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Corporate & Commercial ALERT

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Director removals: Is there any reason to give reasons?

Navigating the inconsistencies in the manner in which our courts and regulators apply the law regarding director removals at the instance of the shareholders.



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Director removals: Is there any reason to give reasons?

Navigating the inconsistencies in the manner in which our courts and regulators apply the law regarding director removals at the instance of the shareholders.

Section 71(1) and (2) of the Companies Act 71 of 2008 (Companies Act) empowers the shareholders of a company to remove an incumbent director by way of an ordinary resolution adopted at a shareholders' meeting. The Companies Act is explicit that this power of the shareholders prevails over any provision to the contrary in the company's memorandum of incorporation, the rules of the company and/or any agreement between the shareholders, the company and the directors.

However, the inconsistent manner in which the courts have, in recent cases, applied this legal principle, has cast a degree of doubt over what was previously regarded as a relatively settled matter of law.

Two back-to-back decisions handed down by the Companies Tribunal of South Africa (Tribunal), each in direct contradiction of the other, illustrates that this inconsistency has seeped into the regulatory infrastructure, making the matter ever more uncertain for shareholders wishing to utilise the director removal right afforded to them in the Companies Act.

The courts' approach to director removals by the shareholders

The Companies Act distinguishes between director removals at the instance of (i) the shareholders; and (ii) the board.

The powers of the board to remove a director are limited to removals on the basis of a closed list of grounds, including ineligibility to serve as a director, disqualification, incapacity and negligence or derelict performance of their duties (see section 71(3) of the Companies Act).

In contrast, no grounds for the removal of a director at the instance of the shareholders are prescribed in the Companies Act. The generality of this power is consistent with the company law principle that directors serve at the behest of the shareholders. It is a well-established principle of company law that directors may be removed from their position on the board of a company at the discretion of the shareholders, provided that the procedural requirements in respect of director removals by the shareholders are adhered to.



The graphic features a gold diagonal stripe across a grey background. At the top left, it reads 'The LEGAL 500 EMEA'. Below this, the text states: 'Corporate, Commercial/M&A 2023 Rankings', 'Corporate & Commercial practice is ranked in Tier 1.', 'CDH Kenya's Corporate & Commercial practice is ranked in Tier 3.', 'Leading Individuals: Willem Jacobs | David Pinnock', 'Recommended Lawyers: Vivien Chaplin | Peter Hesseling Justine Krige | Sammy Ndolo David Thompson | Roxanna Valayathum Njeri Wagacha', 'Next Generation Lawyers: Justine Krige', and 'Hall of Fame: Ian Hayes'.

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The Western Cape High Court's judgment in the case of *Pretorius and another v Timcke and others* [2017] JOL 38461 (WCC) cast a degree of doubt on this position as the court held that the removal of a director by way of shareholder resolution in terms of section 71(1) and (2) of the Companies Act is invalid and should be set aside unless the director is furnished with reasons for their proposed removal.

Four years later, the Gauteng High Court in *Miller v Natmed Defence (Pty) Ltd* (18245/2019) [2021] ZAGPJHC 352 (24 August 2021) held that that the court in *Pretorius* "impermissibly resorted to the remedy of reading in circumstances where the Companies Act is clear and the reading in not warranted" and held that section 71(1) of the Companies Act does not require shareholders to provide a statement with reasons for the removal as provided in 71(3). The court further held that "the legislature has deliberately preserved the right of the majority shareholders to remove a director who they no longer support. Directors serve at

the behest of shareholders who elected them. The shareholders can remove them at will without having to provide reasons."

While many legal commentators are of the view that the approach of the court in *Miller* is likely correct in law (i.e. that there is no requirement for shareholders to give an incumbent director a list of reasons for their proposed removal in terms of section 71(1) and (2) of the Companies Act), the judgment in *Pretorius* has not been overturned and remains binding in the Western Cape. This glaring inconsistency in the case law has resulted in widespread uncertainty in determining the requirements for removing a director at the instance of the shareholders.

The impact of the courts' inconsistency on the processes of the CIPC

All director elections, appointments and removals are filed with and processed by the Companies and Intellectual Property Commission (CIPC). Procuring that a director removal is duly processed by the

CIPC without delay is an additional administrative step that should be considered when charting a course in relation to a proposed director removal by the shareholders.

The CIPC published a guidance note in 2019 (CIPC Guidance Note) which stated that, when a director is to be removed in terms of section 71(1) of the Companies Act by means of an ordinary shareholders resolution, in order for the CIPC to process the removal, the following documents are required during filing:

- a notice of the meeting and the resolution, as well as proof that the director to be removed was awarded the opportunity to make a presentation;
- a statement setting out the reasons for removal;
- minutes of the meeting or a copy of the resolution by the shareholders;
- proof that a quorum was reached at the meeting (attendance register);

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- proof of shareholding (certified copy of share register and share certificates); and
- the notice of Change of Company Directors (CoR 39) reflecting the correct status change (removal).

The CIPC Guidance Note appears to be consistent with the application of the law in the *Pretorius* case. Notably, the CIPC Guidance Note was not updated or retracted after the judgment in *Miller* was handed down. Consequently, the CIPC has been rejecting director removals made in terms of a shareholders' resolution where the company is unable to provide the CIPC with proof that reasons were given to the director for such removal.

This approach of the CIPC was re-affirmed by the Tribunal on 10 March 2023 in the case of *Applied Cyber Defense Systems (Pty) Ltd v Commissioner of the Companies and Intellectual Property Commission* (CT01187ADJ2022) [2023] COMPTRI 22 (10 March 2023), wherein the Commissioner reiterated that the two requirements for the

removal of a director, in accordance with the CIPC Guidance Note, are that (i) the director must have been afforded a reasonable opportunity to make a presentation during the meeting regarding their removal; and (ii) the director must have received prior notice of the reasons for the removal (i.e. prior to the decision being made in order to make a presentation in their defence).

The Tribunal then performed a rapid about-turn on 14 April 2023, only a month later, in the case of *Daily Grind Innovation Hub NPC v Companies and Intellectual Properties Commission* (CT101115ADJ2022) [2023] COMPTRI 45 (14 April 2023). While the facts of this case did not relate directly to the reasons for the removal of a director, the Commissioner outlined the procedures which need to be followed when removing a director and confirmed the decision of the courts in *Miller* in providing that, when shareholders remove a director in terms of section 71(1) and (2) of the Companies Act, no reasons need to be provided by the shareholders for such removal.

Notwithstanding this apparent change of approach by the Tribunal, to date the CIPC Guidance Note has not been revoked or updated, leaving the matter subject to continued uncertainty.

Practical implications

While the Tribunal's most recent decision appears to be applying the approach adopted in the *Miller* case, the CIPC has not yet published an updated CIPC guidance note wherein the CIPC confirms that it no longer requires companies to provide proof that reasons for the removal of directors by the shareholders were given to the director in order to process the removal.

In terms of judicial precedent, the *Pretorius* judgment remains binding on courts in the Western Cape while the *Miller* case is binding on courts in Gauteng.

Moreover, notwithstanding any decision of the Tribunal and any guidance notes published by the CIPC, the decision of a High Court will always trump the Tribunal's

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decision and the CIPC's guidance notes. Therefore, a decision made by the Tribunal holds little to no legal weight if there has been a High Court judgment on the same matter, however for administrative ease there is value in complying as far as possible with the CIPC's requirements.

Given this inconsistency in the courts and among other relevant regulators, it would be prudent for shareholders wishing to procure the removal of an incumbent director by way of shareholder resolution to adopt the following course of action:

- **A shareholders' meeting must be convened:** the director must be given notice of the shareholders' meeting convened to consider, and if appropriate, approve, the removal of the director (section 71(1) of the Companies Act).
- **The applicable director must be given sufficient notice of the meeting:** the director concerned must be given notice of the shareholders' meeting that is at least equivalent to the notice that a shareholder is entitled to receive in respect of the meeting (section 71(2)(a) of the Companies Act).
- **Provision of reasons for the proposed removal communicated to the director:** shareholders wishing to propose the resolution for the removal of a director should provide reasons for the removal and require the company to inform the applicable director of the reasons together with the notice of shareholder meeting, thereby giving the director sufficient time to prepare their presentation to the meeting (*Pretorius* judgment; the CIPC Guidance Note).
- **Director given the opportunity to make a presentation:** the director must be afforded a reasonable opportunity to make a presentation, in person or through a representative, before the resolution is put to a vote at the shareholders' meeting (section 71(2)(b) of the Companies Act).
- **Minutes of the shareholders' meeting:** the reasons for the proposed removal of the director should be stated at the shareholders' meeting and this, together with a recordal that the director was afforded an opportunity to make a presentation at the meeting, should be recorded in the minutes of the meeting that will be submitted to the CIPC as part of the removal filing (CIPC Guidance Note).

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BBBEE STATUS: LEVEL ONE CONTRIBUTOR

Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

PLEASE NOTE

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