

The Removal of Directors by a Company's Board of Directors under the Companies Act 71 of 2008: Should it be a Mandatory or an Alterable Provision?

*Rehana Cassim**

Abstract

The Companies Act 71 of 2008 introduced into South African law a provision which for the first time permits a company's board of directors to remove a director from office in certain circumstances. This provision is contained in section 71(3). Compared to the equivalent provisions in some leading foreign jurisdictions, section 71(3) of the Companies Act is unique in two important respects. First, a board's power to remove board members is an unalterable and a mandatory power. Second, a board's removal rights do not follow appointment rights. Consequently, a board is empowered to remove from office any director, regardless of whether shareholders or any other person had appointed that director to office. This article questions whether a board's power to remove directors from office under the Companies Act ought, instead, to be an alterable provision. With a view to protecting the minority shareholder representatives on the board of directors, it questions whether section 71(3) should distinguish between directors appointed by a board and directors elected by shareholders. The comparable provisions on the removal of directors by a board of directors in corporate legislation in Australia, the United Kingdom, and the United States of America are examined. Some recommendations are made to modify section 71(3) of the Companies Act to improve the new power conferred on boards of directors to remove fellow board members.

INTRODUCTION

The Companies Act 71 of 2008 (the Companies Act) which came into force on 1 May 2011, introduced into South African law a provision that, for the first time, permits a company's board of directors to remove a director from office in certain circumstances. This provision is contained in section 71(3).

* BA (cum laude), LLB (cum laude), LLM (cum laude) (University of the Witwatersrand); LLD (University of South Africa). Associate Professor, Department of Mercantile Law, School of Law, University of South Africa; Attorney and Notary Public of the High Court of South Africa. This article is based on sections of the author's LLD thesis.

Compared to the equivalent provision in some leading foreign jurisdictions, section 71(3) of the Companies Act is unique in two important respects. First, a board's power to remove board members is a mandatory power. Second, a board's removal rights do not follow appointment rights. Thus, a board of directors is empowered, in defined circumstances, to remove any director from office, regardless of whether shareholders or any other person had appointed that director to that particular board.

This article questions whether a board's power to remove directors under the Companies Act ought, instead, to be an alterable power. With a view to protecting the minority shareholder representatives on the board of directors, it questions whether section 71(3) should distinguish between directors appointed by the board and directors elected by the shareholders. The comparable provisions on the removal of directors by a board of directors under the Australian Corporations Act of 2001, the United Kingdom (UK) Companies Act of 2006, the Revised Model Business Corporation Act 1984 (MBCA), the Delaware General Corporation Law (DGCL), and the relevant corporate legislation of various states in the United States of America (USA) are examined. This comparative study is conducted in order to determine the nature of a board's power to remove directors in these jurisdictions with a view to ascertaining whether there are any guidelines that may be applied to the South African Companies Act.

Section 5(2) of the Companies Act provides 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 v Bestvest 153 (Pty) Ltd*¹ the High Court observed that company law in South Africa has for many decades tracked the English law system and has taken its lead from the relevant English Companies Act and jurisprudence, but section 5(2) of South Africa's Companies Act now encourages South African courts to look further afield and in appropriate circumstances, have regard to other corporate law jurisdictions (be they American, European, Asian or African) in interpreting the Companies Act. It is notable that the corporate legislation of Australia, the UK and the USA have strongly influenced the Companies Act. Consequently, important guidance may be sought from the corporate legislation in these jurisdictions.

Finally, this article makes some recommendations to modify section 71(3) of the Companies Act to improve the new power conferred on boards of directors to remove fellow board members.

¹ 2012 (5) SA 497 (WCC) para 26.

THE POWER OF A BOARD TO REMOVE DIRECTORS FROM OFFICE

The Power of the Board to Remove Directors under the South African Companies Act

The Companies Act in general 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 required 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 which expressly contemplates that its effect on a particular company may be negated, restricted, limited, qualified, extended, or otherwise altered in substance or effect by that company's Memorandum of Incorporation.⁵ This type of provision usually has 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.' 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

Section 71(3) of the Companies Act states that:

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

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 or any similarly more onerous requirement than would otherwise apply to the company in terms of an unalterable provision of the Companies Act.

⁵ Section 1 of the Companies Act.

⁶ Maleka Femida Cassim, 'Formation of Companies and the Company Constitution' in FHI Cassim and others (eds), *Contemporary Company Law* (2 edn, Juta 2012) 126.

(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.

It is clear from the wording of section 71(3) of the Companies Act that the power conferred by this sub-section on a company's board of directors to remove board members is a mandatory provision. It may not be contracted out of 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 or alter the substance or effect of the power conferred by section 71(3) of the Companies Act on a company's board of directors to remove board members.

Both section 69ter(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 these 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 earlier provision has been removed from the Companies Act it would seem that a director of a company must be removed solely and strictly in terms of the Companies Act and in accordance with the provisions of section 71 of the Companies Act.

Unlike some other provisions of the Companies Act, section 71 does not explicitly exclude any right at common law to remove a director from office.⁸ It consequently is 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, as 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

⁷ HS Cilliers and ML Benade, *Corporate Law* (3 edn, Butterworths 2002) 128.

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.

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 given to directors by section 71 of the Companies Act.

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

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

The Australian Corporations Act of 2001 draws a distinction between public companies and private companies with regard to the removal of directors by a board of directors. 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 or her office or requires a director to vacate his or her office. 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.⁹ Section 203E of the Australian Corporations Act of 2001 embodies in public companies the concept of shareholder democracy and control, that shareholders should ultimately have the power to remove directors.¹⁰

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.¹¹ Pre-nuptial agreements in this context require a director to resign if a board resolves to pass a vote of no confidence in him or her.¹² It has been controversial in Australia whether such pre-nuptial agreements are valid, and whether shareholders have an exclusive, or merely unenforceable, right

⁹ Australian Institute of Company Directors 'Resignations or Removal of Directors' Position Paper No 6 (May 2007) 2.

¹⁰ James McConvill and Evan Holland, "Pre-nuptial Agreements" for Removing Directors in Australia – Are they a Valid Part of the Marriage between Shareholders and the Board?' (2006) *Journal of Business Law* 206; Robert Austin and Ian Ramsay, *Ford, Austin and Ramsay's Principles of Corporations Law* (17 edn, LexisNexis Butterworths 2018) 308–309.

¹¹ See Austin (n 10) 308; James McConvill, 'Removal of Directors of Public Companies takes Centre Stage in Australia' (2005) 191 *The Corporate Governance LR* 194; and Stephen Knight, 'The Removal of Public Company Directors in Australia: Time for Change?' (2007) 25 *Company and Securities LJ* 352.

¹² McConvill (n 11) 194.

to remove directors of a public company from office.¹³ 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 Australian Corporations Act of 2001.¹⁴ In 2004, the Australian Securities and Investment Commission (ASIC), Australia's corporate regulator, 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 any attempts by directors to remove a fellow director from office are void.¹⁵ 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.¹⁶ In light of ASIC considering the pre-nuptial agreements to be ineffective, 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.¹⁷ This, however, is not expressly stated in the Australian Corporations Act of 2001. In terms of section 203C of the Australian Corporations Act of 2001, which is a replaceable rule¹⁸ the shareholders of a private company may remove a director by an ordinary resolution passed at a general meeting. As 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.¹⁹ 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. Consequently, private companies have the flexibility to decide for themselves whether the board of directors may remove board members from office.

¹³ 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 (n 11) 200–232; Knight (n 11) 356–362 and Jennifer Hill, 'The Rising Tension between Shareholder and Director Power in the Common Law World' (2010) 18(4) *Corporate Governance: An International Review* 353.

¹⁴ See McConvill (n 11) 232 and Hill (n 13) 353.

¹⁵ *Australian Securities and Investments Commission* Information Release IR 04-40 *Removal of Directors of Public Companies* (17 August 2004).

¹⁶ *ibid.*

¹⁷ See Knight (n 11) 353 and Hill (n 13) 353.

¹⁸ In terms of s 135(2) of the Australian Corporations Act of 2001 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.

¹⁹ See the heading to s 203C which expressly states that it is a replaceable rule; Knight (n 11) 353 and Hill (n 13) 353.

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 empowering the board of directors to remove directors from office.²⁰ 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 specific provisions of the constitution of each company.

The 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 directors to remove a fellow director from office. Only the shareholders are empowered 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, notwithstanding anything contained in any agreement between the director and the company. In contrast to section 203E of the Australian Corporations Act of 2001, there is no provision in the UK Companies Act of 2006 that 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.²¹ 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.²² 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 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.

²⁰ 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).

²¹ Paul Davies and Sarah Worthington, *Gower Principles of Modern Company Law* (10 edn, Sweet & Maxwell 2016) 379.

²² Nicholas Bourne, 'The Removal of Directors' (2004) *Business LR* 195; Andrew Key, 'Company Directors Behaving Poorly: Disciplinary Options for Shareholders' (2007) *J of Business L* 670; Davies (n 21) 379.

An example of the board of directors of a UK company removing a fellow director from office while acting under a power conferred on it by the articles of association of the company, emanates from *Bersel Manufacturing Co Ltd v Berry*.²³ 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,²⁴ 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.²⁵ 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*²⁶ article 88(e) of the articles of association of the company had conferred power on all the directors of the company, acting together, to give notice to a director to vacate office, whereupon that director’s 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, under 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 shareholders’ agreement. This power was invoked by the directors of the company. Accordingly, a notice under article 88(e) of the articles of association of the company was served on Jackson 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 the 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 that to imply a term that it did, would be an impermissible re-writing of the

²³ [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 (n 21) 379.

²⁴ *Bersel Manufacturing Co Ltd v Berry* (n 23) 554.

²⁵ *ibid* 555.

²⁶ 2013 WL 617163.

parties' agreement.²⁷ Consequently, Jackson could effectively be removed from office under article 88(e) of the articles of association of the company.

As is the position under the Australian Corporations Act of 2001, the UK Companies Act of 2006 does not specify the grounds on which a director may be removed by the board of directors, in the event that such a provision is included in the articles of association of the company. The procedures under which a director is to be removed by the board of directors are not specified by the UK Companies Act of 2006 either. This means that the manner in which a director is removed from office by the board of directors will vary from company to company, as determined by the provisions of the constitution of each company. In *Jackson v Dear*²⁸ the relevant provision in the articles of association required all the directors on the board of directors to give written notice requesting a director to vacate his office, but it would seem 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 case examples discussed above that the courts in the UK construe a provision in a company's constitution empowering the board of directors to remove a director from office strictly in accordance with its terms. They moreover regard the office of director as vacated once the event specified in the constitution occurs.

The Power of the Board of Directors to Remove Directors in the USA

The power of the board of directors to remove directors under the MBCA

The Revised Model Business Corporation Act 1984 does not make provision for the board of directors to remove a fellow director from office. It makes provision only 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 provide that directors may be removed only for cause.²⁹ If a director was elected by a voting group of shareholders only the shareholders of that voting group may participate in a vote to remove him.³⁰ A voting group of shareholders is a group of shareholders who have all agreed, by written

²⁷ *Jackson v Dear* (n 26) paras 28–30.

²⁸ See (n 26).

²⁹ 'For cause' means that there must be a justifiable reason for the removal, while 'without cause' means removal for any reason whatsoever. To remove a director without cause all that is needed are sufficient votes for the removal. As a general proposition, a director must be guilty of some abuse of trust or malfeasance or nonfeasance in office to justify the removal for cause (see *Petition of Korff* 198 App Div 553 (1921) 559; DM Bolling, 'Removal of Directors in Closely Held Corporations' (1959) 12 University of Florida LR 234; James Cox and Thomas Lee, *Corporations* (2 edn, Aspen Publishers 2003) 168 and Kenneth Ferber, *Corporation Law* (Prentice Hall 2002) 40–41).

³⁰ Section 8.08(b) of the MBCA.

agreement, to either appoint one person to vote on their behalf as a group or that they will all vote together as one.³¹

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 them) 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, the voting power of minority shareholders may be enhanced. Consequently, a minority 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 100 shares may cast 400 votes in favour of one candidate, or may distribute the votes in favour of one or more persons for the four vacancies.³² 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. It favours minority shareholders when all of the minority shareholders agree to vote all of their shares for the same director.³³ It thus preserves the balance of power within the corporation.³⁴ If there is no cumulative voting then there usually would be one vote per share and directors would be elected by a plurality of the votes cast by the shares entitled to vote in the election of the directors.³⁵ Under the MBCA shareholders do not have a right to cumulate their votes for directors unless

³¹ Ferber (n 29) 41.

³² See Cox (n 29) 349.

³³ John Hupp, 'Corporations: Officers and Directors: Relationship between Cumulative Voting and Removal Provisions' (1953) 51(5) Michigan LR 745; Samuel Hoffman, 'Status of Shareholders and Directors under New York's Business Corporation Law: A Comparative View' (1962) 11 Buffalo LR 520; Stewart Burbury, 'The Role of the Board of Directors in the Closely Held Corporation: A Comparative Assessment of Recent Legislation' (1971) 6 The J of Intl L and Economics 59 at 65; Richard Dalebout, 'Cumulative Voting for Corporation Directors: Majority Shareholders in the Role of a Fox Guarding a Hen House' (1989) Brigham Young University LR 1199; Olga Sirodоеva-Paxson, 'Judicial Removal of Directors: Denial of Directors' License to Steal or Shareholders' Freedom to Vote?' (1999) 50 Hastings LJ 121; Ferber (n 29) 110–111.

³⁴ Sirodоеva-Paxson (n 33) 102.

³⁵ 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 (June Striegel, 'Cumulative Voting, Yesterday and Today: The July, 1986 Amendments to Ohio's General Corporation Law' (1987) 55 Cincinnati LR 1266; Dalebout (n 33) 1201–1202).

the articles of incorporation so provide.³⁶ In the leading case of *Bruch v National Guarantee Credit Corp*³⁷ the court said that:

[t]he 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 proceedings³⁸ 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 (or her) 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 would be able to protect that director from removal by the remaining shareholders.³⁹

The power of the board of directors to remove directors under the DGCL

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.⁴⁰ Like the MBCA, the Delaware General Corporation Law (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 vote at an election of

³⁶ Section 7.28(b) of the MBCA.

³⁷ 116 Atl 738 (Ch.1922) 741.

³⁸ Under US 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) 321–322).

³⁹ 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 (n 33) 1221–1222).

⁴⁰ See for example the leading cases of *Bruch v National Guarantee Credit Corp* (n 37); *Dillon v Berg* 326 F Supp. 1214 (D. Del. 1971) and *Kurz v Holbrook* 989 A.2d 140 (Del. Ch. 2010).

directors, unless the board of directors is classified,⁴¹ or certain directors are elected by shareholders using cumulative voting.

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,⁴² 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*⁴³ 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.’⁴⁴

The power of the board of directors to remove directors under the corporate law provisions of US states

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*⁴⁵ most US states reserve the power to remove a member of the board to the shareholders who elected

⁴¹ 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.

⁴² 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 (n 29) 31–32; Cox (n 29) 51–60).

⁴³ See (n 37) 741.

⁴⁴ See *Rohe v Reliance Training Network, Inc.* CA No 17992 (Del. Ch. July 21, 2000) para 11.

⁴⁵ 795 N.E.2d 454 (Ind. 2003) 456.

the director. The Indiana Court of Appeals in *Murray v Conseco Inc*⁴⁶ found that thirty-nine states in the USA, 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 states in the USA do empower the board of directors to remove directors from office in certain circumstances.⁴⁷

Notably, those states in the USA which do empower the board of directors to remove directors from office have made this power alterable, and not mandatory. For instance, the board of directors may remove a fellow director only if it has been empowered by the shareholders to do so. For example, section 706(a) of the New York Business Corporation Law empowers the board of directors to remove 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 board member. Section 7-1.2-805 of the Rhode Island Business Corporation Act emulates section 706(a) of the New York Business Corporation Law. Section 14A:6-6(3) of the New Jersey Business Corporation Act 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 board members only if the shareholders have empowered the directors to do so. Section 48-18-108(d) of the Tennessee Business Corporation Act similarly 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).

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, other states in the USA permit the board of directors to remove board members *unless* this power has been modified. For example, under section 302A.223(2) of the Minnesota Business Corporation Act, and section 10-19.1-41 of the North Dakota Business Corporation Act the board of directors is empowered to remove board members *unless* this power is modified by the articles of incorporation, the by-laws or a shareholders' 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.⁴⁸

⁴⁶ 766 N.E.2d 38 (Ind. Ct. App. 2002) 46.

⁴⁷ These are Ohio, California, Alaska, Pennsylvania, Massachusetts, Missouri, Minnesota, North Dakota, New Jersey, New York, Rhode Island, Tennessee and Indiana.

⁴⁸ See further William Archerd and Timothy Scallen, 'A Comparison of Minnesota and Delaware Business Corporation Statutes' (1990-1991) 14 Hamline LR 164.

Section 23-1-33-8(a) of the Indiana Business Corporation Law 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 permits the board of directors to remove directors from office on certain specified grounds unless provided otherwise in a by-law adopted by the shareholders.

Only two states in the USA have made the board's power of removal of directors mandatory. As is the position under section 71(3) of the South African Companies Act, a corporation in Massachusetts and Missouri is not authorised to limit or eliminate the board's power of removal in its articles of incorporation or by-laws. However, as discussed below, unlike section 71(3) of the Companies Act, the provisions of these statutes contain certain safeguards to protect minority shareholder representatives on the board of directors.

In terms of section 8.08(d) of the Massachusetts Business Corporation Act, 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 organisation or by-laws to take action under section 8.24 of the Massachusetts Business Corporation Act (dealing with quorum and voting). This provision differs from section 71(3) of the Companies Act 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 or her. In contrast, under section 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 provides 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 that director and the corporation relating to that director's services as a director or employee of the corporation. This provision differs from section 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, as is the case under section 71(3) of the Companies Act. This is further explained below.

Under section 73(5)(d) of the Companies Act, 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 the resolution. The default position regarding 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 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. 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 board member. In this example, the approval of less than half of the board members is in effect required to remove a board member from office. In contrast, even though section 351.317 of the Missouri General Business Corporation Law is a mandatory provision with regard to the removal of directors by the board, it nevertheless requires a majority of the *entire* board of directors, and not simply a majority of the quorum, to vote in favour of the resolution to remove a board member.

The question arises whether the board's power of removal should be a mandatory power or whether section 71(3) of the Companies Act must, in line with the foreign jurisdictions considered above that have influenced the Companies Act, make the conferral of power on the board of directors to remove board members, an alterable power. This is discussed below.

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

An important issue under the Companies Act is 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 elected 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. Consequently, the board of directors is empowered to remove from office any director, regardless of who had appointed that director to the board of directors.

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, as section 71(3) of the Companies Act does not draw 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 a director so appointed by the person named in the Memorandum of Incorporation.

In sharp contrast, those states in the USA that permit directors to remove board members, distinguish between directors who were appointed by the board of directors and those who were elected by the shareholders. For instance, 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 by the shareholders. Furthermore, where the certificate of incorporation empowers a director to be elected by the holders of the shares of a class or series,⁴⁹ 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 board members. These two exceptions are designed to protect minority shareholders and director representatives of a specific class of shares. It also adopts the approach that removal rights follow appointment rights. Section 7-1.2-805(a) of the Rhode Island Business Corporation Act also protects minority shareholder representatives on the board by not 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 states in the USA that protect minority shareholder representatives on the board from removal by the board, 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 elected 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*⁵⁰ where the court held that the power to remove a director must be exercised by the power that elected the director.⁵¹

⁴⁹ Directors appointed by a class or series of shares are referred to as class directors.

⁵⁰ See (n 37) 741.

⁵¹ In a similar vein, under 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.

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(b) of the Indiana Business Corporation Law 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. 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.⁵²

In many states in the USA cumulative voting is permissible if so stated in the articles of incorporation or the by-laws, and in a few states in the USA cumulative voting is mandatory. Many of the states in the USA 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. For instance, as discussed, New York and Rhode Island do not permit the board of directors to remove board members where the directors were elected by cumulative voting. 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 alterable provision and that the Memorandum of Incorporation of a for-profit company may deviate from section 68(2)(b) of the Companies Act. In other words, the Memorandum of Incorporation of a for-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.

EVALUATION OF SECTION 71(3) OF THE COMPANIES ACT

It is submitted that, because section 71(3) of the Companies Act is a mandatory provision, it does not distinguish between the directors appointed by the board or the shareholders, and that it fails to make any provision to protect the shareholder representatives on the board from removal by the board of directors, a shift has been caused in the balance of power between the directors and the shareholders. In terms of section 66(4)(b) of the Companies Act, the Memorandum of Incorporation of a for-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

⁵² *Murray v Conesco Inc.* (n 45) 458–459 and 460.

at least half of the directors on the board. In many instances the directors elected by the shareholders are the representatives of the shareholders. If the board of directors were to remove from office one of the shareholder representatives, this would result in shareholder control over the board of directors being attenuated, with a consequent shift in 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 board would have a far-reaching 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 board⁵³ and consequently between the majority and minority shareholders. 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. The board may well remove a minority shareholder representative on the board and fill the vacancy, albeit on a temporary basis, with a director whom they favour.

It is important to bear in mind the provisions of section 7 of the Companies Act, setting out the purposes of the Companies Act. 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 v Bestvest 153 (Pty) Ltd*⁵⁴ 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 observed that the legislature has pertinently charged the courts with the duty to interpret the Companies Act such that the spirit and purpose of the Companies Act is given effect to.⁵⁵ It emphasised further that one of the purposes of the Companies Act is to balance the rights and obligations of shareholders and directors within companies.⁵⁶ This purpose is enshrined in section 7(i) of the Companies Act.

It is submitted that there may be advantages in empowering the board of directors to remove any director from office, including those directors elected by the shareholders or a third party in terms of section 66(4)(a)(i) of the Companies Act. One advantage of permitting the board of directors to remove any director from office is that if a shareholder-appointed director

⁵³ See Sirodoeva-Paxson (n 33) 148.

⁵⁴ See (n 1) para 20.

⁵⁵ *ibid.* See further *Booyesen v Jonkheer Boerewynmakery (Pty) Ltd (in business rescue)* [2017] 1 All SA 862 (WCC) para 46, where the court endorsed this approach.

⁵⁶ *Nedbank Ltd v Bestvest* (n 1) para 20.

or a director appointed by a third party neglects his or her duty or is derelict in the performance of his or her functions or if any other valid ground for removal referred to in section 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, to balance the rights between the directors and the shareholders, as required by section 7(i) of the Companies Act, it is submitted that the power to remove directors in section 71(3) of the Companies Act should be an alterable power rather than a mandatory power. More specifically, following the position adopted in the US states of Minnesota, North Dakota, Indiana and Pennsylvania, 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 explicitly so stipulating in its Memorandum of Incorporation. It is consequently submitted that the wording of section 71(3) of the Companies Act should be preceded by the phrase: 'Except to the extent that the company's Memorandum of Incorporation provides otherwise.' A 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, or qualifying the board's power to remove fellow board members. An 'opt-out' provision would also empower a company to distinguish between directors elected by the shareholders and directors appointed by the board of directors, should it wish to do so. A company would accordingly 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. Guidance on the protection of minority shareholder representatives on the board may be sought from the provisions of the corporate law statutes of the states in the USA discussed above.

For instance, as mentioned above, section 68(2)(b) of the Companies Act is an alterable provision. It provides that, unless a company's Memorandum of Incorporation provides otherwise, in each vote to fill a vacancy, each voting right of a shareholder entitled to be exercised may be exercised once. 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, in the nature of cumulative voting, with a view to protecting minority shareholder representatives, then, under an alterable power of director removal, the Memorandum of Incorporation could specifically restrict the power of the board of directors from removing those directors who were elected by cumulative voting by such shareholders. Another example would be if the Memorandum of Incorporation were to empower a voting group or a particular person under 66(4)(a)(i) of the Companies Act

to appoint a director, under an ‘opt-out’ provision, a limitation to the board’s power of removal may be provided in the Memorandum of Incorporation to the effect that only the voting group or the particular person who had appointed that director, may remove him or her from office. Such provisions would serve to protect the minority shareholder representatives on the board of directors.

CONCLUSION

Section 71(3) of the Companies Act is unique in that the board’s power to remove board members is a mandatory, and not an alterable power. Under the Australian Corporations Act of 2001, the board’s power of removal of directors is alterable in that the board of private companies (but not public companies) is empowered to remove a director from office only if the constitution of the company permits this to be done. Similarly, under the UK Companies Act of 2006 the board of directors, of both public and private companies, is empowered to remove a fellow director from office only if the articles of association of a company permit this to be done. While the MBCA and the DGCL do not permit the board of directors to remove a fellow director, some states in the USA, such as New York, Rhode Island, New Jersey and Tennessee, have made company boards’ power of removal of directors alterable in that the board is permitted to remove directors from office *only* if empowered by the shareholders to do so. Other states in the USA, such as Minnesota, North Dakota, Indiana, and Pennsylvania, have made the board’s power of removal alterable in that they permit the board of directors to remove board members *unless* this power has been modified by the article of incorporation or the by-laws. Only two states in the USA, namely Massachusetts and Missouri, have made the board’s power of removal of board members mandatory, as is the position under section 71(3) of the Companies Act. Despite the mandatory nature of these provisions, they contain safeguards designed to protect the minority shareholder representatives on the board from removal by the board. Similar safeguards are absent from section 71(3) of the Companies Act.

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 directors appointed by the board and directors elected 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. Consequently, the board of directors is empowered to remove from office any board member, regardless of who had appointed that director to the board. In sharp contrast, the corporate legislation of the states in the USA, which permit the board of directors to remove fellow board members, contain various safeguards to protect the minority shareholder representatives on the board of directors from removal by the

board of directors. It was argued that section 71(3) of the Companies Act has shifted the balance of power between the directors and shareholders in a company and even amongst the shareholders themselves.

It is submitted that the power to remove directors in section 71(3) of the Companies Act should be an alterable rather than an unalterable and mandatory power. More specifically, in accordance with the position adopted in the USA states of Minnesota, North Dakota, Indiana, and Pennsylvania, the provision should be an 'opt-out' provision, in that a particular 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. It consequently is recommended that section 71(3) of the Companies Act should be amended as follows:

Except to the extent that the company's Memorandum of Incorporation provides otherwise. If a company has more than two directors, and a shareholder or director has alleged that a director of the company ...⁵⁷

If section 71(3) of the Companies Act were to be an alterable provision, as suggested, companies would have the option and the flexibility of weighing up the advantages and disadvantages of empowering its particular board of directors to remove directors. A company would consequently be empowered to determine whether it wishes to retain the default provision under the Companies Act of empowering the board of directors to remove board members, or whether it wishes to limit or amend this default provision to suit its particular needs. This may be done by negating, restricting, limiting, or qualifying the board's power to remove board members. An alterable power of removal would, moreover, empower a company to insert in its Memorandum of Incorporation provisions designed to protect the minority shareholder representatives on the board from removal, should this be deemed necessary based on the specific needs and requirements of the company. Such a provision would bring section 71(3) in line with the equivalent provisions in the foreign jurisdictions discussed in this article. Furthermore, an alterable power of removal conferred on the board of directors would go some way toward satisfying the purpose of the Companies Act enshrined in section 7(i), of balancing the rights and obligations of shareholders and directors within companies.

⁵⁷ The recommended insertion to s 71(3) of the Companies Act is underlined, while the recommended deletion of specific wording is 'struck out.'