirlaw* [1940] AC 701; *Read v Astoria Garage* (*Streatham*) *Ltd* [1952] 2 All ER 292; *De Villiers v Jacobsdal Saltworks* (*Michaelis & De Villiers*) (*Pty*) *Ltd* 1959 (3) SA 873 (O); Blackman et al *Commentary on the Companies Act* 8-285-286; Griffin *Company Law Fundamental Principles* 287; Dignam *Hicks & Goo's Cases and Materials on Company Law* 338; French, Mayson & Ryan *Mayson, French & Ryan on Company Law* 447; Worthington *Sealy & Worthington's Text, Cases and Materials in Company Law* 304; Davies & Worthington *Gower Principles of Modern Company Law* 382-383; Hannigan *Company Law* 299.

contract, in which event the director would be entitled to such agreed compensation upon his removal from office.[43]

Even if the removal of a director does constitute a breach of contract by the company this will not prevent the director from being removed from office. This is because the nature of a director's office is such that courts will not force a company to have a director it does not want.[44] In order to sustain an action for damages or compensation against the company for his loss of office as a director, the director must not have breached the Memorandum of Incorporation or his contract of service such that he has given cause to the company to cancel its contract with him.[45] In the event of such a breach by a director, he would not be entitled to damages or compensation for loss of office.[46]

Under the Companies Act 61 of 1973 the memorandum and articles of association of a company did not constitute a contract between the company and a director in his capacity as a director.[47] Instead, they constituted a contract between the company and its shareholders to the extent that the provisions affected the shareholders in their capacity as shareholders.[48] A director could therefore not rely on the terms of the articles of association to claim damages from the company as a consequence of being removed from office.[49] It was necessary for the director to have had a separate contract of service with the company binding the company to hold the director's

[43] Davies & Worthington *Gower Principles of Modern Company Law* 382-383.

[44] Blackman et al *Commentary on the Companies Act* 8-284; Davies & Worthington *Gower Principles of Modern Company Law* 383.

[45] *Farmers' Associated Dairies Ltd v Goldstein* 1924 WLD 181 at 183; Blackman et al *Commentary on the Companies Act* 8-286; Keay "Company Directors Behaving Poorly: Disciplinary Options for Shareholders" 673; Birds et al *Boyle and Birds' Company Law* 559.

[46] *Knopp v Thane Investments Ltd and Another, Knopp v Tomlinson* [2003] 1 BCLC 380 para 131; *Item Software (UK) Ltd v Fasshihi and Others* [2003] 2 BCLC 1 para 97; Blackman et al *Commentary on the Companies Act* 8-286; Birds et al *Boyle and Birds' Company Law* 559.

[47] *De Villiers v Jacobsdal Saltworks* (*Michaelis and De Villiers) (Pty) Ltd* 1959 (3) SA 873 (O).

[48] *Hickman v Kent or Romney Marsh Sheep Breeders' Association* [1915] 1 Ch 881 at 900; *Rayfield v Hands* [1958] 2 All ER 194 (CA); *De Villiers v Jacobsdal Saltworks (Michaelis and De Villiers) (Pty) Ltd* 1959 (3) SA 873 (O) at 874*; Gohlke & Schneider v Westies Minerale (Edms) Bpk* 1970 (2) SA 685 (A) at 692; Henochsberg *Henochsberg on the Companies Act* 123-124; Cilliers & Benade *Corporate Law* 79-80; Blackman et al *Commentary on the Companies Act* 4-156.

[49] D Botha "Some Aspects Concerning the Removal of Directors" 465; Cilliers & Benade *Corporate Law* 81.

position for a fixed term, or not to terminate his office, or to compensate him if he were removed from office.[50]

This position changed under the Companies Act (71 of 2008) since, in terms of section 15(6)(*c*)(i), the Memorandum of Incorporation is binding between the company and each director of the company.[51] It follows that a director who is removed from office under section 71 of the Companies Act now has a remedy based on a breach of a provision of the Memorandum of Incorporation. It is no longer essential for a director to have a separate contract of service in order to claim damages or other compensation from the company for loss of office as a director.[52]

If a company has agreed to compensate a director in the event of his removal from office prior to the expiry of his term of office, a director who has so been removed from office may claim compensation from the company.[53] Where the contract does not contain any specific provision for compensation, the director would have to prove that he has suffered damages as a result of the termination of his appointment.[54] The damages would be the amount of remuneration which the director would have received had he not been removed from office.[55] These damages could potentially be quite high. They may even include damages for loss of collateral benefits. For example, in *Bold v Brough, Nicholson & Hall Ltd*[56] a director who had served the company for

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[50] *Beattie v E & F Beattie Ltd* [1938] Ch 708; *Southern Foundries (1926) Ltd v Shirlaw* [1940] AC 701; *De Villiers v Jacobsdal Saltworks* (*Michaelis and De Villiers) (Pty) Ltd* 1959 (3) SA 873 (O); *Shindler v Northern Raincoat Co Ltd* [1960] 2 All ER 239.

[51] Section 15(6)(*c*) of the Companies Act is discussed in chapter 5, para 2.1.

[52] R Cassim "Governance and the Board of Directors" in FHI Cassim et al *Contemporary Company Law* 452; R Cassim "Contesting the Removal of a Director by the Board of Directors under the Companies Act" 155; Delport *New Entrepreneurial Law* 126-127; Esser & Havenga "Directors and Other Officers" in Loubser & Mahony *Company Secretarial Practice* 8-17.

[53] Henochsberg *Henochsberg on the Companies Act* 422(3). A company may insert a liquidated damages provision in its service contract with a director to the effect that if the director is removed from office by the board of directors he will be entitled to a set amount of compensation (Bourne "The Removal of Directors" 194). See also *Beach v Reed Corrugated Cases, Ltd* [1956] 2 All ER 652 at 659 and *Yetton v Eastwoods Froy Ltd* [1966] 3 All ER 353 on the calculation of damages when a director's service agreement is terminated in circumstances which amount to a wrongful dismissal.

[54] *Hayes v Bristol Plant Hire Ltd and Others* [1957] 1 All ER 685; Henochsberg *Henochsberg on the Companies Act* 422(3).

[55] Henochsberg *Henochsberg on the Companies Act* 422(3).

[56] [1963] 3 All ER 849.

forty years had been wrongfully dismissed both as a director and as the managing director of the company. The company had agreed to appoint the director as a managing director for ten years, but after approximately three years, the company had summarily and wrongfully removed the director from this position. The damages awarded by the Queens Bench Division to the director included loss of salary, loss of commission on the profits of the company, diminution in the pension the director would have received under the company's staff pension and assurance scheme, loss of life insurance cover under the scheme, the amount of premiums payable under the company's discretionary pension and life assurance scheme which the company had undertaken to pay on behalf of the director, as well as interest on the total amount of damages awarded.[57]

A director is under a duty to mitigate his loss by looking for and taking alternative employment where this is reasonably expected.[58] His damages would generally be reduced by the value of any such alternative employment which he could have taken. In *Bold v Brough, Nicholson & Hall Ltd*[59] the Queens Bench Division found that the director in question, at the age of fifty five, had a very small chance of finding a higher executive position in the textile trade in a depressed market. For this reason the court found that the director had complied with his duty to mitigate his damages by trying to find employment as a consultant even though he had not been successful. In mitigating his damages, a director is entitled to seek employment in a position which is reasonably commensurate with his status. In *Yetton v Eastwoods Froy Ltd*[60] the Queens Bench Division held that a managing director was justified in refusing a job as an assistant managing director at the same salary. The court held that the director had not acted unreasonably in seeking employment at a level comparable to that of his previous salary. His refusal of re-employment as an assistant managing director was found to be reasonable in view of the loss of status involved.[61]

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[57] *Bold v Brough, Nicholson & Hall Ltd* [1963] 3 All ER 849 at 850 and 858.

[58] *Bold v Brough, Nicholson & Hall Ltd* [1963] 3 All ER 849 at 853; *Yetton v Eastwoods Froy Ltd* [1966] 3 All ER 353 at 365; Birds et al *Boyle and Birds' Company Law* 559; Worthington *Sealy & Worthington's Text, Cases and Materials in Company Law* 304.

[59] [1963] 3 All ER 849 at 853.

[60] [1966] 3 All ER 353.

[61] *Yetton v Eastwoods Froy Ltd* [1966] 3 All ER 353 at 365.

A director may in addition have a claim for damages for the loss of any other office as a consequence of being removed as a director.[62] For instance, if the removal of the director from office breaches a second contract, such as that of a managing director, which the person could perform only by being a director, a claim for the loss of the office of managing director may also be brought under section 71(9)(*b*) of the Companies Act.[63] Under section 71(9)(*b*) a director who holds an *ex officio* directorship in any other company by virtue of his directorship in the company from which he is removed may also claim damages for the loss of the *ex officio* directorship.[64]

The board of directors should bear in mind when removing a director from office that he may have a claim against the company for payment for damages or other compensation for the loss of his office and that these damages may be substantive. The measure of the damages resulting from the removal of the director from office may be prohibitive to the extent that the removal could become impractical for the company.[65] The longer the period of the service contract, the greater the damages that are payable to a director who has been removed before the expiry of

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[62] Section 71(9)(*b*) of the Companies Act.

[63] *Southern Foundries (1926) Ltd and Federated Foundries Ltd v Shirlaw* [1940] AC 701; *Read v Astoria Garage (Streatham) Ltd* [1952] 2 All ER 292; *Shindler v Northern Raincoat Co Ltd* [1960] 2 All ER 239; Henochsberg *Henochsberg on the Companies Act* 422(3); D Botha "Some Aspects Concerning the Removal of Directors" 468; Beuthin & Luiz *Beuthin's Basic Company Law* 211; Blackman et al *Commentary on the Companies Act* 8-286; Kershaw *Company Law in Context* 222; Birds et al *Boyle and Birds' Company Law* 558-559; French, Mayson & Ryan *Mayson, French & Ryan on Company Law* 447; Worthington *Sealy & Worthington's Text, Cases and Materials in Company Law* 304; Davies & Worthington *Gower Principles of Modern Company Law* 381-382; Hannigan *Company Law* 264. Section 168(5)(a) of the UK Companies Act of 2006 likewise provides that if the shareholders remove a director from office the director would not be deprived of compensation or damages payable to him in respect of the termination of his appointment as director or of "any appointment terminating with that as director".

[64] Ncube "You're Fired! The Removal of Directors under the Companies Act 71 of 2008" 47. Refer to chapter 5, para 2.3.2 for a discussion on the removal of *ex officio* directors from office.

[65] Cilliers & Benade *Corporate Law* 128; Bourne "The Removal of Directors" 194; Davies & Worthington *Gower Principles of Modern Company Law* 383-384. To use an example, in 2015 MTN awarded its chief executive officer twenty three million seven hundred thousand Rand as compensation for loss of office. In 2016 MTN again awarded significant loss of office payments to its chief executive officer who left the company abruptly as a large fine was being negotiated with the Nigerian Government in settlement of events which had occurred during his tenure as the chief executive officer. This payment amounted to nineteen million six hundred thousand Rand. According to MTN the former chief executive officer was paid this amount as "compensation for loss of office, comprising notice pay and a restraint of trade payment" (see Tarrant "MTN slammed on remuneration" (29 May 2017) available at http://citizen.co.za/business/1527577/mtn-slammed-remuneration/ (accessed on 19 June 2017) and Prinsloo "Ex-MTN boss paid R24 for 'loss of office'" (25 April 2016) available at http://www.iol.co.za/business-report/companies/ex-mtn-boss-paid-r24m-for-loss-of-office-2013990) (accessed on 19 June 2017).

the period specified in his service contract.[66] The Companies Act does not specify a limit with regard to the number of years for which a director may be appointed.[67] Under section 68(1) of the Companies Act a director of a profit company may be elected to serve for an indefinite term, or for a term set out in the Memorandum of Incorporation. If the Memorandum of Incorporation does not specify a term, a director may be appointed for an indefinite term. In such event if the board of directors removes a director from office, it may be required to pay damages to the director for loss of office as a director, and for the loss of any other office as a consequence of being removed as a director. It is advisable to refrain from stipulating lengthy terms of appointment for directors because of the potential financial implications involved in removing them from office prior to the expiry of their contractual terms. This is important to ensure that the removal of a director from office prior to the expiry of his fixed term contract does not lead to economically impractical or unsustainable consequences.

The amount of compensation paid to a director for loss of office must be disclosed to the shareholders of the company. In terms of section 30(4)(*c*) of the Companies Act the annual

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[66] FHI Cassim "The Division and Balance of Power" 166.

[67] In the UK, the Model Articles for Private Companies do not specify a term of office, and accordingly a person appointed as a director of a private company with model articles would be appointed until he is removed or resigns (refer to articles 17 and 18 of the Model Articles for Private Companies Limited by Shares, contained in Schedule 1 of the Companies (Model Articles) Regulations 2008. See further Kershaw *Company Law in Context* 221). With regard to public companies article 21 of the Model Articles for Public Companies (contained in Schedule 3 of the Companies (Model Articles) Regulations 2008) makes provision for the retirement of a third of the board of directors at each annual general meeting (also known as a classified or staggered board where only a fraction of the board is elected each year). This effectively provides each director with a three-year term (Kershaw *Company Law in Context* 221). A director may be reappointed at the end of this term. Under s 188 of the UK Companies Act of 2006 a company may not agree to a director's employment under a service contract being for a period longer than two years unless it has been approved by a resolution of the shareholders of the company. This applies to all companies in the UK other than a company which is a wholly-owned subsidiary (s 188(6)). A director's "service contract" is (i) a contract under which a director undertakes personally to perform services (as director or otherwise) for the company or for a subsidiary of the company; or (ii) services (as director or otherwise) that a director undertakes personally to perform are made available by a third party to the company or to a subsidiary of the company (s 227(1) of the UK Companies Act of 2006). If a UK company agrees to a service contract which contravenes s 188 of the UK Companies Act of 2006, the provision will be void, to the extent of the contravention (s 189(a)). Furthermore, the contract will be deemed to contain a term entitling the company to terminate it at any time by the giving of reasonable notice (s 189(b)). This measure is designed to draw the shareholders' attention to the compensation which may be payable should the director be dismissed (Hannigan *Company Law* 297). In Australia the term of office of directors is usually determined by the constitution. The constitution of a proprietary company may provide for the appointment of named individuals who are to hold office indefinitely (Austin & Ramsay *Ford, Austin and Ramsay's Principles of Corporations Law* para 7.160 at 253). Under the MBCA directors are appointed for a default period of one year and a maximum in most instances of three or four years for staggered or classified boards. Section 8.05(a) of the MBCA provides that the terms of the initial directors of a corporation expire at the first shareholders' meeting at which directors are elected. The terms of all other directors expire at the next annual shareholders' meeting following their election unless their terms of appointment are staggered (s 8.05(b) of the MBCA; Ferber *Corporation Law* 40; Bainbridge *Corporate Law* 79).

financial statements of a company required to have its annual financial statements audited,[68] must include, *inter alia*, particulars showing the amount of any compensation paid in respect of loss of office to current or past directors. However, the Companies Act does not require the termination payments to be approved by shareholders of the company. Thus, while the amount of compensation paid to directors for loss of office would be public knowledge, the disclosure thereof to shareholders need not take place prior to payment of the termination payment.

In sharp contrast, in the UK a quoted company[69] is, in terms of section 226C of the UK Companies Act of 2006, prohibited from making a payment for loss of office[70] to a person who

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[68] The annual financial statements of a public company must be audited (s 30(2)(*a*) of the Companies Act). In the case of any other profit or non-profit company, the annual financial statements must be audited if so required by the regulations made by the Minister in terms of s 30(7), taking into account whether it is desirable in the public interest, having regard to the economic or social significance of the company, as indicated by any relevant factors, including its annual turnover, the size of its workforce, or the nature and extent of its activities (s 30(2)*(b)*(i)). A company may audit its financial statements voluntarily if the company's Memorandum of Incorporation or a shareholders' resolution so requires or if the company's board of directors has so determined (s 30(2)(*b*)(ii)(*aa*)). In terms of regulation 28(2) of the Companies Regulations, 2011, in addition to public companies and state-owned companies, any company that falls into the following categories in any financial year must have its annual financial statements for that financial year audited: (i) any profit or non-profit company if in the ordinary course of its primary activities, it holds assets in a fiduciary capacity for persons who are not related to the company and the aggregate value of such assets held at any time during the financial year exceeds five million Rand; (ii) any non-profit company if it was incorporated directly or indirectly by the state, an organ of state, a state-owned company, an international entity, a foreign state entity or a foreign company, or if it was incorporated primarily to perform a statutory or regulatory function in terms of any legislation, or to carry out a public function at the direct or indirect initiation or direction of an organ of the state, a state-owned company, an international entity, or a foreign state entity, or for a purpose ancillary to any such function; or (iii) any other company whose public interest score in that financial year is three hundred and fifty or more, or is at least one hundred, if its annual financial statements were internally compiled. Regulation 26(2) of the Companies Regulations, 2011 sets out details on how the public interest score is to be calculated.

[69] A quoted company is a company whose equity share capital has been included in the official list in accordance with part 6 of the Financial Services and Markets Act 2000, or is officially listed in a European Economic Area state, or is admitted to dealing on either the New York Stock Exchange or Nasdaq (s 385(2) of the UK Companies Act of 2006). The "official list" is the Financial Conduct Authority's (FCA) list of securities that have been admitted to listing. The Financial Conduct Authority is required to maintain the official list in accordance with Part VI of the Financial Services and Markets Act 2000 (see s 103(1) of the Financial Services and Markets Act 2000). A quoted company is similar to, but not exactly the same, as a listed public company in South Africa.

[70] In terms of s 215 of the UK Companies Act of 2006 a "payment for loss of office" means a payment made to a director or past director of a company—

(a) by way of compensation for loss of office as director of the company,
(b) by way of compensation for loss, while director of the company or in connection with his ceasing to be a director of it, of—
  (i) any other office or employment in connection with the management of the affairs of the company, or
  (ii) any office (as director or otherwise) or employment in connection with the management of the affairs of any subsidiary undertaking of the company,
(c) as consideration for or in connection with his retirement from his office as director of the company, or
(d) as consideration for or in connection with his retirement, while director of the company or in connection with his ceasing to be a director of it, from—

has been a director of the company unless the payment is consistent with the approved directors' remuneration policy or the payment has been approved by a resolution of the shareholders of the company.[71] The approved directors' remuneration policy is the most recent remuneration policy to have been approved by a resolution passed by the shareholders of the company in general meeting.[72] The resolution of the shareholders approving the loss of office payment may not be passed unless a memorandum setting out the particulars of the proposed payment is made available for inspection by the shareholders of the company.[73] The memorandum must be made available at the company's registered office for not less than fifteen days prior to the date of the meeting at which the resolution is to be considered and it must also be available at the meeting itself.[74] The memorandum must explain the ways in which the loss of office payment is inconsistent with the approved directors' remuneration policy.[75] In addition, the company must ensure that the memorandum is made available on its website from the first day on which the memorandum is made available for inspection until its next accounts meeting.[76] These provisions ensure that shareholders are informed beforehand about the scale of the compensation payments to be made to directors in the event of loss of office and that such payments are approved by the shareholders.[77]

(i) any other office or employment in connection with the management of the affairs of the company, or
(ii) any office (as director or otherwise) or employment in connection with the management of the affairs of any subsidiary undertaking of the company.

[71] These provisions were inserted by s 80 of the Enterprise and Regulatory Reform Act 2013 which introduced amendments to the UK Companies Act of 2006 with regard to payments to directors of quoted companies (see ss 79-82 of this Act). Section 80 of this Act introduced a new Chapter 4A into the UK Companies Act of 2006 titled "Directors of quoted companies: special provision".

[72] Section 226C(2) of the UK Companies Act of 2006.

[73] Section 226D(1) of the UK Companies Act of 2006.

[74] Section 226D(1) of the UK Companies Act of 2006.

[75] Section 226D(2) of the UK Companies Act of 2006.

[76] Section 226D(3) of the UK Companies Act of 2006. If a payment is made in contravention of s 226C of the UK Companies Act of 2006 that payment will be held by the recipient on trust for the company or other person making the payment (s 226E(2)(a)). In the case of a payment by a company, any director who authorised the payment will be jointly and severally liable to indemnify the company that made the payment for any loss resulting from it (s 226E(2)(b)). A court may however relieve the director, wholly or in part, from liability on such terms as the court thinks fit if the director shows that he acted honestly and reasonably and the court considers that, having regard to the circumstances of the case, the director ought to be relieved of liability (s 226E(5)).

[77] Madlela & R Cassim "Disclosure of Directors' Remuneration Under South African Company Law: Is it Adequate?" 407.

Likewise, section 200E of the Australian Corporations Act of 2001 requires the shareholders to approve a payment given to a director by way of compensation for the loss of the office or position.[78] Section 200E calls for a binding vote and not merely an advisory vote to be passed by the shareholders to approve the director's compensation for loss of office.[79] This section applies to all companies registered under the Australian Corporations Act of 2001.[80] The approval must be given by way of a resolution passed at a general meeting of the company.[81] The details of the compensation must be set out in the notice of the general meeting that is to consider the resolution.[82] At the general meeting a vote on the resolution may not be cast in any capacity by or on behalf of the director whom it is sought to remove or by an associate of that director.[83] The resolution passed at the general meeting of the company may approve a lesser amount than the amount proposed in the resolution.[84] Section 200(4) of the Australian Corporations Act of 2001 makes it clear that shareholder approval of compensation to be paid to directors for loss of office does not relieve a director from any duty to the company, whether under sections 180, 181, 182, 183 or 184[85] or otherwise and whether of a fiduciary nature or

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[78] Section 200E must be read with ss 200A(1) and 200B(1) of the Australian Corporations Act of 2001.

[79] Austin & Ramsay *Ford, Austin and Ramsay's Principles of Corporations Law* para 7.365 at 318. An advisory vote is a qualitatively different vote from a binding vote in that, unlike a binding vote, an advisory vote does not bind the directors or the company (see s 250R(3) of the Australian Corporations Act of 2001 and *Dr Nair v Arturus Capital Limited* [2010] NSWSC 329 para 40). In *Dr Nair v Arturus Capital Limited* [2010] NSWSC 329 para 40 the New South Wales Supreme Court remarked that the knowledge by shareholders that a resolution is advisory only and would not bind the company or the directors, might influence their approach to the resolution and the care that they might be expected to give to the matter under consideration.

[80] See Austin & Ramsay *Ford, Austin and Ramsay's Principles of Corporations Law* para 7.350 at 308.

[81] Section 200E(1B) of the Australian Corporations Act of 2001.

[82] Section 200E(2) of the Australian Corporations Act of 2001.

[83] Section 200E(2A) of the Australian Corporations Act of 2001. An associate is a person with whom the director is acting or proposes to act (s 15 of the Australian Corporations Act of 2001). A person would not be an associate of another person if he gives advice to the other person, or acts on the other's behalf, in the proper performance of the functions attaching to a professional capacity or a business relationship (s 16(1)(a) of the Australian Corporations Act of 2001). A person would also not be an associate of another person if, otherwise than for valuable consideration, he has been appointed to vote as a proxy or representative at a shareholders' meeting (s 16(1)(d) of the Australian Corporations Act of 2001).

[84] Section 200E(3) of the Australian Corporations Act of 2001.

[85] These duties are the duty to exercise powers and discharge duties with care and diligence (s 180), the duty to exercise powers and discharge duties in good faith and in the best interests of the corporation and for a proper purpose (s 181), the duty not to improperly use their position to gain an advantage for themselves (s 182) and the duty not to improperly use information to gain an advantage for themselves (s 183). Section 184 sets out the offences for a contravention of these duties.

not, in connection with the giving of the compensation. These provisions were introduced in Australia in order to strengthen the regulations on termination benefits by "better empowering shareholders to disallow excessive termination benefits . . . improving the accountability of company management in setting remuneration and promoting responsible remuneration practices."[86]

Section 227(1)(*a*) of the previous South African Companies Act 61 of 1973 contained a provision akin to section 226C of the UK Companies Act of 2006 and section 200E of the Australian Corporations Act of 2001.[87] Section 227(1)(*a*) prohibited a company from making any payment or granting any benefit or advantage to any director or past director of the company or of its subsidiary company or holding company or any subsidiary of its holding company by way of compensation for loss of office unless full particulars with respect to the proposed payment (including the amount thereof), benefit or advantage had been disclosed to the shareholders of the company and the making of the payment or the grant of the benefit or advantage had been approved by a special resolution of the company. This provision applied to both public and private companies. In view of the many initiatives to enhance corporate governance and transparent practices it is both surprising and disappointing that the Companies Act (71 of 2008) has failed to retain this provision and does not require compensation for loss of office to directors to be approved by the shareholders. Dispensing with such approval does not accord with the purpose of the Companies Act (71 of 2008) of encouraging transparency and high standards of corporate governance, as set out in section 7(*b*)(iii).

The King IV Report requires the board of directors to ensure that the company remunerates directors fairly, responsibly and transparently so as to promote the achievement of strategic objectives and positive outcomes in the short, medium and long term.[88] The Report states that the implementation report must disclose any payments made on termination of office and the

[86] The Explanatory Memorandum to the Corporations Amendment (Improving Accountability on Termination Payments) Bill 2009 para 2.7. The Corporations Amendment (Improving Accountability on Termination Payments) Act 2009 amends the Australian Corporations Act of 2001 in order to strengthen the regulatory framework in Australia relating to termination benefits and to curb excessive termination benefits paid to directors of companies (see paras 2.1 and 2.2 of the Explanatory Memorandum to the Corporations Amendment (Improving Accountability on Termination Payments) Bill 2009).

[87] Section 227(1)(*a*) of the Companies Act 61 of 1973 dealt with payments to directors for loss of office or in connection with arrangements and take-over schemes.

[88] Principle 14 of the King IV Report.

reasons for such payment.[89] The implementation report should be tabled every year for a separate non-binding advisory vote by shareholders at the annual general meeting.[90] While the King IV Report makes provision for the disclosure of termination payments to be paid to directors, it does not require shareholder approval of such payments.[91] The JSE Listings Requirements also do not make provision for binding shareholder approval of termination payments to directors for loss of office.[92]

The advantage of requiring shareholders to approve the termination payments of directors is that it confers on shareholders some control over termination payments and results in enhanced transparency with regard to the termination payments of directors.[93] It further serves to moderate the extent of the termination payments to be paid to directors for loss of office and prevents directors from abusing their influence and serving their own interests.[94] It is submitted that for these reasons provisions akin to section 226C of the UK Companies Act of 2006 or section 200E of the Australian Corporations Act of 2001 requiring shareholder approval for

[89] King IV Report, principle 14, recommended practice 35c. The King IV Report (principle 14, recommended practice 32) recommends that remuneration of directors of a company be disclosed by means of a remuneration report in three parts. The first part is a background statement, the second part is an overview of the main provisions of the remuneration policy of the company, and the third part is an implementation report which contains details of all remuneration awarded to individual members of the board of directors during the reporting period.

[90] King IV Report, principle 14, recommended practice 37.

[91] The King IV Report provides that the remuneration policy should record the measures that the board commits to take in the event that either the remuneration policy or the implementation report or both are voted against by twenty five per cent or more of the voting rights exercised. These measures should provide for taking steps in good faith and with best reasonable effort towards an engagement process to ascertain the reasons for the dissenting votes and appropriately addressing legitimate and reasonable objections and concerns raised (King IV Report, principle 14, recommended practice 38).

[92] The Amendments to the JSE Listings Requirements of 1 November 2016, which came into force on 1 June 2017, require the remuneration policy and the implementation report to be tabled every year for separate non-binding advisory votes by shareholders of the issuer at the annual general meeting. The remuneration policy must record the measures that the board of directors of the issuer commits to take in the event that either the remuneration policy or the implementation report, or both, are voted against by twenty five per cent or more of the votes exercised. In order to give effect to the minimum measures referred to in the King IV Report (see principle 14, recommended practices 38 and 39) (referred to as the "King Code" in the JSE Listings Requirements), in the event that either the remuneration policy or the implementation report, or both are voted against by shareholders exercising twenty five per cent or more of the voting rights exercised, the issuer must in its voting results announcement provide an invitation to dissenting shareholders to engage with the issuer, and for the manner and timing of such engagement (para 3.84(k) of the JSE Listings Requirements).

[93] Madlela & R Cassim "Disclosure of Directors' Remuneration Under South African Company Law: Is it Adequate?" 407.

[94] See Kunst, Delport & Vorster *Henochsberg on the Companies Act* 437-441 and Cilliers & Benade *Corporate Law* 152 and on s 227(1)(*a*) of the Companies Act 61 of 1973.

payment for loss of office must be included in the (South African) Companies Act. Such approval should be required with regard to both public and private companies. Doing so would accord with the purposes of the Companies Act of promoting the development of the South African economy by encouraging transparency,[95] and encouraging the efficient and responsible management of companies.[96]

4. OPPRESSION REMEDY

Section 163 of the Companies Act provides a remedy for directors and shareholders to apply for relief from oppressive or prejudicial conduct. Under section 252 of the Companies Act 61 of 1973,[97] the predecessor to section 163 of the Companies Act (71 of 2008), the oppression remedy was available to shareholders only. The remedy has traditionally served the purpose of protecting oppressed minority shareholders.[98] Section 163 of the Companies Act now extends the oppression remedy to directors. Thus a person who is oppressed in his capacity as a director may now also rely on section 163 of the Companies Act.[99]

Under section 163 an application for relief may be instituted in three instances: (a) if any act or omission of the company, or a related person, has had a result that is oppressive or unfairly prejudicial to, or that unfairly disregards the interests of, the applicant;[100] (b) the business of

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[95] Section 7(*b*)(iii) of the Companies Act.

[96] Section 7(*j*) of the Companies Act.

[97] Section 252 of the Companies Act 61 of 1973 provided as follows:

> "(1) Any member of a company who complains that any particular act or omission of a company is unfairly prejudicial, unjust or inequitable, or that the affairs of the company are being conducted in a manner unfairly prejudicial, unjust or inequitable to him or to some part of the members of the company, may, subject to the provisions of subsection (2), make an application to the Court for an order under this section."

[98] *Off-beat Holiday Club and Another v Sanbonani Holiday Spa Shareblock Ltd and Others* 2017 (5) SA 9 (CC) para 27.

[99] See s 163(1) of the Companies Act which expressly empowers a director to rely on the oppression remedy. A detailed analysis of s 163 of the Companies Act is beyond the scope of this study. For a detailed discussion of this remedy refer to Delport *Henochsberg on the Companies Act 71 of 2008* 573-574(17); MF Cassim "Shareholder Remedies and Minority Protection" in FHI Cassim et al *Contemporary Company Law* 757-775; Sibanda "The Statutory Remedy for Unfair Prejudice in South African Company Law" 70-76 and MF Cassim *The New Derivative Action under the Companies Act: Guidelines for Judicial Discretion* 179-217.

[100] Section 163(1)(*a*) of the Companies Act.

the company, or a related person, is being or has been carried on or conducted in a manner that is oppressive or unfairly prejudicial to, or that unfairly disregards the interests of, the applicant;[101] or (c) the powers of a director or prescribed officer of the company, or a person related to the company, are being or have been exercised in a manner that is oppressive or unfairly prejudicial to, or that unfairly disregards the interests of, the applicant.[102]

An "act or omission of the company" encompasses the resolutions of the board of directors and the acts of the board of directors.[103] In *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd and Others*[104] the High Court observed that in most cases the exercise by a director of a corporate power will also be an act of the company. To this extent, the court remarked that section 163(1)(*c*) may not add much to sections 163(1)(*a*) and (*b*) of the Companies Act.[105] An "act or omission of the company" may also comprise an act or omission of the directors which is done in breach of a duty owed to the company.[106] In *Civils 2000 Holdings (Pty) Ltd v Black Empowerment Partner Civils 2000 (Pty) Ltd*[107] the High Court affirmed that a breach of fiduciary duty on the part of the directors amounted to conduct of a company as contemplated in section 252 of the Companies Act 61 of 1973.

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[101] Section 163(1)(*b*) of the Companies Act.

[102] Section 163(1)(*c*) of the Companies Act.

[103] *Civils 2000 Holdings (Pty) Ltd v Black Empowerment Partner Civils 2000 (Pty) Ltd* [2011] 3 All SA 215 (WCC) paras 17-21. See further Blackman et al *Commentary on the Companies Act* 9-9.

[104] 2014 (5) SA 179 (WCC) para 53.

[105] *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd and Others* 2014 (5) SA 179 (WCC) para 53.

[106] Blackman et al *Commentary on the Companies Act* 9-9.

[107] [2011] 3 All SA 215 (CC) para 21. In this case the plaintiff, a shareholder of the company, contended that the affairs of the company were being conducted by the directors of the company in a manner which was unfairly prejudicial, unjust or inequitable. The plaintiff alleged that the directors had committed a number of corporate misdemeanours (such as taking up office in a competitor company) which constituted fundamental breaches of their fiduciary duties towards the company (para 16). The plaintiff was unable to remove the directors from office due to the structure of the shareholders' agreement. It therefore approached the court for an order under s 252 of the Companies Act 61 of 1973. The directors raised an exception that success under s 252 of the Companies Act 61 of 1973 could only follow if a plaintiff had established that the proscribed conduct complained of was that of the company itself, as opposed to the directors in their individual capacities (para 13). The court affirmed that the plaintiff's allegation that a breach of fiduciary duty by the directors constituted conduct of the company as contemplated under s 252 of the Companies Act 61 of 1973, was legally sound (para 21). It held that the acts or omissions of the directors of a company are acts or omissions of the company even when they injure the company and constitute a breach of any duty owed to that company (para 17). The exception raised by the directors was accordingly dismissed.

Consequently, a director who has been removed from office by the board of directors may rely on section 163(1)(*a*) of the Companies Act on the basis that an act or omission of the company (being the board of directors) has had a result (his removal from office) that is oppressive, unfairly prejudicial or that unfairly disregards his interests. If the removal of the director from office was based on a valid ground as set out in section 71(3) of the Companies Act, the director will not be able to successfully rely on section 163 of the Companies Act since his removal will not have been unfair. Since a breach of fiduciary duty may amount to conduct that is oppressive or unfairly prejudicial, if the board of directors removes a director from office in breach of its fiduciary duty,[108] a director may apply to court for relief under section 163 of the Companies Act. A director may also rely on section 163(1)(*c*) of the Companies Act to contend that the powers of a director or directors have been exercised in a manner that is oppressive or unfairly prejudicial to him or that unfairly disregards his interests. The director who has been removed from office must prove to the court that his removal from office is oppressive, unfairly prejudicial or unfairly disregards his interests.[109] On considering such an application, a court may make any interim or final order it considers fit.[110]

The terms "oppressive", "unfairly prejudicial" and "unfairly disregards" in respect of the interests of the applicant are open-ended terms that have not been defined in the Companies Act. The common law jurisprudence relating to section 252 of the Companies Act 61 of 1973 continues to be relevant in determining whether conduct is oppressive or unfairly prejudicial, given the similarities in wording of the two sections.[111] The term "oppressive" has been defined

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[108] The removal of a director in breach of the fiduciary duties of directors is discussed in chapter 4.

[109] *Aspek Pipe Co (Pty) Ltd and Another v Mauerberger and Others* 1968 (1) SA 517 (C) at 525; *Louw and Others v Nel* 2011 (2) SA 172 (SCA) para 23; *De Sousa and Another v Technology Corporate Management (Proprietary) Limited and Others* 2017 (5) SA 577 (GJ) para 38. In *Louw and Others v Nel* 2011 (2) SA 172 (SCA) para 23 the Supreme Court of Appeal asserted that an "applicant for relief under s 252 cannot content himself or herself with a number of vague and rather general allegations." In *De Sousa and Another v Technology Corporate Management (Proprietary) Limited and Others* 2017 (5) SA 577 (GJ) para 38 the Gauteng Local Division, Johannesburg stated as follows:

> "The court's jurisdiction to make an order does not arise until the statutory criteria have been satisfied. The plaintiff (or applicant) bears the onus of satisfying the court that the particular act or omission has been committed, or that the affairs of the company are being conducted in the manner he alleges; and that such act or omission or conduct of the company's affairs is unfairly prejudicial, unjust or inequitable to him or to some part of the members of the company".

[110] Section 163(2) of the Companies Act.

[111] *Grancy Property Ltd v Manala and Others* 2015 (3) SA 313 (SCA) para 22. See further *Peel and Others v Hamon J & C Engineering (Pty) Ltd and Others* 2013 (2) SA 331 (GSJ) para 43; *Omar v Inhouse Venue Technical Management (Pty) Ltd and Others* 2015 (3) SA 146 (WCC) para 4 and *Geffen and Others v Martin and Others*

as involving a lack of probity and fair dealing in the affairs of the company.[112] In *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd and Others*[113] the High Court remarked that the term "oppressive" appears to cover conduct of a more egregious kind than conduct which is "unfairly prejudicial to" or that "unfairly disregards the interests of" the applicant.[114] In *Grancy Property Ltd v Manala and Others*[115] the Supreme Court of Appeal commented that, following the approach adopted under section 252 of the Companies Act 61 of 1973, the terms "oppressive",

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[2018] 1 All SA 21 (WCC) para 23 where the respective courts stated that in interpreting s 163 of the Companies Act (71 of 2008) case law on s 252 of the Companies Act 61 of 1973 is instructive. For a detailed discussion on the meaning of these terms see Delport *Henochsberg on the Companies Act 71 of 2008* 574(3)-574(12); MF Cassim "Shareholder Remedies and Minority Protection" in FHI Cassim et al *Contemporary Company Law* 769-772; Sibanda "The Statutory Remedy for Unfair Prejudice in South African Company Law" 66-69 and MF Cassim *The New Derivative Action under the Companies Act: Guidelines for Judicial Discretion* 190-199.

[112] *Scottish Co-operative Wholesale Society Ltd v Meyer and Another* [1958] 3 All ER 66 (HL) at 86; *Aspek Pipe Co (Pty) Ltd and Another v Mauerberger and Others* 1968 (1) SA 517 (C) at 526; *Donaldson Investments (Pty) Ltd and Others v Anglo-Transvaal Collieries Ltd: SA Mutual Life Assurance Society and Another Intervening* 1979 (3) SA 713 (W) at 722; *Omar v Inhouse Venue Technical Management (Pty) Ltd and Others* 2015 (3) SA 146 (WCC) para 9; *Grancy Property Ltd v Manala and Others* 2015 (3) SA 313 (SCA) para 23; *De Sousa and Another v Technology Corporate Management (Proprietary) Limited and Others* 2017 (5) SA 577 (GJ) para 40; *Harilal v Rajman and Others* [2017] 2 All SA 188 (KZD) para 85.

[113] 2014 (5) SA 179 (WCC) para 54.

[114] The terms "oppressive", "unfairly prejudicial" and "unfairly disregards" may be construed as distinct alternatives in respect of the interests of the applicant, but may also be read as a compound expression directed at conduct that is unjustly detrimental to the interest of the applicant or conduct that is commercially unfair (MF Cassim *The New Derivative Action under the Companies Act: Guidelines for Judicial Discretion* 190-191). Australian law adopts the view that the words are to be viewed as a compound expression (see for instance *Fexuto Pty Limited v Bosnjak Holdings Pty Limited* Matter No 3799/97 [1998] NSWSC 413 (9 September 1998) where the Supreme Court of New South Wales stated that the different elements of the oppression remedy are to be looked at as a composite whole and that the individual elements in the section should be considered merely as different aspects of the essential criterion, which is commercial unfairness). For a discussion whether these words are to be read as a compound expression or as separate grounds under Australian law see Austin & Ramsay *Ford, Austin and Ramsay's Principles of Corporations Law* para 10.450 at 746-747. Section 232 of the Australian Corporations Act of 2001 states as follows:

"The Court may make an order under section 233 if:

(a) the conduct of a company's affairs; or
(b) an actual or proposed act or omission by or on behalf of a company; or
(c) a resolution, or proposed resolution, of members or a class of members of a company;

is either:

(d) contrary to the interests of the members as a whole; or
(e) oppressive to, unfairly prejudicial to, or unfairly discriminatory against, a member or members whether in that capacity or in any other capacity."

Section 233 of the Australian Corporations Act of 2001 sets out the various orders a court may make if it finds that the affairs of the company have been conducted in a manner that is oppressive or unfairly prejudicial to or unfairly discriminatory against a shareholder. In *Count Gotthard SA Pilati v Witfontein Game Farm (Pty) Ltd and Others* [2013] 2 All SA 190 (GNP) para 17.12 the High Court held that it was not necessary in the context of that case to decide whether the phrases in s 163(1) of the Companies Act must be read as a composite whole or not, but that the interests which are unfairly prejudiced must result in commercial unfairness affecting the applicant in such capacity.

[115] 2015 (3) SA 313 (SCA) para 26.

"unfairly prejudicial" and "unfairly disregards" must be construed in a manner that will advance, rather than limit, the remedy.[116]

The essential test of the oppression remedy is unfairness, not unlawfulness.[117] In *Off-beat Holiday Club and Another v Sanbonani Holiday Spa Shareblock Ltd and Others*[118] the Constitutional Court stated as follows:

> "Fairness is the criterion by which a court must decide whether it has jurisdiction to grant relief. The test of fairness is an objective one."

Conduct may be unfair without necessarily being unlawful.[119] Mere prejudice is not sufficient to succeed under section 163 of the Companies Act, but the conduct must be "unfairly"

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[116] In *Donaldson Investments (Pty) Ltd and Others v Anglo-Transvaal Collieries Ltd: SA Mutual Life Assurance Society and Another Intervening* 1979 (3) SA 713 (W) at 719 the High Court stated that in interpreting s 252 of the Companies Act 61 of 1973, construction should be given to the words in the section that will advance the remedy rather than limit it, as was the case in matters dealt with under the previous s 111*bis* of the Companies Act 46 of 1926. This was affirmed by the full court in *Donaldson Investments (Pty) Ltd and Others v Anglo-Transvaal Collieries Ltd and Others* 1980 (4) SA 204 (T) at 209. See also *Kudumane Investment Holding Ltd v Northern Cape Manganese Company (Pty) Ltd and Others* [2012] 4 All SA 203 (GSJ) para 60; *Smyth and Others v Investec Bank Ltd and Another* 2016 (4) SA 363 (GP) para 49; *Off-beat Holiday Club and Another v Sanbonani Holiday Spa Shareblock Ltd and Others* 2017 (5) SA 9 (CC) para 27 and *Smyth and Others v Investec Bank Ltd and Another* [2018] 1 All SA 1 (SCA) para 20. In *Harilal v Rajman and Others* [2017] 2 All SA 188 (KZD) the court stated (para 86) that interpreting s 163 of the Companies Act in a way which advances the remedy rather than limits it, is consistent with the purposes of the Companies Act in s 7 of balancing the rights and obligations of shareholders and directors within the company, and encouraging the efficient and responsible management of companies. In *Peel and Others v Hamon J & C Engineering (Pty) Ltd and Others* 2013 (2) SA 331 (GSJ) para 52 the South Gauteng High Court, Johannesburg observed that a careful consideration of the interpretation given by our courts to the provisions of s 252 of the Companies Act 61 of 1973 and the provisions of s 163 of the Companies Act shows a continuing intention by the legislature to broaden the relief in these provisions rather than to limit them. For a discussion of s 252 of the Companies Act 61 of 1973 see Kunst, Delport & Vorster *Henochsberg on the Companies Act* 477-484(2); Cilliers & Benade *Corporate Law* 313-319 and Blackman et al *Commentary on the Companies Act* 9-1–9-56.

[117] *Donaldson Investments (Pty) Ltd and Others v Anglo-Transvaal Collieries Ltd: SA Mutual Life Assurance Society and Another Intervening* 1979 (3) SA 713 (W) at 722; *Re a Company (No 005134 of 1986), ex parte Harries* [1989] BCLC 383 at 390; *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd and Others* 2014 (5) SA 179 (WCC) paras 57-59; *De Sousa and Another v Technology Corporate Management (Proprietary) Limited and Others* 2017 (5) SA 577 (GJ) para 36; *Off-beat Holiday Club and Another v Sanbonani Holiday Spa Shareblock Ltd and Others* 2017 (5) SA 9 (CC) para 28. "Unfairness" has been held to mean unreasonable (see *Garden Province Investment and Others v Aleph (Pty) Limited and Others* 1979 (2) SA 525 (D) at 531).

[118] 2017 (5) SA 9 (CC) para 28.

[119] *Re Ringtower Holdings plc* (1989) 5 BCC 82 at 90; *Re Saul D Harrison & Sons plc* [1995] 1 BCLC 14 (CA) at 19 and 31. Conduct may be unfair without necessarily being unlawful where it does not violate any rights of the applicant, such as rights conferred by the Companies Act or the company's Memorandum of Incorporation (see MF Cassim *The New Derivative Action under the Companies Act: Guidelines for Judicial Discretion* 191). In *Re Saul D Harrison & Sons plc* [1995] 1 BCLC 14 (CA) the UK Court of Appeal stated that conduct may be unfair without being unlawful in cases in which the letter of the articles of association does not fully reflect the understanding upon which the shareholders are associated (at 19). The court asserted that the personal relationship between a shareholder and those who control the company may entitle the shareholder to say that it would in

prejudicial, or must "unfairly" disregard the interests of the applicant.[120] It must be conduct that departs from the accepted standards of fair play.[121] "Fairness" depends on the context in which the word is being used.[122] In *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd and Others*[123] the High Court remarked as follows, in the context of section 163 of the Companies Act:

> "What is important to emphasise, however, is that it is not enough for an applicant to show that the conduct of which he complains is 'prejudicial' to him or that it 'disregards' his interests. The applicant must show that the prejudice or disregard has occurred 'unfairly'. 'Oppression' likewise connotes an element at least of unfairness if not something worse."

Conduct may be oppressive even if it does not violate any rights of the applicant, such as rights conferred by the Companies Act or the company's Memorandum of Incorporation.[124] Under section 163(1) of the Companies Act, the oppression remedy may be relied on if the powers of a director unfairly disregards the *interests* of the applicant. The term "interests" is not defined in the Companies Act. This term is wider than "rights",[125] and its inclusion in section 163 of the Companies Act highlights the principle that the oppression remedy is not limited to a strict infringement of legal rights but also extends to the protection of the interests of the applicant.[126]

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certain circumstances be unfair for the board to exercise a power conferred on it by the articles of association (at 19).

[120] *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd and Others* 2014 (5) SA 179 (WCC) para 55; *Geffen and Others v Martin and Others* [2018] 1 All SA 21 (WCC) paras 25 and 29.

[121] *Aspek Pipe Co (Pty) Ltd and Another v Mauerberger and Others* 1968 (1) SA 517 (C) at 527-528; *Donaldson Investments (Pty) Ltd and Others v Anglo-Transvaal Collieries Ltd: SA Mutual Life Assurance Society and Another Intervening* 1979 (3) SA 713 (W) at 722.

[122] *De Sousa and Another v Technology Corporate Management (Proprietary) Limited and Others* 2017 (5) SA 577 (GJ) para 36.

[123] 2015 (5) SA 179 (WCC) para 55.

[124] MF Cassim "Shareholder Remedies and Minority Protection" in FHI Cassim et al *Contemporary Company Law* 770.

[125] *Kudumane Investment Holding Ltd v Northern Cape Manganese Company (Pty) Ltd and Others* [2012] 4 All SA 203 (GSJ) para 58; *Count Gotthard SA Pilati v Witfontein Game Farm (Pty) Ltd and Others* [2013] 2 All SA 190 (GNP) paras 15 and 17.2; *Grancy Property Ltd v Manala and Others* 2015 (3) SA 313 (SCA) para 26; *Smyth and Others v Investec Bank Ltd and Another* 2016 (4) SA 363 (GP) para 45. For a discussion of the term "interests" see Delport *Henochsberg on the Companies Act 71 of 2008* 574(12)-574(13); MF Cassim "Shareholder Remedies and Minority Protection" in FHI Cassim et al *Contemporary Company Law* 770 and MF Cassim *The New Derivative Action under the Companies Act: Guidelines for Judicial Discretion* 192.

[126] *Grancy Property Ltd v Manala and Others* 2015 (3) SA 313 (SCA) para 26; Kershaw *Company Law in Context* 682.

"Interests" may include wider equitable considerations, such as the petitioner's legitimate expectations which go beyond his legal rights.[127] In *Count Gotthard SA Pilati v Witfontein Game Farm (Pty) Ltd and Others*[128] the High Court found that the concept of interests included interests not flowing from the Memorandum of Incorporation of the company but from an understanding or agreement between the parties.[129] The court stated that the acts complained of consequently need not necessarily flow from the Companies Act or the Memorandum of Incorporation; they could arise from a breach of trust or some acrimony between the parties flowing from the fundamental understanding between them.[130]

While it is not necessary for a director to prove that the board of directors acted with an underlying dishonest or ulterior motive in removing him from office in order to successfully rely on section 163 of the Companies Act, "in considering whether the conduct complained of reveals a lack of probity and fair dealing and is unfair, motive may not be without its relevance."[131] Thus the motive of the board of directors in removing a director from office may be of assistance to a court in deciding whether the act or the exercise of the power is oppressive,

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[127] *Re Ringtower Holdings plc* (1989) 5 BCC 82 at 90; *Re Saul D Harrison & Sons plc* [1995] 1 BCLC 14 (CA) at 31. Legitimate expectations emanate from a mutual understanding or agreement which form a basis on which the company's affairs are conducted, even though they are not necessarily incorporated in the constitution of the company (Sibanda "The Statutory Remedy for Unfair Prejudice in South African Company Law" 73). In *Re Saul D Harrison & Sons plc* [1995] 1 BCLC 14 (CA) at 19 Hoffmann LJ of the UK Court of Appeal explained that a "legitimate expectation" often arises out of a fundamental understanding between the shareholders which formed the basis of their association but was not put into contractual form, such as an assumption that each of the parties who had ventured his capital would also participate in the management of the company and receive the return on his investment in the form of a salary rather than a dividend. For a discussion of the concept of legitimate expectations in the context of the oppression remedy see Blackman et al *Commentary on the Companies Act* 9-30–9-34; Kershaw *Company Law in Context* 681-690; Sibanda "The Statutory Remedy for Unfair Prejudice in South African Company Law" 73-74; Birds et al *Boyle and Birds' Company Law* 687-689; Austin & Ramsay *Ford, Austin and Ramsay's Principles of Corporations Law* para 10.450 at 749-750 and Davies & Worthington *Gower Principles of Modern Company Law* 665-670.

[128] [2013] 2 All SA 190 (GNP) para 17.4.

[129] See further *Re Saul D Harrison & Sons plc* [1995] 1 BCLC 14 (CA) at 19.

[130] *Count Gotthard SA Pilati v Witfontein Game Farm (Pty) Ltd and Others* [2013] 2 All SA 190 (GNP) para 17.4.

[131] *Aspek Pipe Co (Pty) Ltd and Another v Mauerberger and Others* 1968 (1) SA 517 (C) at 529. See further *Donaldson Investments (Pty) Ltd and Others v Anglo-Transvaal Collieries Ltd: SA Mutual Life Assurance Society and Another Intervening* 1979 (3) SA 713 (W) at 720-721; *Ben-Tovim v Ben-Tovim and Others* 2001 (3) SA 1074 (C) at 1091 and *Grancy Property Ltd v Manala and Others* 2015 (3) SA 313 (SCA) para 27 where the respective courts stated that the motive of the conduct may be relevant in considering whether the conduct complained of constitutes oppressive or unfairly prejudicial conduct.

unfairly prejudicial or unfairly disregards the director's interests in the context of section 163(1) of the Companies Act.

It is well-established that the removal of a director in a small domestic company or a quasi-partnership[132] (where the shareholders are also directors) may amount to unfairly prejudicial conduct in the absence of a fair offer by the majority to purchase the director's shares or some other fair arrangement. In *O'Neill and Another v Phillips and Others*[133] Lord Hoffman of the House of Lords gave as a "standard case" of unjust, inequitable or unfair treatment in the context of section 459 of the UK Companies Act of 1985[134] the example "in which shareholders have entered into association upon the understanding that each of them who has ventured his capital will also participate in the management of the company. In such a case it will usually be considered unjust, inequitable or unfair for a majority to use their voting power to exclude a member from participation in the management without giving him the opportunity to remove his capital upon reasonable terms." In *Barnard v Carl Greaves Brokers (Pty) Ltd and Others Two Other Cases*[135] Binns-Ward AJ in the High Court approved this example as being as being a standard case of unjust, inequitable or unfair treatment in the context of section 252 of the

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[132] Quasi-partnership is a legal concept that describes specific types of relationships in a company (Kershaw *Company Law in Context* 677). It usually involves a small private company which in effect runs as a partnership between the shareholders. The shareholders agree to go into a business venture together on the basis of an agreement or understanding that all the shareholders will participate in the management of the company's business and that they will all be appointed as directors of the company. Voluntary exit of a quasi-partnership by a disgruntled minority shareholder is difficult due to the challenges associated with selling a minority stake in a private company, and due to the restricted transferability of the shares of a private company. It is not required that the company be run as if it were a partnership or that the shareholders regard themselves as being partners (see *Ebrahimi v Westbourne Galleries Ltd and Others* [1972] 2 All ER 492 (HL) at 500; *Barnard v Carl Greaves Brokers (Pty) Ltd and Others Two Other Cases* 2008 (3) SA 663 (C) para 11; *Croly v Good and Others* [2010] EWHC 1 (Ch) paras 9 and 89-93; *De Sousa and Another v Technology Corporate Management (Proprietary) Limited and Others* 2017 (5) SA 577 (GJ) para 47; Fitzpatrick "Re Westbourne Galleries Ltd" 60; Kershaw *Company Law in Context* 674-679; MF Cassim "Shareholder Remedies and Minority Protection" in FHI Cassim et al *Contemporary Company Law* 758 and French, Mayson & Ryan *Mayson, French & Ryan on Company Law* 71).

[133] [1999] 1 WLR 1092 para 6. *See* further Hannigan *Company Law* 503-504. For a discussion of O'*Neill and Another v Phillips and Others* [1999] 1 WLR 1092 see Neyers "Is there an Oppression Remedy Showstopper?: O'Neill v Phillips" 447-464.

[134] Section 459 of the UK Companies Act of 1985 provided as follows:

> "A member of a company may apply to the court by petition for an order under this Part on the ground that the company's affairs are being or have been conducted in a manner which is unfairly prejudicial to the interests of its members generally or of some part of its members (including at least himself) or that any actual or proposed act or omission of the company (including an act or omission on its behalf) is or would be so prejudicial."

[135] 2008 (3) SA 663 (C) para 46.

Companies Act 61 of 1973. The Supreme Court of Appeal in *Bayly and Others v Knowles*[136] agreed with this sentiment.[137]

Section 994(1) of the UK Companies Act of 2006 restricts the unfair prejudice remedy to shareholders of the company.[138] Consequently in order to claim unfair prejudice a director who has been removed from office must be a shareholder of the company or must be a person to whom shares have been transferred or transmitted.[139] In a quasi-partnership, the courts are more willing to find that a director removed from office and thus excluded from the management of the company, has been subjected to unfairly prejudicial treatment in his capacity as a shareholder.[140] In many instances in a quasi-partnership a shareholder who has ventured his capital in the company's business has a legitimate expectation that he will continue to be employed as a director, and his dismissal as a director and exclusion from the management of the company is accordingly regarded as being unfairly prejudicial to his interests as a

[136] 2010 (4) SA 548 (SCA) para 23.

[137] See further *De Sousa and Another v Technology Corporate Management (Proprietary) Limited and Others* 2017 (5) SA 577 (GJ) para 44 where the High Court, in dealing with an action brought at the instance of two minority shareholders for relief in terms of s 252 of the Companies Act 61 of 1973, affirmed that removing a minority shareholder from office in circumstances where he has a right or a legitimate expectation to participate in the management of the company without a reasonable offer or arrangement being made to enable him to dispose of his shares, constitutes unfair prejudice.

[138] Section 994(1) of the UK Companies Act of 2006 states as follows:

> "A member of a company may apply to the court by petition for an order under this Part on the ground –
> (a) that the company's affairs are being or have been conducted in a manner that is unfairly prejudicial to the interests of members generally or of some part of its members (including at least himself),
> (b) that an actual or proposed act or omission of the company (including an act or omission on its behalf) is or would be so prejudicial."

[139] See s 994(2) of the UK Companies Act of 2006, which provides that the unfair prejudice remedy applies to a person who is not a member of a company but to whom shares in the company have been transferred or transmitted by operation of law.

[140] See for instance *Re Bird Precision Bellows Ltd* [1985] 3 All ER 523 and *Re London School of Electronics* [1986] 1 Ch 211 where the respective courts held that the removal of directors from office had been unfairly prejudicial and had contravened s 75 of the UK Companies Act of 1980, which was the equivalent provision to s 994 of the UK Companies Act of 2006. Section 75 of the UK Companies Act of 1980 provided as follows: "Any member of a company may apply to the court by petition for an order under this section on the ground that the affairs of the company are being or have been conducted in a manner which is unfairly prejudicial to the interests of some part of the member (including at least himself) or that any actual or proposed act or omission of the company (including an act or omission on its behalf) is or would be so prejudicial."

shareholder.[141] In *Quinlan v Essex Hinge Co Ltd*[142] a director who had been excluded from participation in the management of a company by a domineering majority shareholder argued that his exclusion from the management of the company was unfairly prejudicial to his interests as a shareholder because the whole basis upon which he had acquired his interest in the company and had contributed his capital thereto was so that he could participate in effect as a partner in the business and affairs of the company. The Chancery Division found that the company had the characteristics of a quasi-partnership. It held that section 459 of the UK Companies Act of 1985 was applicable on the basis of the exclusion of the director from participation in the management of the company.[143]

More recently, in *In Re I Fit Global Ltd*[144] the petitioner and the respondent had agreed on the basis of a partnership understanding to establish a company with each holding an equal shareholding. The petitioner was dismissed as a director nineteen months after the company had been incorporated and was consequently excluded from the management of the company. The Chancery Division found that, given the basis on which the company had been established, the exclusion of the petitioner as a director of the company was clearly unfair and prejudicial to his interests as a shareholder under section 994 of the UK Companies Act of 2006.[145]

The mere fact that the company is a quasi-partnership would not necessarily be sufficient to raise a legitimate expectation that each partner would take part in the management of the company.[146] The legitimate expectation that each partner will take part in the management of

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[141] *Re a Company (No 00477 of 1986)* [1986] BCLC 376 at 379; *O'Neill and Another v Phillips and Others* [1999] 1 WLR 1092 para 6; *Croly v Good and Others* [2010] EWHC 1 (Ch); *In Re I Fit Global Ltd* 2013 WL 3550422 para 46.

[142] [1997] BCC 53. This case was decided in terms of s 459 of the UK Companies Act of 1985.

[143] *Quinlan v Essex Hinge Co Ltd* [1997] BCC 53 at 61. The court ordered the majority shareholder to purchase the director's shares in the company.

[144] 2013 WL 3550422.

[145] *In Re I Fit Global Ltd* 2013 WL 3550422 para 47.

[146] *Ebrahimi v Westbourne Galleries Ltd and Others* [1972] 2 All ER 492 (HL) at 500; *Re Ringtower Holdings plc* (1989) 5 BCC 82 at 93; *Fexuto Pty Limited v Bosnjak Holdings Pty Limited* Matter No 3799/97 [1998] NSWSC 413 (9 September 1998); Dignam *Hicks & Goo's Cases and Materials on Company Law* 448; Kershaw *Company Law in Context* 677; French, Mayson & Ryan *Mayson, French & Ryan on Company Law* 72. For a discussion of *Ebrahimi v Westbourne Galleries Ltd and Others* [1972] 2 All ER 492 (HL) see Fitzpatrick "Re Westbourne Galleries Ltd" 60-62 and Farrar & Boulle "Minority Shareholder Remedies – Shifting Dispute Resolution Paradigms" 11-14.

the company is usually derived from the constitution of the company or from the agreements between the parties, but the relationship between the parties may also give rise to a legitimate expectation to participate in the company's management.[147] The legitimate expectation of participation, being the arrangement or understanding, must be proved as a fact.[148] This makes it difficult to establish a legitimate expectation in larger companies which are not run as quasi-partnerships.[149] For example, in *Re Blue Arrow plc*[150] the petitioner was the president of a public listed company. Under the constitution of the company the president was removable from office by an ordinary resolution passed at a shareholders' meeting. The directors of the company convened a meeting to amend the articles of association of the company to make the president removable by the directors. The petitioner sought relief under section 459 of the UK Companies Act of 1985 to restrain the company from passing a special resolution amending the articles of association of the company. The Chancery Division held that the petitioner had a legitimate expectation that the affairs of the company would be properly conducted within the framework of its constitution, but not that the constitution would not be altered by a special resolution in a way which enabled her office to be terminated by some different machinery.[151] The court held that while there are cases where a legitimate expectation might be inferred from arrangements outside the formal constitution of a company, in a large public listed company outside investors were entitled to assume that the whole of its constitution was contained in the articles of association, read with the relevant Companies Act.[152] In dismissing the petitioner's claim under section 459 of the UK Companies Act of 1985, the court held that the affairs of the company were not being conducted in a manner unfairly prejudicial to the petitioner and that there was

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[147] *De Sousa and Another v Technology Corporate Management (Proprietary) Limited and Others* 2017 (5) SA 577 (GJ) para 47. See also *Erasmus v Pentamed Investments (Pty) Ltd* 1982 (1) SA 178 (W) at 182 and Kershaw *Company Law in Context* 689.

[148] *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd and Others* 2014 (5) SA 179 (WCC) para 62. See further *Re Ringtower Holdings plc* (1989) 5 BCC 82 where the court held that the fact that a company is small or private is not enough to establish that the company is a quasi-partnership giving rise to legitimate expectations (at 93). The court stated further that mutual trust and confidence are not in themselves sufficient to make the shareholders' association in substance a partnership with partner-like obligations owed by each shareholder to the others, in the absence of proof of a mutual understanding as to those obligations (at 93).

[149] *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd and Others* 2014 (5) SA 179 (WCC) para 62; Dignam *Hicks & Goo's Cases and Materials on Company Law* 448; French, Mayson & Ryan *Mayson, French & Ryan on Company Law* 72 and 583.

[150] (1987) 3 BCC 618.

[151] *Re Blue Arrow plc* (1987) 3 BCC 618 at 623.

[152] *Re Blue Arrow plc* (1987) 3 BCC 618 at 623.

no room for any legitimate expectation founded on some agreement between the directors and not disclosed to investors.[153]

A position similar to the one adopted in the UK has been adopted in Australia, under the Australian Corporations Act of 2001, where the exclusion of a director from management was held to be oppressive in circumstances where there was a legitimate expectation of participation in management.[154] Like section 994 of the UK Companies Act of 2006, section 232 of the Australian Corporations Act of 2001[155] confers *locus standi* on members[156] to apply for relief but the provision does not extend to directors.[157] However section 232(e) of the Australian Corporations Act of 2001 provides relief where conduct is oppressive to, unfairly prejudicial to or unfairly discriminatory against "a member or members whether in that capacity or in any other capacity".[158] It follows that a member may seek relief for oppressive conduct that affects

[153] *Re Blue Arrow plc* (1987) 3 BCC 618 at 623. See also *Re Ringtower Holdings plc* (1989) 5 BCC 82 where the petitioners argued that they had been wrongfully excluded from participation in the management of the company and that this had constituted unfairly prejudicial conduct in terms of s 459 of the UK Companies Act of 1985. The parties had regulated their relationship in the articles of association of the company but had in addition spelt out in detailed agreements all the matters which were to govern their relationship. The Chancery Division held that the petitioners' claim that they had legitimate expectations which were not limited to their rights under the service agreements was not sustainable. The court emphasised that the fact that a company is small or private is not sufficient for it to be construed as a quasi-partnership in the absence of proof of a mutual understanding as to the partner-like obligations owed by each shareholder to the others (at 93). It held that the company in question was not a quasi-partnership giving rise to a legitimate expectation that the petitioners would continue to participate in management, and consequently dismissed the petitioners' claim under s 459 of the UK Companies Act of 1985 (at 94). The more detailed the agreements the more likely it is that the company is being operated on a purely commercial basis and that it is not a quasi-partnership (Hannigan *Company Law* 401).

[154] See for instance *Hogg v Dymock* (1993) 11 ACSR 14 and *Yazbek v Aldora Holdings Pty Ltd* [2003] NSWSC 330. See further Austin & Ramsay *Ford, Austin and Ramsay's Principles of Corporations Law* para 10.460 at 756-757 on the improper exclusion from participation in management constituting oppressive or unfairly prejudicial conduct in Australian law.

[155] Section 232 of the Australian Corporations Act of 2001 states that a court may make an order under s 233 of the Australian Corporations Act of 2001 if the conduct of a company's affairs, or an actual or proposed act or omission by or on behalf of a company, or a resolution or a proposed resolution, of members or a class of members of a company, is either contrary to the interests of the members as a whole, or oppressive to, unfairly prejudicial to, or unfairly discriminatory against, a member or members whether in that capacity or in any other capacity.

[156] See chapter 5, note 150 for the definition of a "member" under the Australian Corporations Act of 2001.

[157] See s 234 of the Australian Corporations Act of 2001 which lists the persons who may apply for an order under ss 232 and 233 of the Australian Corporations Act of 2001.

[158] In accord with s 232(e) of the Australian Corporations Act of 2001, s 234(a)(i) of the Australian Corporations Act of 2001 confers *locus standi* on a member of the company, even if the application relates to an act or omission that is "against the member in a capacity other than as a member". Section 234(e) confers *locus standi* on a person whom ASIC thinks is appropriate having regard to investigations it is conducting or has conducted into the company's affairs or matters connected with the company's affairs. Consequently the application may be brought by a member if it relates to an act or omission against the member in a capacity other than as a member, and, furthermore, ASIC may authorise someone else to bring an application for relief under s 232 of the Australian

him in his capacity as a director.[159] This puts it beyond doubt that conduct which unfairly removes a member from a directorship could attract relief under section 232 of the Australian Corporations Act of 2001 on the basis that it is oppressive or unfairly prejudicial to a member in his capacity as a director.[160]

A director of a quasi-partnership who has been unfairly removed from office as a director by the board of directors in terms of section 71(3) of the (South African) Companies Act has not one, but two, grounds on which he may rely on the oppression remedy of section 163 of the Companies Act. The first ground is that in his capacity as a shareholder of the quasi-partnership, he may contend that an act of the majority shareholders in removing him from office unfairly disregards his interests, or legitimate expectation as a shareholder to participate in the management of the company, and that neither a fair offer nor some other fair arrangement was made to purchase his shares. The second ground is that in his capacity as a director of the quasi-partnership, he may contend that the powers of the board of directors in removing him from office have been exercised in a manner that is oppressive or unfairly prejudicial to, or that unfairly disregards, his interests.

Unlike the position under section 994 of the UK Companies Act of 2006 and section 232 of the Australian Corporations Act of 2001, a director instituting an action under section 163 of the (South African) Companies Act with regard to his removal from office need not prove that the company is a quasi-partnership nor that he had a legitimate expectation that he would not be removed from office. Section 163(1)(*c*) of the Companies Act confers *locus standi* on a director to base his remedy on oppression. A director may rely on section 163 of the Companies Act if

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Corporations Act of 2001. See further Austin & Ramsay *Ford, Austin and Ramsay's Principles of Corporations Law* para 10.470 at 761-762 for a discussion of the other capacities which may be applicable in this context, such as a director, an employee or a creditor.

[159] Austin & Ramsay *Ford, Austin and Ramsay's Principles of Corporations Law* para 10.470 at 761-762.

[160] Section 14.30(2)(ii) of the MBCA empowers a shareholder to petition a court for the judicial dissolution of a company if it is established that the directors or those in control of the corporation have acted or are acting or will act in a manner that is illegal, oppressive or fraudulent. *Locus standi* has not been conferred by s 14.30 on a director to apply to court for relief or to dissolve the corporation if the directors have acted in a manner that is oppressive. Judicial dissolution may be an extreme remedy in the case of a director who has been improperly removed from office. Since s 163 of the (South African) Companies Act is modelled on and draws from s 994 of the UK Companies Act of 2006 and s 232 of the Australian Corporations Act of 2001 this chapter has focused on the application of the oppression remedy under these latter statutes and not the MBCA. For a discussion of the oppression remedy under s 14.30(2) of the MBCA and in various USA States see Art "Shareholder Rights and Remedies in Close Corporations: Oppression, Fiduciary Duties, and Reasonable Expectations" 371-418.

he is able to establish that he was removed from office by the board of directors in circumstances that were oppressive or unfairly prejudicial to him or that unfairly disregarded his interests. Since a director may be removed by the board of directors in terms of section 71(3) of the Companies Act, he would have to prove that his removal from office was oppressive or *unfairly* prejudicial or *unfairly* disregarded his interests in order to successfully institute an action in terms of section 163 of the Companies Act.

Section 163(2) of the Companies Act confers wide powers and a discretion on the court to make any interim or final order "it considers fit".[161] Section 163(2) lists certain orders that a court may make, but this list is not closed.[162] In making an order under section 163 of the Companies Act a court must consider the whole range of possible remedies; it would not be limited to putting right the immediate conduct which justifies the order.[163] A court must also look to put right and remedy for the future the unfair prejudice suffered by the petitioner and the likelihood of the conduct recurring.[164]

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[161] See *Count Gotthard SA Pilati v Witfontein Game Farm (Pty) Ltd and Others* [2013] 2 All SA 190 (GNP) para 25.1; *Omar v Inhouse Technical Management (Pty) Ltd and Others* 2015 (3) SA 146 (WCC) para 50 and *Off-beat Holiday Club and Another v Sanbonani Holiday Spa Shareblock Ltd and Others* 2017 (5) SA 9 (CC) para 28 where this is affirmed. In *Kudumane Investment Holding Ltd v Northern Cape Manganese Company (Pty) Ltd and Others* [2012] 4 All SA 203 (GSJ) para 61 the High Court remarked that the "powers of a court to grant appropriate relief in such circumstances are framed in the broadest of terms in section 163". In *De Klerk v Ferreira and Others* 2017 (3) SA 502 (GP) para 16 the High Court commented that s 163 of the Companies Act confers on courts a wide discretion to compel a transfer of shares or interests in order to deal with prejudicial, oppressive, unjust and inequitable conduct by a company, director, shareholder or member.

[162] This is made clear by the use of the word "including" in s 163(2) of the Companies Act, which indicates that the court is not limited to the remedies listed in s 163(2) of the Companies Act. See *Grancy Property Ltd v Manala and Others* 2015 (3) SA 313 (SCA) para 31 where the Supreme Court of Appeal affirmed that the orders that a court may make under s 163(2) of the Companies Act are non-exhaustive and open-ended. The orders which are listed in s 163(2) of the Companies Act are as follows: (i) an order restraining the conduct complained of; (ii) an order appointing a liquidator, if the company appears to be insolvent; (iii) an order placing the company under supervision and commencing business rescue proceedings if the court is satisfied that the company is financially distressed and the other circumstances set out in s 131(4)(*a*) of the Companies Act apply; (iv) an order to regulate the company's affairs by directing it to amend its Memorandum of Incorporation or to create or amend a unanimous shareholder agreement; (v) an order directing an issue or exchange of shares; (vi) an order appointing directors in place of or in addition to all or any of the directors then in office, or declaring a director to be delinquent or placing a director under probation; (vii) an order directing the company or any other person to restore to a shareholder any part of the consideration that the shareholder paid for shares, or pay the equivalent value, with or without conditions; (viii) an order varying or setting aside a transaction or an agreement to which the company is a party and compensating the company or any other party to the transaction or agreement; (ix) an order requiring the company, within a time specified by the court, to produce to the court or an interested person financial statements in a form required by the Companies Act, or an accounting in any other form the court may determine; (x) an order to pay compensation to an aggrieved person, subject to any other law entitling that person to compensation; (xi) an order directing rectification of the registers or other records of the company; and (xii) an order for the trial of any issue as determined by the court.

[163] See *Re Bird Precision Bellows Ltd* [1985] 3 All ER 523 at 529 and Hannigan *Company Law* at 408.

[164] See *Re Bird Precision Bellows Ltd* [1985] 3 All ER 523 at 529 and Hannigan *Company Law* at 408.

In terms of section 163(2)(*a*) of the Companies Act, one of the orders that a court may make is an order restraining the conduct which is the subject of the complaint. It is submitted that a director would probably not be able to obtain a court order to restrain the board of directors from passing a board resolution to remove him from office, even if the resolution would constitute oppressive or unfairly prejudicial conduct or that unfairly disregards his interests. The director who is the subject of a board resolution to remove him from office must be given a reasonable opportunity, in terms of section 71(4)(*b*) of the Companies Act, to make a presentation to the board of directors, in person or through a representative, before the resolution is put to a vote.[165] In his presentation a director may well be able to persuade the board of directors to vote against his removal from office. Therefore a court order in terms of section 163(2)(*a*) of the Companies Act restraining the board of directors from voting on the proposed resolution, would be inappropriate and premature.[166] In terms of section 163(1)(*a*) of the Companies Act the act or omission of the company must have "had a result" that is oppressive or unfairly prejudicial or that unfairly disregards the interests of the applicant. As the court in *Count Gotthard SA Pilati v Witfontein Game Farm (Pty) Ltd and Others*[167] emphasised, the phrase "has had a result" in section 163(1)(*a*) of the Companies Act indicates that the act must be completed and that it is the result, and not the act, that must be oppressive

[165] The presentation which a director may make to the board of directors is discussed in chapter 3, para 8.4.

[166] It is of interest that a director cannot prevent the shareholders from passing a resolution to remove him from office since the shareholders have a legal right to remove him under s 71(1) of the Companies Act and may exercise their vote as they please (see chapter 4, para 2 where this is discussed). For example, in *Desai and Others v Greyridge Investments (Pty) Ltd* 1974 (1) SA 509 (A) two directors applied for an interim interdict to restrain the shareholders from removing them from office pending the final determination of an action they intended instituting for a declaration of rights. The shareholders had lost confidence in the directors because they had breached their fiduciary duties as directors in connection with a certain property transaction. The then Appellate Division refused to grant the interim interdict requested by the directors. Likewise, in *Bentley-Stevens v Jones* [1974] 2 All ER 653 two directors wished to remove a third director from office. They sent a letter to him notifying him of a board meeting of the company to be held the next day at which it was to be resolved that the company should convene an extraordinary general meeting for the purpose of removing the director from office. The director did not receive the letter until the company had requisitioned the extraordinary general meeting to remove him from office. The director who had convened the extraordinary general meeting of the company purported to be acting by order of the board thereof whereas in fact no board meeting had been held. At the extraordinary general meeting the votes were cast in favour of removing the director from office. The removed director applied for an interlocutory injunction restraining the directors from acting on the resolution to remove him from office. The Chancery Division declined to grant the interlocutory injunction. It held that even if the director's complaint of irregularities was correct, the irregularities could be cured by going through the proper processes and the ultimate result would inevitably be the same (*Bentley-Stevens v Jones* [1974] 2 All ER 653 at 655. See also *James North (Zimbabwe) Pvt Ltd v Mattinson* 1990 (2) SA 228 (ZHC) at 235 where the court agreed with the approach adopted in *Bentley-Stevens v Jones* [1974] 2 All ER 653).

[167] [2013] 2 All SA 190 (GNP) para 17.6.

or unfairly prejudicial. This was further affirmed in *Kudumane Investment Holding Ltd v Northern Cape Manganese Company (Pty) Ltd and Others*[168] where the High Court found that the act under section 163 of the Companies Act must be something which had already been done or performed at the time of the application, and not an act which may or will occur only in the future.[169] This buttresses the argument that a director would have to apply for relief under section 163 of the Companies Act only when the board of directors has removed him from office in a manner that was oppressive, unfairly prejudicial or that unfairly disregarded his interests.

Section 163(1) of the Companies Act confers *locus standi* on a "director" to apply to court for relief, and not on a "former director". As discussed above, a director may apply for relief under section 163 of the Companies Act only when the board of directors has removed him from office in a manner that was oppressive, unfairly prejudicial or that unfairly disregarded his

[168] [2012] 4 All SA 203 (GSJ) para 52. The company in this case was a joint venture company constituted for the purpose of exploiting prospecting rights. As a result of infighting in the company, the applicant, a forty nine per cent shareholder in the company, sought an order to amend the shareholders' agreement between itself and the second respondent, a fifty one per cent shareholder. The order sought by the applicant was the removal of the directors of the second respondent from the board of directors so as to retain only one of the current directors of the second respondent on the board. In support of the order sought by it the applicant alleged that the infighting harmed the company's ability to conduct the affairs for which it was constituted, and thereby prejudiced the commercial rationale behind its existence. The result relied on by the applicant was the uncertainty as to the identity of the directors of the second respondent. The court held that the result requirement had been satisfied in that there was doubt as to which directors would be authorised to sit on the board of the company, and that no meeting could be held or resolution passed in the complete confidence that such meeting or resolution would be secure from challenge (para 57). The lack of confidence and uncertainty in this regard was held by the court to be the "result" (para 57).

[169] See also *Porteus v Kelly and Others* 1975 (1) SA 219 (W) where the court held that the mere calling of a meeting to pass a resolution to amend the articles of association of a private company was not unfairly prejudicial in itself (in the context of s 252 of the Companies Act 61 of 1973) on the basis that it related to threatened conduct. The court remarked that s 252 of the Companies Act 61 of 1973 did not empower a court to interfere to prevent the resolution being passed, but the provision only related to something which had been done or performed (at 222). It was argued in this case by counsel for the applicant that if a court could interfere after a resolution has been passed there is no reason in principle why it could not interfere to prevent the resolution from being passed. The court conceded that while it may well be that prevention of an act would be better than curing it after it has been committed, the section does not provide therefor, and that this may be a *casus omissus* (at 222). See further *Investors Mutual Funds Ltd and Another v Empisal (South Africa) Ltd and Others* 1979 (3) SA 170 (W) at 177 where the High Court agreed with this dictum in *Porteus v Kelly and Others* 1975 (1) SA 219 (W) and affirmed that s 252 of the Companies Act 61 of 1973 did not empower a court to interfere to prevent the passing of a proposed resolution, and that the section related to something which had already been done or performed and not to something which was to be done in the future. In contrast, s 994(1)(b) of the UK Companies Act of 2006 refers to an "actual or proposed" act or omission of the company that "is or would be so prejudicial". Under this approach it would not be necessary for the harm to be inflicted. It is also of interest that s 232(c) of the Australian Corporations Act of 2001 (the equivalent provision to s 163 of the (South African) Companies Act) refers to a "resolution, or a proposed resolution" being oppressive or unfairly prejudicial. See further Sibanda "The Statutory Remedy for Unfair Prejudice in South African Company Law" 75-76 for a discussion of the non-applicability of s 163 of the Companies Act to threatened conduct or anticipated oppression.

interests, and not when such removal is anticipated. This raises the question whether a director who has been removed from office by the board of directors or by the Companies Tribunal in a manner that was oppressive, unfairly prejudicial or that unfairly disregarded his interests, and is no longer a "director" of the company, would have *locus standi* to institute an application for relief under section 163 of the Companies Act, or whether he would lack standing to do so.

It is noteworthy that section 234 of the Australian Corporations Act of 2001, which sets out the list of persons who have *locus standi* to apply to court for relief from oppressive conduct under section 233 of the Australian Corporations Act of 2001,[170] explicitly makes provision for former members to apply to court for relief from oppressive conduct, in two instances. The first instance is where a person has been removed from the register of members because of a selective reduction of capital,[171] and the second instance is where a person has ceased to be a member of the company and the application relates to the circumstances in which such person ceased to be a member.[172] In a similar vein, it is submitted that, in the interests of fairness, clarity and certainty, section 163 of the (South African) Companies Act should be amended to state that the provision may be relied on by a person who has been removed from office by the board of directors (in terms of section 71(3) of the Companies Act) or the Companies Tribunal (in terms of section 71(8) of the Companies Act) if the application relates to the circumstances in which he was removed from office. Such an amendment would make it clear that former directors, who have been removed from office by the board of directors or the Companies Tribunal in a manner that was oppressive, unfairly prejudicial or that unfairly disregarded their

[170] Section 233 of the Australian Corporations Act of 2001 lists examples of the orders a court may make if it finds that s 232 of the Australian Corporations Act of 2001 is breached. The list of orders in s 233 of the Australian Corporations Act of 2001 is not a closed list (see further Austin & Ramsay *Ford, Austin and Ramsay's Principles of Corporations Law* para 10.490 at 762-766 on the forms of relief that a court may grant under s 233 of the Australian Corporations Act of 2001).

[171] Section 234(b) of the Australian Corporations Act of 2001. The rules to be followed by a company for reductions in share capital and for share buy-backs are set out in Chapter 2J (Transactions Affecting Share Capital) of the Australian Corporations Act of 2001. These rules are designed to protect the interests of members and creditors by, *inter alia*, seeking to ensure fairness between the company's members (s 256A(b) of the Australian Corporations Act of 2001). A reduction is either an equal reduction or a selective reduction (s 256B(2) of the Australian Corporations Act of 2001). A reduction is an equal one if it relates only to ordinary shares, it applies to each holder of ordinary shares in proportion to the number of ordinary shares they hold, and the terms of the reduction are the same for each holder of ordinary shares (s 256B(2) of the Australian Corporations Act of 2001). In all other instances, the share reduction is regarded as a selective reduction (s 256(B(2) of the Australian Corporations Act of 2001).

[172] Section 234(e) of the Australian Corporations Act of 2001.

interests, would be entitled to apply to court for relief under section 163 of the Companies Act.[173]

A court may under section 163(2)(*f*)(ii) of the Companies Act declare any person involved in the decision to remove a director in the manner prescribed delinquent or under probation, as contemplated in section 162 of the Companies Act. The placing of a director under probation in terms of section 163(2)(*f*)(ii) of the Companies Act is reinforced by section 162(7)(*a*)(iii) of the Companies Act. The latter provision states that a court may place a person under probation if while serving as a director the person acted in or supported a decision of the company to act in a manner contemplated in section 163(1) of the Companies Act. A court may place a person under probation under this ground only if it is satisfied that the declaration is justified having regard to the circumstances of the company's conduct, if applicable, and the person's conduct in relation to the management, business or property of the company at the time.[174] In other words, the company's conduct and the conduct of the particular oppressor are examined by a court in exercising its discretion[175] under section 162(7)(*a*)(iii) whether to place a director under probation. Any person with *locus standi* may raise the ground of acting in an oppressive manner as a basis to apply to court to place a director under probation.[176]

In contrast, section 162(5) of the Companies Act, which sets out the grounds under which a director may be declared delinquent, does not list as a ground a director acting in an oppressive manner as contemplated in section 163(1) of the Companies Act. It appears from section 163(2)(*f*)(ii) that acting in an oppressive manner as contemplated in section 163(1) is an additional ground under which a director may be declared delinquent. However, this ground of delinquency may not be relied upon by the persons with *locus standi* under section 162 of the Companies Act since the ground is not listed in section 162(5). It may only be relied upon by a court in making an order under section 163(2) of the Companies Act when a director has been

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[173] A discussion whether or not s 163 of the Companies Act should apply to former shareholders (as is the case under s 234(b) and s 234(c) of the Australian Corporations Act of 2001) or to directors who have been removed from office by the shareholders under s 71(1) of the Companies Act, is beyond the scope of this study.

[174] Section 162(8)(*a*) of the Companies Act.

[175] Section 162(7) of the Companies Act gives a court a discretion whether or not to place a person under probation, as discussed in chapter 6, para 3.9.

[176] See chapter 6 para 3.3 for a discussion of the persons with *locus standi* to apply to court to place a director under probation and chapter 3, para 3.5.3 where s 162(7)(*a*)(iii) is discussed.

found to have acted in an oppressive manner. It is submitted that this is a proper approach. A court does not have a discretion whether or not to declare a director delinquent if any of the grounds set out in section 162(5) are established.[177] If this ground were to be listed in section 162(5) a court would be obliged to declare a director who had acted in an oppressive manner delinquent. Such an order could, in certain circumstances, be too harsh. Under the current regulation a court has a discretion, under section 163(2)(*f*)(ii), whether or not to declare a director delinquent if he had acted in an oppressive manner.

Under section 163(2)(*j*) of the Companies Act a court may also order compensation to be paid to an aggrieved person, subject to any other law entitling that person to compensation. It is submitted that a court may even, if it considers it fit, make an order reinstating a director to the board of directors if it finds that the removal of a director by the board of directors was oppressive, unfairly prejudicial or unfairly disregarded his interests.[178] A director who applies for relief in terms of section 163 of the Companies Act should indicate the nature of the relief that he seeks.[179] Nevertheless, even if he does not do so, or does not include a particular remedy, section 163(2) empowers a court to make "any interim or final order it considers fit".

5. DEFAMATION

Even if a court were to find that a director's removal from the board of directors was invalid, this may not entirely alleviate the humiliation a director may have suffered on his purported removal from office by his fellow board members. This is particularly so in the case of an unfair removal of a director of a listed company, where much publicity may have been given to the director's removal director from office. A director who has unlawfully suffered reputational damage in the course of being removed from office may have a right to institute an action in delict for defamation against the director or directors responsible for the defamation. A defamation action would not arise in every instance when a director is removed from office. It

[177] See s 162(5) of the Companies Act which obliges a court to declare a person a delinquent director if any of the grounds set out in that section are established. The absence of a discretion in s 162(5) of the Companies Act is discussed in chapter 6, para 3.9.

[178] For a discussion on the reinstatement of a director who has been removed from office in breach of the fiduciary duties of the board of directors, see chapter 4, para 4.1, and see chapter 5, para 2.2 on the reinstatement of an executive director.

[179] *Lourenco and Others v Ferela (Pty) Ltd and Others (No 1)* 1998 (3) SA 281 (T) at 295; *Louw and Others v Nel* 2011 (2) SA 172 (SCA) para 23.

may arise in addition to the other remedies which a director may have for removal from office by the board of directors, in circumstances where the director has unlawfully or wrongfully suffered reputational harm in the course of his removal from office.

Defamation law seeks to protect the legitimate interest that individuals have in their reputation.[180] Defamation claims often attract constitutional law issues because they require a balance to be struck between the entrenched right of an individual to reputation, privacy and dignity on the one hand and the entrenched right to freedom of expression on the other.[181] The right to dignity is enshrined in section 10 of the Constitution,[182] while section 16 protects the right to freedom of expression.[183] Section 14 of the Constitution protects the right to privacy,[184] but there is no explicit provision in the Constitution protecting one's right to a reputation. In *National Media Ltd and Others v Bogoshi*[185] the Supreme Court of Appeal stated that the right to reputation is encapsulated in the constitutional right to dignity. This was followed by the Constitutional Court in *Khumalo v Holomisa*[186] where the court stated that "human dignity in our Constitution . . . values both the personal sense of self-worth as well as the public's estimation of the worth or value of an individual." Human dignity accordingly includes the

[180] *Khumalo and Others v Holomisa* 2002 (5) SA 401 (CC) para 28. South African common law draws a distinction between three categories of legal interest, being *corpus*, *fama* and *dignitas*. *Corpus* protects against infringements to the bodily integrity of a person, *fama* is the right to reputation protected by the law of defamation and *dignitas* is an umbrella concept which embraces personality rights such as the right to dignity, the right to identity, the right to feelings and the right to privacy. *Fama* is protected in South African law as an independent personality interest (see Neethling, Potgieter & Visser *Neethling's Law of Personality* 129; Van der Walt & Midgley *Principles of Delict* 111-122 and Milo *Defamation and Freedom of Speech* 25-26).

[181] *Botha and Others v Mthiyane and Another* 2002 (1) SA 289 (W) para 58; *Le Roux and Others v Dey (Freedom of Expression Institute and Restorative Justice Centre as Amici Curiae)* 2011 (3) SA 274 (CC) para 171; *Waldis and Another v Von Ulmenstein* 2017 (4) SA 503 (WCC) para 22.

[182] Section 10 of the Constitution states that everyone has inherent dignity and the right to have his dignity respected and protected.

[183] In terms of s 16 of the Constitution, everyone has the right to freedom of expression, which includes freedom of the press and other media, freedom to receive or impart information or ideas, freedom of artistic creativity and academic freedom and freedom of scientific research. This right does not extend to propaganda for war, incitement of imminent violence or advocacy of hatred that is based on race, ethnicity, gender or religion and that constitutes incitement to cause harm.

[184] Section 14 of the Constitution states that everyone has the right to privacy, which includes the right not to have their person or home searched, their property searched, their possessions seized or the privacy of their communications infringed.

[185] 1998 (4) SA 1196 (SCA) at 1216.

[186] 2002 (5) SA 401 (CC) para 27.

intrinsic worth of human beings shared by all people as well as the reputation of each person built upon his own individual achievements.[187]

Defamation is the wrongful, intentional publication of words or behaviour concerning another which has the effect of injuring his status, good name or reputation.[188] The requirements for an action based on defamation are the wrongful and intentional publication of a defamatory statement concerning the plaintiff.[189] The wrongfulness element lies in the infringement of the right to *fama* or a good name.[190] The plaintiff in a defamation action must prove that there was (i) publication (ii) of a defamatory statement (iii) referring to him.[191] Proof of the publication of defamatory matter referring to the plaintiff gives rise to the presumptions of wrongfulness and *animus injuriandi* (intention on the part of the defendant to impair the plaintiff's reputation, with knowledge of wrongfulness).[192]

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[187] *Khumalo and Others v Holomisa* 2002 (5) SA 401 (CC) para 27.

[188] *Tap Wine Trading CC v Cape Classic Wines (Western Cape) CC and Another* [1998] 4 All SA 86 (C) at 107; *Waldis and Another v Von Ulmenstein* 2017 (4) SA 503 (WCC) para 19; Neethling, Potgieter & Visser *Neethling's Law of Personality* 131.

[189] *Khumalo and Others v Holomisa* 2002 (5) SA 401 (CC) para 17; *Botha and Others v Mthiyane and Another* 2002 (1) SA 289 (W) para 47; *Waldis and Another v Von Ulmenstein* 2017 (4) SA 503 (WCC) para 19; Neethling, Potgieter & Visser *Neethling's Law of Personality* 131. A detailed discussion of the defamation action is beyond the scope of this study. See generally Burchell *The Law of Defamation in South Africa* 59-145; Burchell *Personality Rights and Freedom of Expression: The Modern* Actio Injuriarum 179-204; Neethling, Potgieter & Visser *Neethling's Law of Personality* 131-171; Van der Walt & Midgley *Principles of Delict* 117-122; Du Bois et al *Wille's Principles of South African Law* 147-155 and 1165-1197 and Midgley & Bester "Delict" in *LAWSA* paras 105-133.

[190] Neethling, Potgieter & Visser *Neethling's Law of Personality* 135.

[191] *A Neumann CC v Beauty Without Cruelty International* 1986 (4) SA 675 (C) at 680-681; *Sauls and Others v Hendrikse* 1992 (3) SA 912 (A) at 918; *Argus Printing and Publishing Co Ltd v Esselen's Estate* 1994 (2) SA 1 (A) at 20; *Sokhulu v New Africa Publications Ltd and Others* 2001 (4) SA 1357 (W) para 4; *Khumalo and Others v Holomisa* 2002 (5) SA 401 (CC) para 18*; Botha and Others v Mthiyane and Another* 2002 (1) SA 289 (W) para 48; *Mthembi-Mahanyele v Mail & Guardian and Another* 2004 (6) SA 329 (SCA) para 25; *Independent Newspapers Holdings Ltd and Others v Suliman* 2004 3 All SA 137 (SCA) para 19; *National Education, Health & Allied Workers Union and Another v Tsatsi* [2006] 1 All SA 583 (SCA) para 8; *Aymac CC and Another v Widgerow* 2009 (6) SA 433 (W) para 20; *Le Roux and Others v Dey (Freedom of Expression Institute and Restorative Justice Centre as Amici Curiae)* 2011 (3) SA 274 (CC) para 84; *Afriforum and Another v Pienaar* 2017 (1) SA 388 (WCC) para 12. See Burchell *The Law of Defamation in South Africa* 59-145; Burchell *Personality Rights and Freedom of Expression: The Modern* Actio Injuriarum 179-204; Neethling, Potgieter & Visser *Neethling's Law of Personality* 131-171; Van der Walt & Midgley *Principles of Delict* 117-123; Du Bois et al *Wille's Principles of South African Law* 1167-1176 and Midgley & Bester "Delict" in *LAWSA* para 105 where these requirements are discussed in detail.

[192] Burchell *Personality Rights and Freedom of Expression: The Modern* Actio Injuriarum 179. These presumptions are discussed further below.

Defamation may occur only if the defamatory statement is made known to a third party because without such publication the esteem which others hold for that person cannot be diminished.[193] The publication may be written or verbal, and it may be to a particular person or persons or generally to the public at large.[194] A distinction is drawn between "particular publication" to named and known individuals and "publication to the public at large".[195] In *Rivett-Carnac v Wiggins*[196] the court explained that particular publication is publication to one or more named or known or specific persons, while publication at large is publication to the public at large or a class or number of unknown or undesignated persons. A plaintiff in a defamatory action may rely on either particular publication or publication to the public at large.[197] The publication requirement would be met even if the defamatory statement were published to only one person.[198] In the case of particular publication, the names of all the persons to whom the publication was made must be provided in a defamation action, but this is not essential with regard to publication to the public at large.[199]

The defamatory material must refer to the plaintiff, whether expressly or by implication.[200] It must be such that it lowers the plaintiff in the estimation of right-thinking or right-minded

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[193] Neethling, Potgieter & Visser *Neethling's Law of Personality* 131. The element of publication distinguishes the action for defamation from the action for impairment of dignity (the inherent self esteem of all human beings). Publication to a person other than the plaintiff is not required for an action for the impairment of dignity (Burchell *Personality Rights and Freedom of Expression: The Modern* Actio Injuriarum 181).

[194] *Vermaak v Van Der Merwe* 1981 (3) SA 78 (N) at 80; *Botha and Others v Mthiyane and Another* 2002 (1) SA 289 (W) para 48; *Le Roux and Others v Dey (Freedom of Expression Institute and Restorative Justice Centre as Amici Curiae)* 2011 (3) SA 274 (CC) para 86; Van der Walt & Midgley *Principles of Delict* 117; Du Bois et al *Wille's Principles of South African Law* 1168.

[195] *Rivett-Carnac v Wiggins* 1997 (3) SA 80 (C) at 88; *Botha and Others v Mthiyane and Another* 2002 (1) SA 289 (W) para 48; Van der Walt & Midgley *Principles of Delict* 117; Du Bois et al *Wille's Principles of South African Law* 1169.

[196] 1997 (3) SA 80 (C) at 88. In drawing the distinction between particular publication and publication at large the court relied on the dictum in (1) *African Life Assurance Society Ltd*, (2*) African Guarantee and Indemnity Co Ltd*, (3) *African Consolidated Investment Corporation Ltd v Robinson & Co Ltd and Central News Agency Ltd* 1938 NPD 277 at 296-297. In this latter case the court stated that general publication would include publication in newspapers and books or orally to a public meeting or audience, while particular publication would include communications in a letter or in private conversation (at 297).

[197] Burchell *The Law of Defamation in South Africa* 67.

[198] *Vermaak v Van der Merwe* 1981 (3) SA 78 (N) at 83; *Le Roux and Others v Dey (Freedom of Expression Institute and Restorative Justice Centre as Amici Curiae)* 2011 (3) SA 274 (CC) para 86.

[199] *Rivett-Carnac v Wiggins* 1997 (3) SA 80 (C) at 88; Burchell *The Law of Defamation in South Africa* 70-71.

[200] *A Neumann CC v Beauty Without Cruelty International* 1986 (4) SA 675 (C) at 680-681; *Sauls and Others v Hendrikse* 1992 (3) SA 912 (A) at 918; *Aymac CC and Another v Widgerow* 2009 (6) SA 433 (W) para 20.

persons of society generally.[201] "Right-thinking" is generally equated with meaning a person of reasonable, ordinary or average understanding and development.[202] The test therefore for determining whether material is defamatory is whether a reasonable person of ordinary intelligence might reasonably understand the words published to convey a meaning that is defamatory to the plaintiff.[203] The test is objective.[204] The determination of whether a publication is defamatory involves a two-stage enquiry. The first is to establish the natural or ordinary meaning of the words and the second is to determine whether that meaning is defamatory.[205] A defamatory statement is one which injures the reputation of another with

[201] *Esselen v Argus Printing and Publishing Co Ltd and Others* 1992 (3) SA 764 (T) at 767; *Mohamed and Another v Jassiem* 1996 (1) SA 673 (A) at 702-703; *Sokhulu v New Africa Publications Ltd and Others* 2001 (4) SA 1357 (W) para 5; *Independent Newspapers Holdings Ltd and Others v Suliman* 2004 3 All SA 137 (SCA) para 29; *National Education, Health & Allied Workers Union and Another v Tsatsi* [2006] 1 All SA 583 (SCA) para 8; *Raliphaswa v Mugivhi and Others* 2008 (4) SA 154 (SCA) para 16; *Council for Medical Schemes v Selfmed* (561/2010) [2011] ZASCA 207 (25 November 2011) para 63; *Ketler Investments CC t/a Ketler Presentations v Internet Service Providers' Association* 2014 (2) SA 569 (GJ) para 48; Van der Walt & Midgley *Principles of Delict* 118; Du Bois et al *Wille's Principles of South African Law* 1171; Midgley & Bester "Delict" in *LAWSA* para 106. In *Sokhulu v New Africa Publications Ltd and Others* 2001 (4) SA 1357 (W) para 7 and *Afriforum and Another v Pienaar* 2017 (1) SA 388 (WCC) para 60 the respective courts stated that it must be accepted that all right-thinking or reasonable members of society subscribe to the norms and values of the Constitution.

[202] *Mohamed and Another v Jassiem* 1996 (1) SA 673 (A) at 706; *Kyriacou v Minister of Safety and Security and Another* 1999 (3) SA 278 (O) at 287; *Sindani v Van der Merwe and Others* 2002 (2) SA 32 (SCA) para 11; *Le Roux and Others v Dey (Freedom of Expression Institute and Restorative Justice Centre as Amici Curiae)* 2011 (3) SA 274 (CC) para 168. See Neethling, Potgieter & Visser *Neethling's Law of Personality* 135-140 for a detailed discussion on the reasonable person of ordinary intelligence and development in this context.

[203] *Argus Printing and Publishing Co Ltd v Esselen's Estate* 1994 (2) SA 1 (A) at 20; *Sokhulu v New Africa Publications Ltd and Others* 2001 (4) SA 1357 (W) para 4; *Mthembi-Mahanyele v Mail & Guardian and Another* 2004 (6) SA 329 (SCA) para 25; *Independent Newspapers Holdings Ltd and Others v Suliman* 2004 3 All SA 137 (SCA) para 19; *National Education, Health & Allied Workers Union and Another v Tsatsi* [2006] 1 All SA 583 (SCA) para 8; *Le Roux and Others v Dey (Freedom of Expression Institute and Restorative Justice Centre as Amici Curiae)* 2011 (3) SA 274 (CC) para 89; *Waldis and Another v Von Ulmenstein* 2017 (4) SA 503 (WCC) para 22; Du Bois et al *Wille's Principles of South African Law* 1171-1172.

[204] *A Neumann CC v Beauty Without Cruelty International* 1986 (4) SA 675 (C) at 680; *Argus Printing and Publishing Co Ltd v Esselen's Estate* 1994 (2) SA 1 (A) at 20; *Sindani v Van der Merwe and Others* 2002 (2) SA 32 (SCA) para 11; *National Education, Health & Allied Workers Union and Another v Tsatsi* [2006] 1 All SA 583 (SCA) para 8; *Mthembi-Mahanyele v Mail & Guardian and Another* 2004 (6) SA 329 (SCA) para 25; *Le Roux and Others v Dey* 2010 (4) SA 210 (SCA) para 6; *Modiri v Minister of Safety and Security and Others* 2011 (6) SA 370 (SCA) para 13; *Le Roux and Others v Dey (Freedom of Expression Institute and Restorative Justice Centre as Amici Curiae)* 2011 (3) SA 274 (CC) paras 39 and 89. The reasonable person of ordinary intelligence is regarded as understanding the words alleged to be defamatory, "in their natural and ordinary meaning" (*Argus Printing and Publishing Co Ltd v Esselen's Estate* 1994 (2) SA 1 (A) at 20; *Mthembi-Mahanyele v Mail & Guardian and Another* 2004 (6) SA 329 (SCA) para 25). In determining the natural and ordinary meaning of words a court must take account not only of what the words expressly say but also of what they imply (*Argus Printing and Publishing Co Ltd v Esselen's Estate* 1994 (2) SA 1 (A) at 20; *Sindani v Van der Merwe and Others* 2002 (2) SA 32 (SCA) para 11; *Mthembi-Mahanyele v Mail & Guardian and Another* 2004 (6) SA 329 (SCA) para 25).

[205] *Sindani v Van der Merwe and Others* 2002 (2) SA 32 (SCA) para 10; *Le Roux and Others v Dey* 2010 (4) SA 210 (SCA) para 5; *Council for Medical Schemes v Selfmed* (561/2010) [2011] ZASCA 207 (25 November 2011) paras 57-58; *Le Roux and Others v Dey (Freedom of Expression Institute and Restorative Justice Centre as Amici Curiae)* 2011 (3) SA 274 (CC) paras 38 and 89.

reference to moral character, professional or business reputation, or which exposes him to enmity, ridicule or contempt.[206] In *Le Roux and Others v Dey (Freedom of Expression Institute and Restorative Justice Centre as Amici Curiae)*[207] the Constitutional Court gave the following examples of statements that are defamatory:

> "Examples of defamatory statements that normally spring to mind are those attributing to the plaintiff that he or she has been guilty of dishonest, immoral or otherwise dishonourable conduct. But defamation is not limited to statements of this kind. It also includes statements which are likely to humiliate or belittle the plaintiff; which tend to make him or her look foolish, ridiculous or absurd; and which expose the plaintiff to contempt or ridicule that renders the plaintiff less worthy of respect by his or her peers."

Once the publication of defamatory material has been proved, the presumptions arise that the publication of the defamatory material was wrongful and that it was intentional.[208] The onus is then on the defendant to rebut these presumptions by proving a defence which excludes either wrongfulness or intent, such as fair comment, privileged occasion, reasonable publication, or

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[206] *A Neumann CC v Beauty Without Cruelty International* 1986 (4) SA 675 (C) at 686; *Botha and Others v Mthiyane and Another* 2002 (1) SA 289 (W) para 49; *Ketler Investments CC t/a Ketler Presentations v Internet Service Providers' Association* 2014 (2) SA 569 (GJ) para 49; Van der Walt & Midgley *Principles of Delict* 118-119; Midgley & Bester "Delict" in *LAWSA* para 106.

[207] 2011 (3) SA 274 (CC) para 91.

[208] See *National Media Ltd and Others v Bogoshi* 1998 (4) SA 1196 (SCA) at 1202; *Khumalo and Others v Holomisa* 2002 (5) SA 401 (CC) para 18; *Botha and Others v Mthiyane and Another* 2002 (1) SA 289 (W) paras 51 and 171; *Modiri v Minister of Safety and Security and Others* 2011 (6) SA 370 (SCA) para 12; *Le Roux and Others v Dey (Freedom of Expression Institute and Restorative Justice Centre as Amici Curiae)* 2011 (3) SA 274 (CC) para 85; *Waldis and Another v Von Ulmenstein* 2017 (4) SA 503 (WCC) para 20; Burchell *Personality Rights and Freedom of Expression: The Modern* Actio Injuriarum 207-230; Neethling, Potgieter & Visser *Neethling's Law of Personality* 135-140; Du Bois et al *Wille's Principles of South African Law* 1176-1177 and Midgley & Bester "Delict" in *LAWSA* para 111 where these presumptions are discussed in detail. The presumption of intention relates to the defendant's subjective state of mind, that is, the deliberate intention to inflict injury is presumed, while the presumption of wrongfulness relates to objective matters of law and fact (*National Media Ltd and Others v Bogoshi* 1998 (4) SA 1196 (SCA) at 1202; *Botha and Others v Mthiyane and Another* 2002 (1) SA 289 (W) para 51; *Modiri v Minister of Safety and Security and Others* 2011 (6) SA 370 (SCA) para 12).

truth and for the public benefit (or public interest).[209] The onus on the defendant to rebut either of these presumptions must be discharged on a balance of probabilities.[210]

With regard to the defence of truth and for the public benefit or public interest (which defence rebuts the presumption of wrongfulness) the defendant need not prove that the defamatory statement was true in every detail. He merely needs to prove that the gist or the sting of the statement was true.[211] Even if the defendant is able to prove that the defamatory statement is true, this would not be sufficient to succeed in this defence.[212] The defendant must also prove that the statement was made for the public benefit or public interest. The public benefit must be determined having regard to questions of legal or public policy.[213] Whether or not a

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[209] *Khumalo and Others v Holomisa* 2002 (5) SA 401 (CC) para 18; *Le Roux and Others v Dey (Freedom of Expression Institute and Restorative Justice Centre as Amici Curiae)* 2011 (3) SA 274 (CC) para 85. These defences are not all-encompassing. Publication of defamatory material which amounts to fair comment or a fair expression of opinion based upon true facts and which is shown to be in the public interest is justified, and is therefore lawful. In respect of the defence of privileged occasion, the publication of defamatory material in privileged circumstances is also justified and therefore lawful. A privileged occasion includes one where material is published while exercising a right, in discharging a duty or in furthering a legitimate interest; in judicial or quasi-judicial proceedings, and where material is published in reports on court proceedings, proceedings of Parliament and proceedings of public bodies. With regard to the defence of reasonable publication, publication of false defamatory statements will not be regarded as unlawful if, upon a consideration of all the circumstances of the case, it is found to have been reasonable to publish the particular facts in the particular way and at the particular time. Publication of defamatory material which is true and for the public benefit or public interest is justified and therefore lawful. A detailed discussion of the defences to a defamation claim is beyond the scope of this study. For a general discussion of these defences and their specific requirements see *Argus Printing and Publishing Co Ltd v Inkatha Freedom Party* 1992 (3) SA 579 (A) at 588-590; *National Media Ltd and Others v Bogoshi* 1998 (4) SA 1196 (SCA); *Khumalo and Others v Holomisa* 2002 (5) SA 401 (CC) paras 18-20; *Lady Agasim-Pereira v Johnnic Publishing Eastern Cape (Pty) Ltd and Others* [2003] 2 All SA 416 (SE); *Allie v Foodworld Stores Distribution Centre (Pty) Ltd and Others* 2004 (2) SA 433 (SCA) paras 55-56; *Independent Newspapers Holdings Ltd and Others v Suliman* 2004 3 All SA 137 (SCA) paras 34-51; Burchell *The Law of Defamation in South Africa* 203-286; Burchell *Personality Rights and Freedom of Expression: The Modern* Actio Injuriarum 207-300; Neethling, Potgieter & Visser *Neethling's Law of Personality* 143-161; Van der Walt & Midgley *Principles of Delict* 147-155; Du Bois et al *Wille's Principles of South African Law* 1177-1190; Milo *Defamation and Freedom of Speech* 68-75 and Midgley & Bester "Delict" in *LAWSA* paras 110-133.

[210] *Mohamed and Another v Jassiem* 1996 (1) SA 673 (A) at 709; *National Media Ltd and Others v Bogoshi* 1998 (4) SA 1196 (SCA) at 1202; *Modiri v Minister of Safety and Security and Others* 2011 (6) SA 370 (SCA) para 10; *Le Roux and Others v Dey (Freedom of Expression Institute and Restorative Justice Centre as Amici Curiae)* 2011 (3) SA 274 (CC) para 85.

[211] *Argus Printing and Publishing Co Ltd v Inkatha Freedom Party* 1992 (3) SA 579 (A) at 589; *Modiri v Minister of Safety and Security and Others* 2011 (6) SA 370 (SCA) para 13; *Waldis and Another v Von Ulmenstein* 2017 (4) SA 503 (WCC) para 41. See *Independent Newspapers Holdings Ltd and Others v Suliman* 2004 3 All SA 137 (SCA) paras 34-51 for a further discussion of this defence.

[212] In *Modiri v Minister of Safety and Security and Others* 2011 (6) SA 370 (SCA) para 22 the Supreme Court of Appeal pointed out that our law does not regard the publication of a defamatory statement as justified merely because it is true since a court may find that in the particular circumstances of the case, freedom of expression was outweighed by the victim's right to privacy or dignity.

[213] *Argus Printing and Publishing Co Ltd v Inkatha Freedom Party* 1992 (3) SA 579 (A) at 589.

statement is published for the public benefit would depend on the time, manner and the occasion of the publication.[214] When deciding what is in the public interest it is important that a clear distinction be drawn between what is in the public interest to be made known and what is merely interesting to the public.[215] Publication of true statements about public officials and figures is generally regarded as being for the public benefit.[216] But it is not for the public benefit to publish matters which are highly personal and private.[217] The ultimate question is whether or not the disclosure of the material was reasonable in the circumstances.[218] The test for public benefit or interest is objective.[219]

If all the defences fail, a court would find that defamation has been proved and probably award damages to the plaintiff (also referred to as sentimental damages).[220] Damages for defamation should compensate the plaintiff for both wounded feelings and for loss of reputation.[221] The measure of damages is in the discretion of the court.[222] In calculating the amount of damages to be awarded a court must have regard to all the circumstances of the case.[223] The damages awarded by courts are generally not generous because an action for defamation is seen as a

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[214] *Kemp and Another v Republican Press (Pty) Ltd* 1994 (4) SA 261 (E) at 266; *Allie v Foodworld Stores Distribution Centre (Pty) Ltd and Others* 2004 (2) SA 433 (SCA) paras 55-56.

[215] *National Media Ltd and Others v Bogoshi* 1998 (4) SA 1196 (SCA) at 1212; *Lady Agasim-Pereira v Johnnic Publishing Eastern Cape (Pty) Ltd and Others* [2003] 2 All SA 416 (SE) at 425; *Independent Newspapers Holdings Ltd and Others v Suliman* 2004 3 All SA 137 (SCA) para 42; *Waldis and Another v Von Ulmenstein* 2017 (4) SA 503 (WCC) para 23.

[216] *Argus Printing and Publishing Co Ltd v Inkatha Freedom Party* 1992 (3) SA 579 (A) at 589; Du Bois et al *Wille's Principles of South African Law* 1178.

[217] *National Media Ltd and Others v Bogoshi* 1998 (4) SA 1196 (SCA) at 1210; *Lady Agasim-Pereira v Johnnic Publishing Eastern Cape (Pty) Ltd and Others* [2003] 2 All SA 416 (SE) at 425.

[218] Midgley & Bester "Delict" in *LAWSA* para 126.

[219] *Independent Newspapers Holdings Ltd and Others v Suliman* 2004 3 All SA 137 (SCA) para 49.

[220] *Argus Printing and Publishing Co Ltd v Inkatha Freedom Party* 1992 (3) SA 579 (A) at 590; Du Bois et al *Wille's Principles of South African Law* 1190.

[221] *Le Roux and Others v Dey (Freedom of Expression Institute and Restorative Justice Centre as Amici Curiae)* 2011 (3) SA 274 (CC) para 151l; Burchell *Personality Rights and Freedom of Expression: The Modern* Actio Injuriarum 435.

[222] Du Bois et al *Wille's Principles of South African Law* 1191.

[223] *Muller v SA Associated Newspapers Ltd and Others* 1972 (2) SA 589 (C) at 595.

method whereby a plaintiff vindicates his reputation and "not as a road to riches".[224] Factors that a court may take into account in determining the amount of damages are the gravity of the allegation, the nature of the words used, the extent of the publication, its effect, the character and status of the plaintiff, the extent and nature of the plaintiff's reputation and any malice by the defendant.[225]

Applying the above legal principles to the removal of a director from office, a director who has been removed from office by the board of directors in terms of section 71(3) of the Companies Act may institute an action in delict for defamation against the responsible director or directors in circumstances where his personal or professional reputation has been unlawfully harmed, or where he has unlawfully been exposed to enmity, ridicule or contempt. In *Lewis Group Limited v Woollam and Others*[226] the Western Cape Division, Cape Town, stated, *obiter*, that:

> "The appropriate remedy for any damage to the reputation of the applicant or the second to fifth respondents [being directors of the company] that may have been caused unlawfully as a result of the demand (as to which I express no view) falls to be sought in proceedings in delict."

Ncube correctly expresses the view that directors "who are subjected to frivolous dismissal proceedings based on unfounded or unreasonable allegations may have remedies under the common law for defamation."[227] It is, however, submitted that even if a director is lawfully removed from office, he may nevertheless have valid grounds for a defamation action. It is doubtful whether a director who has lawfully been removed from office would institute a defamatory action, but if defamatory statements were wrongfully and intentionally made about him in the course of his removal from office, he would have a right to institute such an action. Even if the director in question has not been removed from office but in an attempt to do so a

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[224] *Argus Printing and Publishing Co Ltd v Inkatha Freedom Party* 1992 (3) SA 579 (A) at 590; Burchell *Personality Rights and Freedom of Expression: The Modern* Actio Injuriarum 436; Du Bois et al *Wille's Principles of South African Law* 1191.

[225] See *Muller v SA Associated Newspapers Ltd and Others* 1972 (2) SA 589 (C) at 595-596; Burchell *Personality Rights and Freedom of Expression: The Modern* Actio Injuriarum 435-475 and Milo *Defamation and Freedom of Speech* 246 for a discussion of these factors.

[226] (17199/2016) [2017] ZAWCHC 15 (1 March 2017) para 15. This case dealt with whether the first respondent (Woollam) was legally able to withdraw a demand made in terms of s 165 of the Companies Act without the consent of Lewis Group Limited or without the leave of the court. The main judgment in this case, reported as *Lewis Group Limited v Woollam* 2017 (2) SA 547 (WCC), is discussed in chapter 6, para 3.3.1.2.

[227] Ncube "You're Fired! The Removal of Directors under the Companies Act 71 of 2008" 40.

director or directors on the board of directors has wrongfully and intentionally injured his reputation, he may have a right to institute an action for defamation against the director or directors concerned. The success of such an action would depend on whether the director in question is able to prove successfully the elements of a defamation action, and on whether such defamatory conduct was wrongful and intentional. In the context of removal proceedings, it may be necessary for a board member to state matters of a defamatory nature about the director whose removal is in issue. It is important to balance the director's right to reputation against the interests of the board of directors and its right to remove a director from office on valid grounds. A fear of a defamation action should not act to inhibit the board of directors from taking the necessary steps under section 71(3) of the Companies Act to remove a director from office where valid grounds to do so exist. At the same time, the board of directors should take care not to unlawfully and intentionally defame a director's reputation in the course of removal proceedings, particularly by making allegations against him which do not relate to any of the grounds of removal provided for in section 71(3) of the Companies Act.

In order to succeed in a defamation action, the director must prove that there was (i) publication (ii) of a defamatory statement (iii) referring to him.[228] Such publication may be written or verbal. For instance, the publication could take place in the statement of reasons proposed for the removal of the director (which is to be included in notice of the meeting),[229] drafted by the chairman of the board of directors and circulated to the board. The notice of a board meeting is generally confidential; it is not a public document, but, as indicated, the publication requirement would be satisfied if publication is made to a particular named or known or specific persons. It need not be publication at large. Thus, the circulation of a statement of reasons drafted by the chairman of the board of directors containing defamatory statements about the director concerned and which is circulated to the board of directors, could arguably constitute publication of defamatory statements by the chairman of the board regarding the director concerned. If the entire board of directors were involved in drafting the defamatory statement of reasons for the removal of a director, and no persons other than the board members had attended the board meeting and, further, the statement is not made available to persons other than those who attended the meeting,[230] a director would find it difficult to prove the element

[228] See note 191 above.

[229] Section 71(4)(*a*) of the Companies Act.

[230] See Du Bois et al *Wille's Principles of South African Law* 1169.

of publication. This is because the defamatory statement must be communicated or made known to at least one person other than the plaintiff.[231] A verbal defamatory statement made by a board member at a board meeting would satisfy the publication element since the defamatory statement would have been communicated or made known to the board members present at the meeting. This would again constitute particular publication to named and known individuals, rather than publication to the public at large.

If the publication element is satisfied the plaintiff director must prove that the statements made are defamatory and that they refer to him. To do this, he would have to prove that a reasonable person of ordinary intelligence would reasonably understand the words published, whether in writing or verbally, to convey a meaning defamatory to him.[232] Whether a director institutes a defamation action against an individual board member or against the entire board of directors, would depend on whether the individual board member, or the entire board had published the defamatory statement.

The director concerned is not required to prove that the defamatory statements are wrongful or that they were published intentionally. If he is able to prove that there was a publication of defamatory material about him, the presumptions would automatically arise that the publication of the defamatory material was wrongful and that it was intentional. The particular board member or members responsible for publishing the defamatory statement would then have the onus of rebutting either the presumption of wrongfulness or intention by proving a defence which excludes either wrongfulness or intention.

One defence that may be raised in this context is that the defamatory statements about the director who was the subject of removal proceedings were true and, in addition, that their publication was in the public benefit. For instance, a defamatory statement which was published for the benefit of the company and its shareholders may arguably be published for the public benefit. It is not however in the public benefit to publish matters which are highly personal and private.[233] If the director in question has a high public profile and is a public figure (such as a

[231] *Le Roux and Others v Dey (Freedom of Expression Institute and Restorative Justice Centre as Amici Curiae)* 2011 (3) SA 274 (CC) para 86.

[232] See note 203 above.

[233] *National Media Ltd and Others v Bogoshi* 1998 (4) SA 1196 (SCA) at 1210; *Lady Agasim-Pereira v Johnnic Publishing Eastern Cape (Pty) Ltd and Others* [2003] 2 All SA 416 (SE) at 425.

director of a well known listed company) this fact may assist the defendants to prove that the statements were made in the public interest since publication of true statements about public officials and figures is generally regarded as being for the public benefit.[234] If, on the other hand, a board member makes a statement at the board meeting about a highly personal matter relating to the director who is the subject of removal proceedings and which has no bearing on the grounds for removal listed in section 71(3) of the Companies Act, that is, whether the director is ineligible, disqualified, incapacitated, negligent or derelict, such a statement would arguably not have been published in the public benefit. If the defendants are not able to prove a defence to the defamation claim which rebuts either the presumption of wrongfulness or intention, the plaintiff director would be successful in his defamation action. A court would in such event most likely make an appropriate award of damages to him for loss of reputation, taking into account, *inter alia*, the nature of the words used, the extent of the publication, its effect, the character and status of the director in question, and any malice by the persons or persons who made the statements.

6. CONCLUSIONS AND RECOMMENDATIONS

This chapter examined the various remedies which a director cold rely on should he be removed from office by the board of directors in terms of section 71(3) of the Companies Act. In order to successfully rely on these remedies, the affected director must of course comply with the specific requirements of each remedy.

A director has a right to institute a review application to court, within twenty business days of his removal from office by the board of directors, in terms of section 71(5) of the Companies Act.[235] The person who had appointed that director in terms of section 66(4)(*a*)(i) of the Companies Act also has *locus standi* to institute the review application.[236] Section 71(5) is silent on the payment of costs of a section 71(5) review application.[237] Presumably the common law civil procedure rule that costs follow the event would be followed.[238] Assuming that a court

[234] *Argus Printing and Publishing Co Ltd v Inkatha Freedom Party* 1992 (3) SA 579 (A) at 589.

[235] See para 2 above.

[236] See para 2 above.

[237] See para 2 above.

[238] See para 2 above.

is empowered to review the substance and merits of the board's decision to remove a director from office, it was argued that a challenge a director may face in relying on section 71(5) is to prove, on a balance of probabilities, that he was removed from office with ulterior motives.[239] This is particularly so if the board has framed the grounds for his removal as neglect of his functions or having been derelict in the performance of his functions, or that he failed to meet any other broadly expressed or subjective standard.[240]

The following recommendations were made with regard to improving and enhancing the review application in terms of section 71(5) of the Companies Act:

- In order for there to be consistency with section 71(6) of the Companies Act and to broaden the scope on which a director may challenge his removal from office, a court should not be confined to enquiring into the procedural correctness of the decision to remove a director from office. It should be empowered under a section 71(5) review to enquire into the merits of the board's decision to remove a director from office.[241]

- In the interests of clarity and legal certainty, section 71(5) should specify when the period of twenty business days would commence. Presumably this would be from the date that the board of directors makes the decision to remove the director from office.[242]

- Clarity must be provided by the legislature on the orders a court may make on a review in section 71(5) should it set aside the board's decision to remove a director from office.[243] It must be elucidated whether a court would be empowered to reinstate an improperly removed director to office, in appropriate circumstances, and whether it may order compensation to be paid to such a director.[244]

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[239] See para 2.1 above.

[240] See para 2.1 above.

[241] See para 2.1 above.

[242] See para 2 above.

[243] See para 2.2 above.

[244] See para 2.2 above.

- Since a director would be suspended from office during the twenty business day period within which the review application may be lodged, it is submitted that, in accordance with section 1726(d) of the Pennsylvania Business Corporation Law, section 70(2) of the Companies Act should incorporate a provision to the effect that any acts of the board during the period of suspension of a director who is later reinstated by a court under a section 71(5) review, may not be impugned or invalidated.[245] This would ensure minimal disruption to the running of the company if the suspended director were to be reinstated to the board by a court.[246] Such a provision would also remove any doubt whether decisions taken by the board of directors in the absence of the suspended director, once he is reinstated to the board, remain valid.[247] It would furthermore ensure that any decisions taken by the board of directors in the absence of the suspended director would not be subject to challenge by third parties when the suspended director is reinstated to the board.[248] The provision would also accord with the purpose of the Companies Act in section 7(*j*) of encouraging the efficient and responsible management of companies.[249]

A second remedy discussed in this chapter was the right of a director to apply for damages or other compensation for loss of office in terms of section 71(9) of the Companies Act.[250] While a director may claim damages or other compensation for loss of office, he may do so only if he has the right to do so under the company's Memorandum of Incorporation or his service contract.[251] In order to successfully claim damages or other compensation the director must not have breached the company's Memorandum of Incorporation or his service contract, and he must be able to prove his damages.[252] Importantly, the director would be under a duty to mitigate his loss by looking for and taking alternative employment where this is reasonably

[245] See para 2 above.

[246] See para 2 above.

[247] See para 2 above.

[248] See para 2 above.

[249] See para 2 above.

[250] See para 3 above.

[251] See para 3 above.

[252] See para 3 above.

expected.[253] His damages would therefore generally be reduced by the value of any such alternative employment which he could have taken.[254]

A director may in addition claim damages or other compensation for the loss of any other office as a consequence of being removed as a director.[255] The damages which a director may claim for his loss of office could be very steep and could result in significant financial loss for the company.[256] It is important for the board of directors to ensure that the measure of the damages resulting from the removal of a director is not prohibitive to the extent that removal becomes impractical for the company.[257] Generally, the longer the period of the service contract, the greater the damages that are payable to a director who has been removed before the end of the period specified in his service contract.[258] It is advisable for directors not to be given lengthy terms of employment because of the potential financial implications involved in removing them from office prior to the expiry of their contractual terms.[259]

Neither the Companies Act, nor the King IV Report or the JSE Listings Requirements require the termination payments of directors for loss of office to be approved by the shareholders of the company.[260] In order to moderate the scale of the termination payments to be paid to directors for loss of office and to prevent directors from abusing their influence and serving their own interests, it was submitted that the (South African) Companies Act must adopt provisions akin to section 226C of the UK Companies Act of 2006 or section 200E of the Australian Corporations Act of 2001 requiring shareholders to approve the payments made to directors for loss of office.[261] This would confer on shareholders some control over termination payments and would result in enhanced transparency with regard to the termination payments

[253] See para 3 above.

[254] See para 3 above.

[255] See para 3 above.

[256] See para 3 above.

[257] See para 3 above.

[258] See para 3 above.

[259] See para 3 above.

[260] See para 3 above.

[261] See para 3 above.

made to directors.[262] Adopting such a provision would also accord with the purposes of the Companies Act in sections 7(*b*)(iii) and 7(*j*) of promoting the development of the South African economy by encouraging transparency, and of encouraging the efficient and responsible management of companies.[263]

A director who has been removed from office by the board of directors in breach of its fiduciary duties may rely on section 163(1)(*a*) of the Companies Act on the ground that an act or omission of the company (the board of directors) has had a result (his removal from office) that is oppressive, unfairly prejudicial or that unfairly disregards his interests.[264] A director may also rely on section 163(1)(*c*) of the Companies Act to contend that the powers of a director or directors have been exercised in a manner that is oppressive or unfairly prejudicial to him or that unfairly disregards his interests.[265] The motive of the board of directors in removing a director from office would assist a court in deciding whether the act or the exercise of the power is oppressive, unfairly prejudicial or unfairly disregarded the director's interests in the context of section 163(1) of the Companies Act.[266] In order to succeed under section 163 of the Companies Act, a director who has been removed from office by the board of directors must be able to prove that his removal was in fact oppressive, unfairly prejudicial or that it unfairly disregarded his interests.[267] These terms have not been defined in the Companies Act but there is ample case law on the meaning of these terms.[268]

If a director who is also a shareholder is removed from office in a small domestic company or a quasi-partnership in the absence of a fair offer by the majority shareholders to purchase his shares or some other fair arrangement, this would assist him to prove that the exercise of the board's power in removing him from office was unfairly prejudicial.[269] The director must

[262] See para 3 above.

[263] See para 3 above.

[264] See para 4 above.

[265] See para 4 above.

[266] See para 4 above.

[267] See para 4 above.

[268] See para 4 above.

[269] See para 4 above.

however be able to prove as a fact that he had a legitimate expectation that he would participate in the company's management.[270] Proving such a legitimate expectation is more challenging in larger companies which are not run as quasi-partnerships.[271] Unlike the position under section 994 of the UK Companies Act of 2006 and section 232 of the Australian Corporations Act of 2001 where the oppression remedy is limited to shareholders, a director acting under the (South African) Companies Act does not have to prove that the company is a quasi-partnership in order to institute an action under section 163 of the Companies Act since section 163(1)(*c*) confers *locus standi* on a director to rely on the oppression remedy in his capacity as a director.[272]

In considering an application in terms of section 163(1) of the Companies Act a court has wide powers and also a discretion to make any interim or final order it considers fit.[273] A director may apply for relief under section 163 only when the board has removed him from office since section 163(1)(*a*) of the Companies Act requires the result, and not the act, to be oppressive.[274] It was submitted that, in the interests of fairness, clarity and certainty, section 163 of the Companies Act should be amended to state that the provision may be relied on by a person who has been removed from office by the board of directors (in terms of section 71(3) of the Companies Act) or the Companies Tribunal (in terms of section 71(8) of the Companies Act) if the application relates to the circumstances in which he was removed from office.[275] Such an amendment would make it clear that former directors who have been removed from office by the board of directors or the Companies Tribunal in a manner that was oppressive, unfairly prejudicial or that unfairly disregarded their interests, would be entitled to apply to court for relief under section 163 of the Companies Act.[276]

A director who applies for relief in terms of section 163 of the Companies Act should indicate the nature of the relief that he seeks, but even if he fails to do so a court is empowered to make

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[270] See para 4 above.

[271] See para 4 above.

[272] See para 4 above.

[273] See para 4 above.

[274] See para 4 above.

[275] See para 4 above.

[276] See para 4 above.

any interim or final order it considers fit.[277] If a court were to find that the removal of a director from office by the board of directors constituted oppressive conduct it may declare any director so involved delinquent or under probation.[278] It may also order compensation to be paid to the affected director, subject to any other law entitling him to compensation.[279] In addition, a court may, if it considers it fit, make an order reinstating the affected director to the board of directors.[280]

In addition to the remedies discussed above, a director may also be able to institute a delictual action against a director or directors for defamation if he has unlawfully suffered reputational damage in the course of his removal from office.[281] The right of a director to institute an action for defamation in the course of his removal from office depends on whether he is able to successfully prove the elements of a defamation action, and on whether such defamatory conduct was wrongful and intentional. If the director is able to prove that there was a publication of defamatory material about him, the presumptions would automatically arise that the publication of the defamatory material was wrongful and that it was intentional. The particular board member or members responsible for publishing the defamatory statement may rebut these presumptions by proving a defence that excludes either wrongfulness or intent.[282] If the defences fail a court would probably award damages to the affected director.[283] In accordance with section 158(1)(*a*) of the Companies Act, in adjudicating a defamation claim by a director who has been removed from office by the board of directors, a court must develop the common law as necessary to improve the realisation and enjoyment of rights established by the Companies Act.[284]

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[277] See para 4 above.

[278] See para 4 above.

[279] See para 4 above.

[280] See para 4 above.

[281] See para 5 above.

[282] See para 5 above.

[283] See para 5 above.

[284] See para 5 above.

CHAPTER 8 CONCLUSIONS AND RECOMMENDATIONS

1. INTRODUCTION

This thesis set out to examine the provisions in the Companies Act relating to the removal of directors from office by the board of directors and the judiciary. The removal of directors by the Companies Tribunal was also examined. The shift in the balance of power between the board of directors and the general body of shareholders brought about by sections 71(3) and 162 of the Companies Act was explored. In addition, the fiduciary duties of directors when removing a fellow director from office were examined. The removal of directors holding additional positions or capacities in relation to the company such as a company employee, or a shareholding-director holding loaded voting rights, was also considered. In the last instance, the remedies on which a director may rely should he be removed from office by the board of directors were examined. This concluding chapter summarises the conclusions and recommendations that were set forth and developed in the preceding chapters of this thesis on these matters.

2. CONCLUSIONS AND RECOMMENDATIONS

The conclusions reached in this thesis on the removal of directors by the board of directors and the judiciary are set out below. As a result of these conclusions, recommendations, including legislative amendments to the Companies Act,[1] are suggested.

[1] In this chapter the recommended insertions to provisions of the Companies Act are underlined, while the recommended deletion of specific wording in the Companies Act is "struck out." This approach was selected rather than the one generally adopted in the amendments to statutes which is slightly more complicated.

2.1 Philosophical Underpinnings with Regard to the Removal of Directors from Office

Chapter 2 of this thesis examined the underpinning philosophy of the removal of directors from office, as well as the division of powers between directors and shareholders.[2] The extent and impact of the innovative power given to the board of directors under section 71(3) of the Companies Act to remove directors from office, and of the equivalent power given to courts under section 162 of the Companies Act, were explored.[3] It was contended that the conferral of power on the board of directors to remove fellow directors has shifted the balance of power and the dynamics between the board of directors and shareholders.[4] It has also had an impact on the balance of power between the shareholders and the board of directors, between the shareholders themselves and between the directors themselves.[5] It was shown that the conferral of power on the judiciary to remove directors from office has impacted on the relationship between the shareholders, the directors and the judiciary.[6] It is submitted that the balance of power between the shareholders and the directors can no longer be maintained in the manner that had existed prior to the conferment of the power of removal on the board of directors and the judiciary.[7] In an effort to achieve the proper balance sought by section 7(*i*) of the Companies Act, that is, to balance the rights and obligations of shareholders and the board of directors within companies, the following submissions are made with regard to containing the redistribution of power between the directors and shareholders:

(a) Before removing a fellow director from office, the board of directors should give due consideration to the concept of corporate democracy. It should consider whether the inherent rights of shareholders to remove directors should be honoured, or whether it

[2] See chapter 2, paras 2, 3 and 4.

[3] See chapter 2, paras 5 and 6.

[4] See chapter 2, para 5.

[5] See chapter 2, para 5.

[6] See chapter 2, para 6.

[7] See chapter 2, para 7.

should be disregarded, particularly where the director in question was appointed by the shareholders and not by the board.[8]

(b) The board should consider whether a fellow director whom the board of directors wishes to remove is a representative of the minority shareholders, and if so, the impact of such removal on the dynamics between the majority and minority shareholders.[9]

(c) The board should consider whether in removing a director from office it would be breaching its fiduciary duties or acting with ulterior motives.[10]

(d) The board should consider whether it is acting openly and transparently at all times and in the best interests of the company when removing a director from office.[11]

It is further suggested that the courts should deliberate on the following factors in exercising their removal power so as to give due consideration to the inherent right of shareholders to remove directors and to the principle of non-interference by courts in the internal affairs of a company:

(a) the circumstances and reasons why the shareholders or the board of directors failed to remove the director in question;

(b) whether the removal of the director would be in the best interests of the company;

(c) the adequacy of any other available remedies;

(d) whether, in making its decision to remove a director from office, the board of directors has complied with its fiduciary duties in removing the director in question, or whether it has acted with ulterior motives;

[8] See chapter 2, para 7.

[9] See chapter 2, para 7.

[10] See chapter 2, para 7.

[11] See chapter 2, para 7.

(e) whether the board of directors has made an objective, and not a subjective, assessment of a fellow director with regard to whether he had neglected his functions or had been derelict in the performance of his functions, should this be the reason the board gives for the removal of the director in question; and

(f) whether the board of directors has acted openly and transparently and in the best interests of the company in removing the director in question.[12]

2.2 The Removal of Directors by the Board of Directors

Chapter 3 of this thesis examined the grounds for the removal of a director by the board of directors, set out in section 71(3) of the Companies Act, and the procedures to remove a director from office, set out in section 71(4) of the Companies Act. It compared the grounds and procedures with the equivalent provisions in the UK Companies Act of 2006, the Australian Corporations Act of 2001, the MBCA, the DGCL and the corporation laws of various States in the USA. The removal of directors by the Companies Tribunal under section 71(8) of the Companies Act was also examined.

Compared to the equivalent provisions in certain foreign jurisdictions, section 71(3) of the (South African) Companies Act is unique in that the board's power to remove fellow board members is an unalterable provision.[13] An unalterable provision is a provision of the Companies Act that does not expressly contemplate that its effect on any particular company may be negated, restricted, limited, qualified, extended or otherwise altered in substance or effect by a company's Memorandum of Incorporation or rules.[14] A company may not "contract out" of the unalterable provisions of the Companies Act, but a company's Memorandum of Incorporation may impose a more onerous requirement on the company than that contained by an unalterable provision of the Companies Act.[15] An alterable provision is a provision of the Companies Act in which it is expressly contemplated that its effect on a particular company may be negated, restricted, limited, qualified, extended or otherwise altered in substance or

[12] See chapter 2, para 7.

[13] See chapter 3, para 2.5

[14] See chapter 3, para 2.1.

[15] See chapter 3, para 2.1.

effect by that company's Memorandum of Incorporation.[16] Many of the alterable provisions of the Companies Act are "opt-out" provisions, that is, they will apply to the company unless it opts out of them by so stipulating in its Memorandum of Incorporation, as opposed to the "opt-in" provisions which do not apply to a company unless it specifically so provides in its Memorandum of Incorporation.[17] The corporation laws of most States in the USA have not conferred on the board of directors the power to remove fellow board members.[18] The majority of the States in the USA that have conferred such power on the board of directors have made such power alterable rather than mandatory, in that the board of directors may remove fellow board members but only if the articles of incorporation or the by-laws make provision for this to be done.[19] The UK Companies Act of 2006 and the Australian Corporations Act of 2001 both provide that the board of directors may remove directors only if empowered to do so by the constitution of the company.[20]

A second unique feature of section 71(3) of the (South African) Companies Act is that the removal rights do not follow appointment rights. The board of directors is empowered to remove from office any director, regardless of whether the shareholders or a person named in, or determined in terms of, the Memorandum of Incorporation had appointed that director to office.[21] It was observed that section 71(3) has not imposed any legal safeguards to ensure that directors cannot remove from office the director representatives of minority shareholders. In contrast, the corporation laws of those States in the USA that permit directors to remove fellow board members distinguish between directors who were appointed by the board of directors and those who were appointed by the shareholders, and contain provisions to protect minority shareholder representatives on the board from removal by the board of directors.[22]

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[16] See chapter 3, para 2.1.

[17] See chapter 3, para 2.1.

[18] See chapter 3, para 2.4.

[19] See chapter 3, para 2.4.

[20] See chapter 3, paras 2.2 and 2.3.

[21] See chapter 3, para 3.

[22] See chapter 3, para 3.

It is submitted that section 71(4) of the (South African) Companies Act has certain commendable elements compared to the equivalent provisions in the foreign jurisdictions reviewed. In general, section 71(4) of the (South African) Companies Act regulates in more detail the procedures for the board of directors to remove a director compared to the equivalent procedures in the Australian Corporations Act of 2001, the UK Companies Act of 2006 and the statutes of the various States in the USA that permit the board of directors to remove directors. The prescribed procedures in the (South African) Companies Act are clear, binding on all companies and standardised for all companies (save to the extent that the notice period for board meetings varies for each company and to the extent that the Memorandum of Incorporation of a company alters the alterable provisions relating to the threshold for passing board resolutions and the quorum for board meetings).[23] The requirement in section 71(4)(*a*) that the board must provide a director with a statement setting out the reasons for the proposed resolution to remove him from office, is unique to the Companies Act.[24] It is submitted that this requirement is a laudable one which enables the impugned director to prepare a response to the allegations made against him, prior to the proposed board meeting to remove him from office.[25]

It is submitted that there is merit in permitting the board of directors to remove fellow board members, and, provided the board acts openly and there are acceptable safeguards against abuse of the power to remove fellow board members, this power ought to remain in the Companies Act.[26] Nevertheless, in order to clarify, enhance and strengthen sections 71(3) and 71(4) of the Companies Act, the following recommendations are made:

(a) It is recommended that the power to remove directors in section 71(3) of the Companies should be an alterable rather than a mandatory power.[27] It should further be an "opt out" provision in that the board's power to remove a director should apply unless the company opts out of it by expressly so stipulating in its Memorandum of

[23] See chapter 3, para 8.5.

[24] See chapter 3, para 8.3.

[25] See chapter 3, para 8.3.

[26] See chapter 2, para 5.1 and chapter 3, para 2.5.

[27] See chapter 3, para 3.

Incorporation.[28] An alterable power of removal of directors by the board of directors would give a company the option of weighing up the advantages and disadvantages of empowering its particular board of directors to remove directors.[29] A company would consequently be empowered to determine whether it wishes to retain the default provision under the Companies Act empowering the board of directors to remove fellow board members or whether to limit or alter this default provision to suit its particular needs by negating, restricting, limiting, qualifying, or extending the board's power to remove fellow board members.[30] Under the terms of an alterable power of removal, a company would additionally be empowered to incorporate in section 71(3) provisions to protect the minority shareholder representatives on the board of directors, should it wish to do so.[31] An alterable power of removal would moreover bring section 71(3) in line with the equivalent provisions in the foreign jurisdictions reviewed. Furthermore, it would accord with the purpose in section 7(*i*) of the Companies Act of balancing the rights and obligations of shareholders and directors within companies.[32] It is consequently recommended that section 71(3) of the Companies Act should be preceded by the following phrase:

> "Except to the extent that the company's Memorandum of Incorporation provides otherwise, ~~I~~if a company has more than two directors, and a shareholder or director has alleged that a director of the company –"

(b) Section 71(3)(*a*) of the Companies Act provides that one of the grounds on which a director may be removed by the board of directors is that he has become ineligible or disqualified in terms of section 69 of the Companies Act.[33] Section 69(6) provides that the Memorandum of Incorporation of a company may impose additional grounds of ineligibility or disqualification of directors or minimum qualifications to be met by

[28] See chapter 3, para 3.

[29] See chapter 3, para 4.4.

[30] See chapter 3, para 3.

[31] See chapter 3, para 3.

[32] See chapter 3, para 3.

[33] See chapter 3, paras 6.1.2 and 6.1.3.

directors. It is proposed that any such additional qualifications in the Memorandum of Incorporation should endeavour to enhance the ability of the board of directors to perform its role effectively, should not be used for improper purposes, and should not be unreasonable or unlawful.[34] An amendment to this effect in section 69(6) would avoid any ambiguity regarding the type of permissible qualifications or additional grounds of ineligibility or disqualification that may be inserted in the Memorandum of Incorporation of a company.[35] It is of concern that section 71(3)(*a*) read with section 69(6) does not contain any provision guarding against the introduction of a new qualification requirement or a new ground of ineligibility or disqualification being misused to remove directors from office.[36] It is recommended that a new section 69(6A) be inserted in the Companies Act in order to prevent a new qualification or a new ground of ineligibility or disqualification being introduced and abused as a means of removing a director from office under section 71(3)(*a*) of the Companies Act. Drawing on the equivalent provisions in sections 8.02(a) and 8.02(e) of the MBCA, it is recommended that section 69(6) of the Companies Act be amended as follows:

> "(6) Subject to subsection (6A), ~~I~~in addition to the provisions of this section, the Memorandum of Incorporation of a company may impose –
>
> *(a)* additional grounds of ineligibility or disqualification of directors; or
>
> *(b)* minimum qualifications to be met by directors of that company~~.~~, provided that such additional grounds or minimum qualifications are reasonable as applied to the company and are lawful.
>
> (6A) Any additional grounds of ineligibility or disqualification or any minimum qualifications to be met by directors, as referred to in subsection (6), which are prescribed after a director has been elected or appointed, shall not apply to that director before the end of that director's term."

[34] See chapter 3, para 6.1.2.3.

[35] See chapter 3, para 6.1.2.3.

[36] See chapter 3, para 6.1.2.3.

(c) It would be too disruptive to the running of a company's business and its affairs if the past acts of an ineligible or disqualified director were not regarded as valid. It is submitted that a provision similar to section 214 of the previous Companies Act 61 of 1973 and section 161 of the UK Companies Act of 2006 should be inserted in the Companies Act, to the effect that the acts of a person acting as a director will be valid notwithstanding that it is afterwards discovered that there was a defect in his appointment or that he was disqualified from holding office.

(d) Incapacity in the employment law context is a form of no-fault dismissal.[37] No-fault dismissal involves a form of behaviour, conduct or inability which is not intentional or negligent.[38] It is proposed that a similar approach be adopted to the ground of incapacity in section 71(3)(*a*)(ii) of the Companies Act. Under this approach, before the board of directors removes a director from office on the ground of incapacity, it should consider the degree of the incapacity, the cause of the incapacity, and the possibility of securing a temporary replacement, such as an alternative director, for the ill or injured director while he recovers from his incapacity.[39] In order to guard against this ground being improperly applied to remove directors from office in instances where the board of directors is not properly qualified to make the relevant incapacity assessment, it is recommended that a registered medical practitioner or a court should assess (i) whether a director is incapacitated to the extent that he is unable to perform the functions of a director and (ii) whether he is incapacitated to the extent that he is unlikely to regain that capacity within a reasonable period of time.[40] This approach would further guard against this ground of removal being abused when conflicts arise between the directors, and would bring section 71(3)(*a*)(ii) in line with the equivalent provisions in the UK and in various States in the USA, which have adopted such an approach.[41] It is recommended that section 71(3)(*a*)(ii) be amended as follows:

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[37] See chapter 3, para 6.2.1.

[38] See chapter 3, para 6.2.1.

[39] See chapter 3, para 6.2.3.

[40] See chapter 3, para 6.2.4.

[41] See chapter 3, para 6.2.4.

"(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, as assessed by a registered medical practitioner or by a court; or"

(e) The phrase "the functions of a director" as used in sections 71(3)(*a*)(ii) and 71(3)(*b*) indicates that an objective standard of assessment is utilised and not a subjective standard.[42] Consequently, in order to ascertain whether a director is incapacitated or has neglected or has been derelict in the performance of the functions of a director, one must objectively determine whether he has failed to fulfil the functions of a director; the issue is not whether he has failed to fulfil his own specific functions as a director of the particular company.[43] It is recommended that a subjective, and not an objective, standard should explicitly be provided for in these provisions.[44] This is important in light of the fact that the functions of a director vary depending on the type of company of which he is a director, the type of director he is, and the nature of the company's business.[45] An objective test does not distinguish between the functions of a director of a public, private, personal liability, non-profit or state-owned company, or between an executive and a non-executive director.[46] A subjective standard would furthermore result in there being consistency between section 71(3)(*b*) and section 162(5)(*c*)(iv)(*aa*) of the Companies Act, which imposes a subjective standard in ascertaining whether a director is delinquent.[47] It is essential that there be consistency and harmony between these two provisions since the right of removal of a director is in addition to the right of a person to apply to a court in terms of section 162 for an order declaring a director delinquent.[48] It is consequently recommended that sections 71(3)(*a*)(ii) and 71(3)(*b*) be amended as follows:

[42] See chapter 3, para 6.3.1.

[43] See chapter 3, para 6.3.1.

[44] See chapter 3, para 6.3.1.

[45] See chapter 3, para 6.3.1.

[46] See chapter 3, para 6.3.1.

[47] See chapter 3, para 6.3.1.

[48] See chapter 3, para 6.3.1.

"Except to the extent that the company's Memorandum of Incorporation provides otherwise, ~~I~~if 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) ...

(ii) incapacitated to the extent that the director is unable to perform the ~~functions of a director~~director's functions within the company, and is unlikely to regain that capacity within a reasonable time, as assessed by a registered medical practitioner or by a court; or

(b) has neglected, or been derelict in the performance of, ~~the functions of director~~the director's functions within the company,"

(f) It is not clear whether the term "derelict" as used in section 71(3)(*b*) of the Companies Act contemplates the fault element of intention or whether a director could be found guilty of being derelict in the performance of the functions of director if he had acted negligently.[49] In the absence of any guidelines from the Companies Act and in light of the fact that a negligent dereliction of duty is recognised in South African case law, it is submitted that a negligent dereliction of duty would suffice as a valid ground of removal under section 71(3)(*b*) of the Companies Act, provided that both the elements of "negligence" and "dereliction" are clearly present, based on the facts and circumstances of the case.[50] Due to the vagueness and imprecision of the term "derelict", which is not defined by the Companies Act, until the legislature or our courts clarify the meaning of this term as used in section 71(3)(*b*) of the Companies Act, it is important to guard against this ground being invoked vexatiously by shareholders or the directors as a ground for the removal of a director in the case of conflicts arising between the shareholders and directors or between the directors themselves.[51] Care must be taken that this ground is not used as a "catch-all" ground where cases are pushed into the mould of "dereliction of duty" when they do not really

[49] See chapter 3, para 6.3.2.

[50] See chapter 3, para 6.3.2.

[51] See chapter 3, para 6.3.2.

fit there.[52] The imputation of a dereliction of duty should not be lightly made against an individual director; there must be a clear and strong basis before the board of directors finds that one of its members has been derelict in the performance of the functions of director.[53]

(g) It was observed that the legislature has used the term "negligent" in sections 71(3), 71(5), 71(6)(*a*) and 71(6)(*b*)(ii) of the Companies Act instead of the term "neglect" when the term "neglect" is referred to in section 71(3)(*b*) as a ground for the proposed removal of a director from office by the board of directors.[54] It was argued that the terms "neglect" and "negligent" do not have the same meaning.[55] It is not clear whether the legislature confused the terms "neglect" and "negligent", and intended to refer to the term "neglectful" instead of "negligent".[56] It is recommended that the legislature clarify this perplexity by amending legislation. Until such clarity is provided, it appears that negligence may be an additional statutory ground which a shareholder or a director may invoke for the removal of a director.[57]

(h) Section 69(6)(*a*) of the Companies Act provides that the Memorandum of Incorporation of a company may impose additional grounds of ineligibility or disqualification of directors. While additional grounds of removal of a director from office may be indirectly inserted in the Memorandum of Incorporation of a company by means of inserting additional grounds of ineligibility or disqualification in the Memorandum of Incorporation, it is not clear whether additional grounds for the removal of a director by the board of directors may be directly inserted in the Memorandum of Incorporation.[58] This must be clarified by the legislature or the

[52] See chapter 3, para 6.3.2.

[53] See chapter 3, para 6.3.2.

[54] See chapter 3, para 6.4.

[55] See chapter 3, para 6.4.

[56] See chapter 3, para 6.4.

[57] See chapter 3, para 6.4.

[58] See chapter 3, para 6.5.

courts.[59] In contrast, section 168(5) of the UK Companies Act of 2006 states that section 168 is not to be taken as "derogating from any power to remove a director that may exist apart from" section 168.[60] This has the implication that the UK articles of association of a company may provide additional grounds for the removal of directors.[61] The corporation laws of most States in the USA that permit directors to remove fellow board members state that the removal must be for "cause", which implies that there is scope for a broad spectrum of grounds for the removal of a director.[62] While the statutes are silent on the meaning of the term "cause" the common law in the USA has provided some guidelines on the meaning of this term.[63] In general, "for cause" means that there must be a justifiable reason for the removal.[64] It was argued that a general ground permitting directors to be removed for "cause" should not be adopted in section 71(3) of the Companies Act.[65] But, in order to ensure that directors may be removed from office by the board of directors in appropriate circumstances that do not fall under any of the grounds listed in section 71(3), it is recommended that the Companies Act should explicitly permit companies to insert in their Memorandums of Incorporation additional grounds for the removal of directors, over and above those specified in section 71(3). This would introduce a level of flexibility in section 71(3) that is currently lacking compared to the equivalent provisions in the UK, Australia and the statutes of many States in the USA.[66] As suggested, if section 71(3) of the Companies Act were an alterable and not a mandatory provision,[67] a company would be empowered to insert specific additional grounds for the removal of a director in order to suit the particular needs of the company. It is accordingly submitted that if the phrase "Except to the extent that the

[59] See chapter 3, para 6.5.

[60] See chapter 3, paras 2.3 and 6.5.

[61] See chapter 3, para 2.3.

[62] See chapter 3, para 6.5.

[63] See chapter 3, para 6.5.

[64] See chapter 3, para 6.5.

[65] See chapter 3, para 6.5.

[66] See chapter 3, para 6.5.

[67] See chapter 3, para 6.5 and para (a) above.

company's Memorandum of Incorporation provides otherwise" were to precede section 71(3) of the Companies Act, this would enable companies to provide for additional specific grounds for the removal of directors to suit their particular needs.[68]

(i) Section 71(4)(*a*) of the Companies Act does not specify the notice period of the board meeting to consider the resolution to remove a director from office.[69] In the interests of clarity and to avoid any controversy regarding the notice period to be given to a director who is to be removed from office, and to ensure that the notice period is fair and reasonable, it is submitted that a director ought to receive notice of the meeting which is at least equivalent to the notice period of any other board meeting.[70] It is consequently recommended that section 71(4)(*a*) be amended as follows:

> "*(a)* notice of the meeting, <u>at least equivalent to the notice period of a board meeting,</u> including a copy of the proposed resolution and a statement setting out reasons for the resolution, with sufficient specificity to reasonably permit the director to prepare and present a response; and"

(j) It is submitted that, in the interests of both clarity and certainty, section 71(4)(*b*) of the Companies Act should make explicit provision for the right of a director to make written representations to the board meeting, which must be circulated to the board members prior to the board meeting. This would remove any uncertainty whether a director is entitled to make written representations to the board meeting or whether the "presentation" referred to in section 71(4)(*b*) of the Companies Act is confined to a verbal presentation.[71] Written representations would give the board members an opportunity to consider and reflect on the director's defence before the meeting is convened.[72] It also gives board members an opportunity to investigate the impugned director's defence, and to prepare pertinent questions for him at the board meeting in

[68] See chapter 3, para 6.5.

[69] See chapter 3, para 8.2.

[70] See chapter 3, para 8.2.

[71] See chapter 3, para 8.4.

[72] See chapter 3, para 8.4.

order to satisfy themselves on the validity and merits of his defence.[73] Written representations may furthermore be more effective than a verbal presentation in a meeting which becomes disorderly, unruly or hostile.[74] In order to ensure that the option of circulating written representations is not abused, it is suggested that, in accordance with section 203D(6) of the Australian Corporations Act of 2001, the written representations need not be circulated if they exceed one thousand words or if they are defamatory. It is submitted further that, as was the case under the Companies Act 61 of 1973, in addition to the right to make written representations, a director should also be entitled to make a verbal presentation to the board meeting, in person or through a representative, before the resolution is put to the vote.[75] Since the written representations would be circulated to the board of directors only (and not to the shareholders) the costs thereof could easily be borne by the director concerned.[76] It is consequently recommended that section 71(4) be amended as follows:

"(4) Before the board of a company may consider a resolution contemplated in subsection (3), the director concerned must be given -

(a) notice of the meeting, at least equivalent to the notice period of a board meeting, including a copy of the proposed resolution and a statement setting our reasons for the resolution, with sufficient specificity to reasonably permit the director to prepare and present a response; ~~and~~

(b) an opportunity to make written representations in respect of the reasons for the resolution referred to in paragraph *(a)*, which representations may not exceed 1 000 words and which shall be circulated by the company, at the costs of the director concerned, prior to the board meeting to every member of the board to whom notice of the meeting is sent, unless such

[73] See chapter 3, para 8.4.

[74] See chapter 3, para 8.4.

[75] See chapter 3, para 8.4.

[76] See chapter 3, para 8.4.

written representations are received by the company too late for it to do so, or they exceed 1 000 words or are defamatory; and

~~(b)~~*(c)* a reasonable opportunity to make a verbal presentation, in person or through a representative, to the meeting before the resolution is put to a vote."

(k) The Companies Act does not require the removal of a director by a person who is named in, or determined in terms of, the Memorandum of Incorporation, pursuant to section 66(4)(*a*)(i), to comply with any specific procedural requirements.[77] Presumably the Memorandum of Incorporation of a company which empowers a specific person to appoint and remove a director from office would prescribe fair procedural requirements to remove such a director, but a company is not compelled to make provision for such procedures in its Memorandum of Incorporation.[78] In the interests of clarity and certainty it is recommended that the Companies Act should state that the removal of a director by a person named in or determined in terms of the Memorandum of Incorporation must follow a fair procedure in that the affected director should be provided with the reasons for his removal from office by the person who appointed him, as well as a reasonable opportunity to make a presentation to such person before the decision to remove him from office is taken.[79] It is consequently recommended that a new section 71(4A) be inserted in the Companies Act, to the following effect:

"71(4A) The provisions of subsection (4), read with the changes required by the context, shall apply to the removal of a director by any person who is named in, or determined in terms of, the Memorandum of Incorporation as contemplated in section 66(4)(*a*)(i)."

In terms of section 71(8) of the Companies Act, the Companies Tribunal must determine whether a director should be removed from office in companies which have less than three

[77] See chapter 3, para 10.

[78] See chapter 3, para 10.

[79] See chapter 3, para 10.

directors.[80] The following recommendations are made with regard to the removal of a director by the Companies Tribunal:

(a) In terms of section 71(8)(*c*) read with section 71(6)(*a*) of the Companies Act any director or shareholder may apply to the Companies Tribunal for a determination concerning the removal of a director from office.[81] If the Companies Tribunal removes a director from office, the director or a person who appointed that director as contemplated in section 66(4)(*a*)(i) of the Companies Act may apply to court within twenty business days to review the decision of the Companies Tribunal.[82] If the Companies Tribunal decides not to remove the director from office, a shareholder with voting rights entitled to be exercised in the election of that director or "any director who voted otherwise on the resolution" may apply to court to review the determination of the Companies Tribunal. Since the remaining director in the company (whose removal is not in issue) would not have voted on the resolution as the matter would have been determined by the Companies Tribunal, it is not clear whether he is empowered to apply to court to review the decision of the Companies Tribunal.[83] It is submitted that in light of the fact that section 71(8)(*c*) of the Companies Act states that section 71(6) would apply to the determination of the removal of a director by the Companies Tribunal as "read with the changes required by the context" that the remaining director ought to have this right.[84] It must however be clarified by the legislature or the courts whether the remaining director does have such a right.

(b) Under section 70(2) of the Companies Act if the board of a company has removed a director under section 71(3) of the Companies Act a vacancy on the board would not arise until the later of the expiry of the time for filing an application for a review of the board's decision in terms of section 71(5) of the Companies Act (which time period is twenty business days), or the granting of an order by the court on such an

[80] See chapter 3, para 9.

[81] See chapter 3, para 9.

[82] See chapter 3, para 9.

[83] See chapter 3, para 9.

[84] See chapter 3, para 9.

application.[85] The director would, however, be suspended from office during that time.[86] It was observed that the legislature did not impose a similar requirement with regard to the removal of a director by the Companies Tribunal.[87] This could be an oversight by the legislature.[88] It is recommended that in the interests of clarity and consistency and to remove any ambiguity, section 70(2) of the Companies Act must be amended to include a reference to a removal of a director by the Companies Tribunal in terms of section 71(8) of the Companies Act.[89] It is consequently recommended that section 70(2) of the Companies Act be amended as follows:

> "If, in terms of section 71(3) or section 71(8), the board of a company or the Companies Tribunal has removed a director, a vacancy on the board does not arise until the later of –
>
> *(a)* the expiry of the time for filing an application for review in terms of section 71(5) or section 71(8)(*c*); or
>
> *(b)* the granting of an order by the court on such an application,
>
> but the director is suspended from office during that time."

2.3 Directors' Fiduciary Duties and the Removal of Directors

Chapter 4 of this thesis examined the fiduciary duties of directors which apply when the board of directors removes a director from office under section 71(3) of the Companies Act. It was argued that when the board removes a director from office it has a duty to act in good faith, for a proper purpose and in the best interests of the company.[90] It was suggested further that directors must exercise their power to remove a fellow board member from office for the proper purpose for which the power was given to them, and not for a collateral or ulterior purpose.[91]

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[85] See chapter 3, para 9.

[86] See chapter 3, para 9.

[87] See chapter 3, para 9.

[88] See chapter 3, para 9.

[89] See chapter 3, para 9.

[90] See chapter 4, paras 3.1 and 3.2.

[91] See chapter 4, para 3.2.

In addition, it was submitted that directors must exercise an unfettered discretion and an independent judgment when removing directors from office.[92] It was argued that these duties would also apply when the board of directors decides not to remove a director from office.[93]

It was seen that in the pivotal UK case of *Lee v Chou Wen Hsien*[94] and the USA case of *Murray v Conseco Inc*[95] the respective courts did not reinstate a director who had been wrongly removed by the board of directors with ulterior motives and in breach of its fiduciary duties.[96] It was contended that the removal of directors under section 71(3) of the (South African) Companies Act is distinguishable from the removal of directors in the circumstances that had applied in these cases.[97] It is consequently submitted that, contrary to the decisions of the respective courts in these cases, a decision to remove a director under section 71(3) of the Companies Act which is made in breach of the fiduciary duties of the directors, must be set aside by a court, and, if appropriate in the circumstances, the improperly removed director should be reinstated to the board of directors.[98]

A further consequence of removing a director from office in breach of the fiduciary duties of directors (or in failing to remove that director from office) is that under section 77(2) of the Companies Act a director may be held liable in accordance with the common law principles relating to a breach of a fiduciary duty for any loss, damages or costs sustained by the company as a consequence of the breach by the director of a duty contemplated in sections 76(3)(*a*) (the duty to act in good faith and for a proper purpose) and 76(3)(*b*) (the duty to act in the best interests of the company).[99] A director who has contravened sections 76(3)(*a*) or (*b*) of the Companies Act in removing a fellow director would also incur liability under section 218(2) of the Companies Act to the improperly removed director, or to any other person, for any loss

[92] See chapter 4, para 3.3.

[93] See chapter 4, para 3.4.

[94] [1984] 1 WLR 1202.

[95] 766 N.E.2d 38 (Ind. Ct App. 2002).

[96] See chapter 4, para 4.1.

[97] See chapter 4, para 4.1.

[98] See chapter 4, para 4.1.

[99] See chapter 4, para 4.2.

or damage suffered by the improperly removed director or third person as a result of the breach of fiduciary duties.[100]

2.4 The Removal of Directors Holding Multiple Positions in a Company

Chapter 5 of this thesis discussed two considerations to be taken into account by the board of directors when removing a director from office. The first consideration is where the director is both a director and an employee of the company.[101] As an executive director he would enjoy the protection of both the Companies Act and the LRA. Thus, when he is removed from office, the provisions of both the Companies Act and the LRA must be taken into account by the board of directors.[102] A distinction must be drawn between the removal of a director from his office as a director of the company, and the removal of a director from his position as an employee of the company.[103] It was argued that automatic termination clauses, which provide for the automatic and simultaneous termination of employment upon the termination of board membership, are not valid.[104] Consequently if an executive director is removed from office by the board of directors, it is essential that the proper procedures under the LRA are followed to dismiss the director as an employee.[105] A company may not contract out of compliance with these procedures by the mechanism of automatic termination clauses. A purported waiver by an executive director of his right to be fairly dismissed as an employee is against public policy and is unenforceable.[106] It was argued that reverse automatic termination provisions (or self-executing rules) which provide for the automatic termination of a directorship upon the occurrence of an event, are however valid.[107]

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[100] See chapter 4, para 4.3.

[101] See chapter 5, para 2.1.

[102] See chapter 5, para 2.1.

[103] See chapter 5, para 2.1.

[104] See chapter 5, para 2.2.

[105] See chapter 5, para 2.2.

[106] See chapter 5, para 2.2.

[107] See chapter 5, para 2.3.

This chapter also highlighted other limitations which the board of directors must take into account prior to removing an executive director from office and terminating his employment with the company. It was submitted that if a company does not have a valid substantive ground to fairly dismiss an executive director as an employee, it may have to accommodate the former director in another employee capacity.[108] If an appropriate vacancy does not exist in the company, the company would have to retrench the former-director employee, and follow the procedures for dismissal based on operational requirements under section 189 of the LRA.[109] It was shown that the consequences of not terminating the employment of an executive director in a substantially and procedurally fair manner are severe for a company.[110] It is suggested that before the board of directors removes an executive director from office, it should consider whether it will be feasible to retain the former director as an employee, particularly if there has been a breakdown in the relationship between the director and the company.[111] It is, however, not always practical to strictly separate the two positions held by an executive director or to consistently apply a strict separation of such positions.[112]

The second consideration which must be taken into account before removing a director from office is whether the director is a shareholder of the company who holds loaded voting rights in the company.[113] The expression "loaded voting rights" or "weighted votes" is used to describe the device whereby certain shares are given additional voting strength above that enjoyed by other shares which, in every other respect, are identical to their participation in the company.[114] In essence, loaded voting rights are voting rights that are disproportionate to shareholdings.[115] This chapter discussed and evaluated the controversial leading UK case of *Bushell v Faith*,[116] in which a shareholding-director successfully prevented his removal from

[108] See chapter 5, para 2.2.

[109] See chapter 5, para 2.2.

[110] See chapter 5, para 2.2.

[111] See chapter 5, para 2.2.

[112] See chapter 5, para 2.2.

[113] See chapter 5, paras 3 and 3.2.

[114] See chapter 5, para 3.

[115] See chapter 5, para 3.

[116] [1970] AC 1099 (HL).

office through the exercise of his loaded voting rights.[117] The persuasive force of the majority and minority judgment in this case in South African law was evaluated.[118] It was argued that there is no difference in general principle between the UK law which applied in *Bushell v Faith*[119] with regard to loaded voting rights and section 37(2) of the (South African) Companies Act, which permits loaded voting rights to be conferred on shareholders.[120] It is submitted that while the majority decision in *Bushell v Faith*[121] may have persuasive authority in South African law, a provision in the Memorandum of Incorporation of a company that confers loaded voting rights on a particular class of shares and has the effect of defeating an ordinary resolution to remove a director, would be an indirect method of entrenching a director in office.[122] Such a provision may contravene section 71(1) of the Companies Act, and may also fall foul of the anti-avoidance provision contained in section 6(1) of the Companies Act.[123] In order to prevent an evasion of section 71(1) of the Companies Act, it is recommended that section 37(2) of the Companies Act be tightened up by the legislature.[124] In this respect it is recommended that section 37(2) of the Companies Act be amended as follows:

> "(2) Each issued share of a company, regardless of its class, has associated with it one general voting right, except to the extent provided otherwise by-
>
> *(a)* this Act; or
>
> *(b)* the preferences, rights, limitations and other terms determined by or in terms of the company's Memorandum of Incorporation in accordance with section 36~~.~~,
>
> provided that the Memorandum of Incorporation may not make provision for an issued share of a company to have associated with it more than one general

[117] See chapter 5, paras 3.3.1 and 3.3.2.

[118] See chapter 5, para 3.3.3.

[119] [1970] AC 1099 (HL).

[120] See chapter 5, para 3.3.3.

[121] [1970] AC 1099 (HL).

[122] See chapter 5, para 3.3.3.

[123] See chapter 5, para 3.3.3.

[124] See chapter 5, para 3.3.3.

voting right in circumstances where this will have the effect of primarily or substantially defeating section 71(1) of this Act."

2.5 The Judicial Removal of Directors from Office

Chapter 6 examined the removal of directors from office under sections 71(6) and 162 of the Companies Act. In terms of section 71(6) a court is empowered to remove a director from office if the board of directors has voted not to remove him from office and a disgruntled director or a holder of voting rights in the election of that director applies to court for the board's decision to be reviewed. Section 71(6) confers on courts a direct power to remove a director from office.[125] It was argued that the court's review powers under section 71(6) may be described as a "substantive" or a "wide review" or as a special statutory power of review.[126] A "substantive" or a "wide review" contains a merits-based substantive element, while a "special statutory power of review" confers on a court powers of both appeal and review.[127] The following recommendations are made with regard to improving and enhancing section 71(6) of the Companies Act:

(a) There is no time bar in which a director or a holder of voting rights is required to apply to court under section 71(6) to review the board's decision not to remove a director from office.[128] In order to bring the matter to a finality and to have consistency with the time limit of twenty business days prescribed in a section 71(5) review (for a director to apply to court to review his removal from office by the board of directors), it is suggested that a time limit of twenty business days should be imposed in section 71(6).[129] It is consequently recommended that section 71(6)(*a*) be amended as follows:

> "*(a)* any director who voted otherwise on the resolution, or any holder of voting rights entitled to be exercised in the election of that director, may

[125] See chapter 6, para 2.

[126] See chapter 6, para 2.2.

[127] See chapter 6, para 2.2.

[128] See chapter 6, para 2.3.

[129] See chapter 6, para 2.3.

apply within 20 business days of the board's determination to a court to review the determination of the board; and"

(b) Section 71(7) of the Companies Act has excluded the common law discretion conferred on courts with regard to the making of a costs order.[130] Courts should be conferred a discretion to make an appropriate costs order under section 71(6) so as to strike the right balance in ensuring, on the one hand, that directors and holders of voting rights are not discouraged from instituting *bona fide* and genuine review applications and that, on the other hand, they do not institute vexatious and frivolous review applications.[131] It is recommended that section 71(7) of the Companies Act should be deleted and replaced with a provision conferring on a court the discretion to make any order it considers appropriate on the costs of the application in terms of section 71(6).[132] It is consequently recommended that section 71(7) be amended as follows:

"71(7) ~~An applicant in terms of subsection (6) must compensate the company, and any other party, for costs incurred in relation to the application, unless the court reverses the decision of the board".~~A court may make an appropriate order of costs in relation to an application in terms of subsection (6)."

The distinct advantage of the provisions of section 71(6) of the Companies Act is that these provisions are a deterrent and a safeguard against the board of directors favouring a director who should be removed from office.[133] Nevertheless, section 71(6) offends the principle of non-interference by courts in the internal affairs of the company.[134] Such judicial interference is arguably justified in instances such as illegality, oppressive conduct or fraudulent conduct by the board of directors in failing to remove a director from office.[135] It is notable that section

[130] See chapter 6, para 2.4.

[131] See chapter 6, para 2.4.

[132] See chapter 6, para 2.4.

[133] See chapter 6, para 2.5.

[134] See chapter 6, para 2.5.

[135] See chapter 6, para 2.5.

71(6)(*b*) gives a court a discretion whether or not to remove a director from office.[136] It is recommended that in order to ensure that a court does not unduly interfere in the internal affairs of the company, before a court exercises its discretion to remove a director from office under a section 71(6) review application, it should give due consideration to the reasons why the board of directors did not remove the director from office, whether the board of directors had complied with its fiduciary duties in not removing the director from office, and whether it had acted openly and transparently and in the best interests of the company in not removing the director from office.[137]

Under section 162 of the Companies Act various stakeholders have *locus standi* to apply to court for an order declaring a director delinquent or under probation. Section 162 confers on courts an indirect power to remove a director from office since a court is empowered to declare a director delinquent which has the effect of disqualifying him to be a director, and hence removing him from office.[138] While section 162 is said to have a protective purpose, it is submitted that there is also a penal element to the section in that a declaration of delinquency involves a substantial and significant interference with the individual's freedom, and carries a stigma and reputational damage for the director.[139] For this reason it is suggested that declaring a director delinquent must not be done without due and proper consideration by a court.[140]

This chapter concluded that section 162 of the (South African) Companies Act is much wider, stricter and far-reaching than its equivalent provisions in the UK, Australia and the USA.[141] For instance, the range of persons who have *locus standi* to apply to court to remove a director from office are much wider under section 162 of the (South African) Companies Act compared to the equivalent provisions in the UK Company Directors Disqualification Act 1986, the Australian Corporations Act of 2001, the MBCA, the DGCL and the legislation of many other

[136] See chapter 6, para 2.6.

[137] See chapter 6, para 2.6.

[138] See chapter 6, para 3.1.

[139] See chapter 6, para 3.2.

[140] See chapter 6, para 3.2.

[141] See chapter 6, para 4.

States in the USA.[142] Care must be taken to guard against the abuse of section 162 by the wide group of person with *locus standi* to apply to court to declare a director delinquent, particularly since the provision does not contain safeguards or filters to protect against vexatious and frivolous applications.[143] It was contended that if shareholders were to institute delinquency proceedings by means of the derivative action this would have the advantage of curbing the abuse of section 162.[144]

In general, the grounds to declare a director delinquent and hence to remove him from office and much wider and far-reaching under section 162, and the threshold of misconduct set much lower, compared to the equivalent provisions in the foreign jurisdictions reviewed.[145] Nevertheless, the specified list of grounds of delinquency in section 162(5) of the (South African) Companies Act is a closed one, unlike the legislation of some USA States which give courts the power to remove directors from office for any proper cause.[146] It is submitted that in light of the harsh effects of a declaration of delinquency it is preferable to have a closed list of grounds on which a director may be declared delinquent.[147] It was shown that in ascertaining whether the grounds in section 162(5)(*c*) of the Companies Act have been breached, the courts apply both an objective and a subjective assessment.[148] The objective element lies in ascertaining whether the relevant ground has been infringed, while the subjective element lies in considering and weighing the personal qualifications and experience of the particular director in determining whether the offence in question has been committed by the particular director.[149]

There is no prescription period imposed on instituting an application to declare a director delinquent or to place him under probation in terms of section 162 of the (South African)

[142] See chapter 6, para 3.3

[143] See chapter 6, para 3.3.4.

[144] See chapter 6, paras 3.3.1.2 and 3.3.4.

[145] See chapter 6, paras 3.4, 3.4.3, 3.4.5, 3.4.7, 3.4.9 and 3.4.11.

[146] See chapter 6, para 3.4.11.

[147] See chapter 6, para 3.4.11.

[148] See chapter 6, para 3.4.6.

[149] See chapter 6, para 3.4.6.

Companies Act, unlike the equivalent provision in the UK Company Directors Disqualification Act 1986 which imposes a prescription period of three years.[150] It is suggested that a statutory time limit of three years should be imposed with regard to instituting applications to declare a director delinquent or to place him under probation.[151] It is submitted further that the twenty four month prescription period imposed on a director who ceases to be a director of a company should be extended to three years, so as to have consistency and harmony with the three-year prescription period imposed with regard to section 77 of the Companies Act, particularly since there is some overlap between the offences in section 77 and those set out in section 162(5)(*c*) of the Companies Act.[152] Imposing a three-year statutory time limit would ensure that directors are not left in a state of uncertainty; that they will be able to organise their affairs once the statutory time bar has passed free of the risk of future delinquency proceedings being instituted against them, and that a delinquent director is not left to function as a director for longer than necessary, thus protecting the public.[153] In order to ensure that in those instances where an application to declare a director delinquent or to place him under probation is not able to be lodged within the three-year time period, it is suggested that, as is the case under section 7(2) of the UK Company Directors Disqualification Act 1986, with the leave of the court, an application to apply to court to declare a director delinquent or to place him under probation after the three-year period may be made.[154] This would ensure that delinquent directors are not immune from applications to declare them delinquent after three years, but in order to bring such an application after three years, the leave of the court must be sought.[155] It will further serve to balance the public interest and the legitimate interests of the director.[156] Factors that may be relevant in considering whether to grant leave to commence delinquency or probation proceedings after three years would be the length of the delay, the reasons for the delay, the strength of the case against the director and the degree of prejudice caused to the director by

[150] See chapter 6, para 3.8.

[151] See chapter 6, para 3.8.

[152] See chapter 6, para 3.8.

[153] See chapter 6, para 3.8.

[154] See chapter 6, para 3.8.

[155] See chapter 6, para 3.8.

[156] See chapter 6, para 3.8.

the delay.[157] It is consequently recommended that sections 162(2)(*a*), 162(3)(*a*) and 162(4)(*a*) of the (South African) Companies Act be amended as follows:

> "(2) . . .
>
> *(a)* the person is a director of that company or, within the ~~24~~ 36 months immediately preceding the application, was a director of that company; and"
>
> "(3) . . .
>
> *(a)* the person is a director of that company or, within the ~~24~~ 36 months immediately preceding the application, was a director of a company; and"
>
> "(4) . . .
>
> *(a)* the person is a director of that company or, within the ~~24~~ 36 months immediately preceding the application, was a director of a company; and"

It is further recommended that a new section 162(14) be inserted, as follows:

> "(14) Except with the leave of the court, an application to declare a director delinquent or under probation under this section may not be commenced more than three years after the act that gave rise to such application."

It is further recommended that the courts make more effective use of their power to impose appropriate ancillary conditions to declarations of delinquency and probation in an effort to protect the public from any recurrence of the conduct by the director in question and to facilitate the rehabilitation of delinquent directors and directors under probation.[158]

It was observed that, unlike the UK Company Directors Disqualification Act 1986, the Australian Corporations Act of 2001, the MBCA, the DGCL and the legislation of various States in the USA, section 162 of Companies Act does not confer on South African courts any discretion to determine the minimum period of the declaration of delinquency.[159] A declaration

[157] See chapter 6, para 3.8.

[158] See chapter 6, para 3.6.3.

[159] See chapter 6, para 3.6.2.

of delinquency which is made on the basis that a person consented to serve as a director or acted in the capacity of a director while ineligible or disqualified in terms of section 69 of the (South African) Companies Act, or acted as a director in a manner that contravened an order of probation, is unconditional and subsists for the lifetime of the person declared delinquent.[160] In all other instances a declaration of delinquency subsists for seven years from the date of the court order, or such longer period as determined by the court at the time of making the declaration.[161] It was argued that the absence of a discretion is justifiable because a delinquent director may apply to court after three years to suspend the order of delinquency.[162] Unlike the legislation of the foreign jurisdictions referred to above, section 162 of the South African Companies Act also does not confer on South African courts any discretion whether or not to declare a director delinquent.[163] The provision is far stricter than the equivalent provisions in the foreign jurisdictions reviewed.[164] It is anomalous that a court has been given a discretion whether to remove a director from office under section 71(6) of the Companies Act, whether to place a director under probation under section 162(7) of the Companies Act and whether to disqualify a person from being a director (under section 69(11) of the Companies Act) but has not been given a discretion under section 162(5) whether to declare a director delinquent when the effect of all of these provisions is that the director in question is not permitted to serve as a director.[165] It was contended that the absence of a discretion results in a clear interference by the judiciary in the internal affairs of a company.[166] Section 162 of the (South African) Companies Act does not contain provisions designed to minimise judicial interference in the internal affairs of the company, unlike the equivalent provision in section 8.09(a) of the MBCA.[167] It is recommended that section 162 of the (South African) Companies Act should incorporate the following provisions modelled on the legislation of foreign jurisdictions in order to limit the extent of judicial interference in the internal affairs of a company:

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[160] See chapter 6, paras 3.6.1 and 3.6.2.

[161] See chapter 6, paras 3.6.1 and 3.6.2.

[162] See chapter 6, para 3.6.2.

[163] See chapter 6, para 3.9.

[164] See chapter 6, para 3.9.

[165] See chapter 6, para 3.9.

[166] See chapter 6, para 3.9.

[167] See chapter 6, para 3.10.

(a) courts should have a discretion whether or not to declare directors delinquent and hence remove them from office;

(b) courts should be required to consider whether the declaration of delinquency and removal of the director would be in the best interests of the company;

(c) courts should consider whether any other remedies besides a declaration of delinquency and removal of the director from office are adequate; and

(d) in addition to being able to grant any conditions ancillary to a declaration of delinquency or probation, courts should have the power to order any other relief under section 162 of the Companies Act.[168]

Setting aside a delinquency order is a two-stage process under section 162(11) of the Companies Act.[169] The applicant must first apply to have the delinquency order suspended and substituted with an order of probation, and thereafter, after a period of at least two years, he may apply for the probation order to be set aside.[170] It is submitted that the mandatory two-stage approach to set aside a delinquency order under section 162(11) of the Companies Act is commendable since it affords a court time and opportunity to monitor and assess the conduct of the delinquent director during the period that the delinquency order is substituted with a probation order.[171] Various challenges which a director may encounter in applying to court to set aside a delinquency order or a probation order were identified.[172] The following recommendations are made with regard to interpreting, applying and enhancing the remedy in section 162(11) of the Companies Act:

[168] See chapter 6, para 3.10.

[169] See chapter 6, para 3.11.1.

[170] See chapter 6, para 3.11.1.

[171] See chapter 6, para 3.11.1.

[172] See chapter 6, paras 3.11.4.1, 3.11.4.2 and 3.11.4.3.

(a) In exercising its discretion whether or not to grant the application in terms of section 162(11) of the Companies Act it is recommended that a court should, in accordance with the approach adopted in the UK and Australia, bear in mind that section 162 of the Companies Act is a protective remedy in the public interest, and that suspending or setting aside a delinquency order or a probation order must not frustrate the achievement of this object.[173] This is important in order to accord with the purpose of the Companies Act in section 7(*j*) of encouraging the efficient and responsible management of companies. It is recommended further that, in accordance with the approach adopted in the UK and Australia, in exercising its discretion under section 162(11) the hardship on the applicant should not weigh too heavily as a factor to be considered by the court.[174]

(b) Courts should ensure that the conditions imposed by them on a suspended delinquency order are capable of being monitored and are not easily disregarded by a director.[175] Suggestions were made on how the compliance with the conditions could be monitored.[176] This is important to ensure the proper protection of the public.[177] It also accords with the purpose of the Companies Act of encouraging the efficient and responsible management of companies, as contained in section 7(*j*) of the Companies Act.

(c) It is recommended that the applicant should propose to the court appropriate conditions which it may consider imposing, should it exercise its discretion to suspend the delinquency order.[178] This would serve to guide the court on the conditions to be imposed on the applicant in order to guard against the recurrence of the applicant's misconduct.[179] It may also serve to persuade a court to grant the application in terms

[173] See chapter 6, para 3.11.2.

[174] See chapter 6, para 3.11.2.

[175] See chapter 6, para 3.11.3.1.

[176] See chapter 6, para 3.11.3.1.

[177] See chapter 6, para 3.11.3.1.

[178] See chapter 6, para 3.11.3.2.

[179] See chapter 6, para 3.11.3.2.

of section 162(11) if the conditions proposed by the applicant would serve to protect the public from a recurrence of the applicant's misconduct.[180]

(d) It is recommended that the conditions to be imposed by a court on a suspended delinquency order should be specifically tailored to the misconduct committed by the director which had resulted in the original delinquency order being granted.[181] This would ensure that during the suspension of the delinquency order the risk of the director committing the same offence again would be minimised.[182]

(e) It is recommended that if an applicant breaches any of the conditions imposed on him by the court during the suspended delinquency order, the original delinquency order should be reinstated in full.[183] It is not clear from section 162 of the Companies Act whether or not a court may extend the delinquency order if the conditions are breached by the applicant.[184] This should be clarified by the legislature.

(f) It is recommended that in considering the circumstances leading to the original delinquency or probation order in terms of section 162(12)(*b*) of the Companies Act, in accordance with the approach adopted in the UK and Australia, a court should take into account the gravity of the misconduct which led to the original order.[185] It is further recommended that a distinction should be drawn between offences that are connected with the conduct of the company's affairs and those that are unrelated to the company's affairs.[186]

(g) Clarity is required on the meaning of the term "conduct" as used in section 162(12)(*b*) of the Companies Act.[187] It is recommended that, in considering the conduct of the

[180] See chapter 6, para 3.11.3.2.

[181] See chapter 6, para 3.11.3.3.

[182] See chapter 6, para 3.11.3.3.

[183] See chapter 6, para 3.11.3.4.

[184] See chapter 6, para 3.11.3.4.

[185] See chapter 6, para 3.11.4.1.

[186] See chapter 6, para 3.11.4.1.

[187] See chapter 6, para 3.11.4.2.

applicant in the ensuing period, a court should take into account both the specific conduct of the applicant in relation to his dealings with companies as well as his general conduct which may demonstrate progress towards rehabilitation.[188]

(h) The meaning of the term "rehabilitation" as used in section 162(12)(*b*)(i) of the Companies Act should be clarified.[189] It is recommended that guidance on the meaning of this term may be sought in the criminal law context, where the term "rehabilitation" is used in sentencing proceedings.[190] In the criminal law context, the term "rehabilitation" connotes positive impressions of the betterment of the offender, and connotes that the offender has learnt new values, has reformed and is now fit to take his place in society.[191]

(i) Certainty is required on the meaning of the phrase "reasonable prospect" of serving successfully as a director in the future, as used in section 162(12)(*b*)(ii) of the Companies Act. The Companies Act does not define this term in the context of section 162(12)(*b*)(ii) and its meaning has been left to the courts to determine.[192] Since the phrase "reasonable prospect" is used in the context of business rescue proceedings in section 131(4)(*a*) of the Companies Act, reference to the numerous judicial decisions on section 131(4)(*a*) would provide useful guidance on the meaning of the phrase in section 162(12)(*b*)(ii) of the Companies Act.[193] Drawing on the interpretation of the phrase "reasonable prospect" in the context of business rescue proceedings, it is submitted that the phrase "reasonable prospect" in section 162(12)(*b*)(ii) of the Companies Act means a possibility based on objectively reasonable grounds, that the director will be able to serve successfully as a director in the future. While vague averments and mere speculative suggestions would not suffice, an applicant need not go so far as to establish a reasonable probability that he would be able to serve successfully as a director of a company in the future.

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[188] See chapter 6, para 3.11.4.2.

[189] See chapter 6, para 3.11.4.3.

[190] See chapter 6, para 3.11.4.3.

[191] See chapter 6, para 3.11.4.3.

[192] See chapter 6, para 3.11.4.4.

[193] See chapter 6, para 3.11.4.4.

2.6 Remedies with Regard to the Removal of Directors from Office by the Board of Directors

Chapter 7 examined the remedies which may be relied on by a director who has been removed from office by the board of directors. The following remedies were examined: (i) application to court under section 71(5) of the Companies Act to review the board's decision;[194] (ii) application for damages or other compensation for loss of office in terms of section 71(9) of the Companies Act;[195] and (iii) the oppression remedy.[196] The right of a director to institute an action for defamation, in appropriate circumstances, was also discussed.[197] It was shown that a director would encounter certain challenges with respect to the application of each of these remedies. The following recommendations are made with regard to improving and enhancing the above remedies:

(a) Clarity should be provided by the legislature whether a court is empowered under a section 71(5) review application to enquire into the merits of the board's decision to remove a director from office. In order to strengthen and enhance the review application in terms of section 71(5) of the Companies Act, it is recommended that a court should be empowered under a section 71(5) review to enquire into the merits of the board's decision to remove a director from office, and should not be confined to only enquiring into the procedural correctness of the decision to remove the director from office.[198] It is further recommended that clarity should be provided by the legislature on the orders a court may make on a review in section 71(5) should it set aside the board's decision to remove a director from office.[199] In order to avoid any ambiguity, it should be specified in section 71(5) that the period of twenty business days for an application to court to review the board's decision to remove a director

[194] See chapter 7, para 2.

[195] See chapter 7, para 3.

[196] See chapter 7, para 4.

[197] See chapter 7, para 5.

[198] See chapter 7, para 2.1.

[199] See chapter 7, para 2.2.

should commence from the date of the board's decision to remove the director from office.[200] A further submission is that in order to ensure that there will be a minimal disruption to the running of the company if the suspended director were to be reinstated to the board by a court, section 70(2) of the Companies Act should provide that any acts of the board of directors during the period that a director is suspended may not be impugned or invalidated if the suspended director were to be later reinstated to office by a court under a section 71(5) review application.[201] Such a provision would also remove any doubt whether decisions taken by the board of directors in the absence of the suspended director, once he is reinstated to the board, remain valid. It would furthermore ensure that any decisions taken by the board of directors in the absence of the suspended director would not be subject to challenge by third parties when the suspended director is reinstated to the board. The provision would also accord with the purpose of the Companies Act in section 7(*j*) of encouraging the efficient and responsible management of companies.[202] It is consequently recommended that sections 71(5) and 70(2) of the Companies Act be amended as follows:

> "(5) If, in terms of subsection (3), the board of a company has determined that a director is ineligible or disqualified, incapacitated, or has been negligent or derelict, as the case may be~~,~~ –
>
> *(a)* the director concerned, or a person who appointed that director as contemplated in section 66(4)(*a*)(i), if applicable, may apply within 20 business days of the board's determination to a court to review the determination of the board~~.~~; and
>
> *(b)* the court, on application in terms of paragraph *(a)*, may –
>
> (i) confirm the determination of the board; or
>
> (ii) reinstate the director to office, if the court is satisfied that the director is not ineligible or disqualified, incapacitated, or has not been negligent or derelict, as the case may be, or make any other order which it considers appropriate."

[200] See chapter 7, para 2.

[201] See chapter 7, para 2.

[202] See chapter 7, para 2.

"(2) If, in terms of section 71(3) or section 71(8), the board of a company or the Companies Tribunal has removed a director, a vacancy on the board does not arise until the later of –

(a) the expiry of the time for filing an application for review in terms of section 71(5) or section 71(8)(*c*); or

(b) the granting of any order by the court on such an application,

but the director is suspended from office during that time, and any acts of the board of directors during the period that a director is suspended are not impugned or invalidated if the suspended director is reinstated to office by a court in terms of section 71(5)."

(b) With regard to the remedy of applying to court for damages or other compensation for loss of office in terms of section 71(9) of the Companies Act, it is recommended that directors should not be given lengthy employment contracts because of the potential financial implications involved in removing them from office prematurely.[203] It is recommended further that the (South African) Companies Act must adopt provisions akin to section 226C of the UK Companies Act of 2006 or section 200E of the Australian Corporations Act of 2001 requiring shareholders to approve payments made to directors for loss of office.[204] Such a provision would confer on shareholders some control over termination payments; would result in enhanced transparency with regard to the termination payments made to directors, and would accord with the purposes of the Companies Act in sections 7(*b*)(iii) and 7(*j*) of promoting the development of the South African economy by encouraging transparency, and encouraging the efficient and responsible management of companies.[205]

(c) With regard to the oppression remedy under section 163 of the Companies Act, it is recommended that, in the interests of fairness, clarity and certainty, section 163 of the Companies Act should be amended to state that the provision may be relied on by a

[203] See chapter 7, para 3.

[204] See chapter 7, para 3.

[205] See chapter 7, para 3.

person who has been removed from office by the board of directors (in terms of section 71(3) of the Companies Act) or the Companies Tribunal (in terms of section 71(8) of the Companies Act) if the application relates to the circumstances in which he was removed from office.[206] Such an amendment would make it clear that former directors, who have been removed from office by the board of directors or the Companies Tribunal in a manner that was oppressive, unfairly prejudicial or that unfairly disregarded their interests, would be entitled to apply to court for relief under section 163 of the Companies Act.[207] It is consequently recommended that a new section 163(4) of the Companies Act be inserted, as follows:

> "(4) This section shall apply to a person who has been removed from office as a director under section 71(3) or section 71(8) of this Act if the application relates to the circumstances in which he was removed as a director."

3. CONCLUDING REMARKS

As indicated, the Memorandum on the Objects of the Companies Bill, 2008 states that clause 71 of the Bill (now the Companies Act 71 of 2008) provides "a more certain and nuanced scheme for the removal of directors from office".[208] It is submitted that this object has, to some extent, been achieved with regard to the provisions in section 71 of the Companies Act on the removal of directors from office. Section 71 of the Companies Act is commendable in several respects. But, in other respects, it is respectfully submitted that the provisions of section 71 do not provide certainty since there are some ambiguities on the interpretation of this provision. The recommendations set out in this chapter seek to clarify certain ambiguities in sections 71(3); to contain the redistribution of power between the directors and shareholders brought about by section 71(3); to guard against the abuse of section 71(3) by the board of directors; to improve and strengthen the procedures in section 71(4) to remove directors from office; to clarify and improve the review procedures in sections 71(5) and 71(6); to clarify certain

[206] See chapter 7, para 4.

[207] See chapter 7, para 4.

[208] See chapter 1, para 1 and the *Memorandum on the Objects of the Companies Bill, 2008*, Companies Bill [B 61D-2008] para 8.

ambiguities in section 71(8) pertaining to the removal of directors by the Companies Tribunal, and to enhance the practical effect of the remedy in section 71(9) to claim damages or other compensation for loss of office.

While the innovative provisions on the removal of a director by the judiciary in section 162 of the Companies Act are also laudable, the recommendations set out in this chapter seek to clarify, improve and strengthen the statutory provisions on the application to court to declare a director delinquent or to place him under probation; to address the principle of non-interference by the judiciary in the internal affairs of a company; to guard against the abuse of section 162, and to offer guidance on the interpretation and application of the remedy in section 162(11) of applying to court to suspend or set aside an order of delinquency or probation.

The recommendations set out above are intended to accord with the purposes of the Companies Act of balancing the rights and obligations of shareholders and directors within companies,[209] promoting the development of the South African economy by encouraging transparency,[210] and encouraging the efficient and responsible management of companies.[211] It is submitted that these recommendations will further clarify, enhance and strengthen the provisions of the Companies Act on the removal of directors by the board of directors and the judiciary.

[209] Section 7(*i*) of the Companies Act.

[210] Section 7(*b*)(iii) of the Companies Act.

[211] Section 7(*j*) of the Companies Act.

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