Short notes on:

EXECUTIVE AND NON-EXECUTIVE DIRECTORS IN TERMS OF THE NEW COMPANIES ACT

1. Introduction

The Companies Act 61 of 1973 (referred to here as the ‘old Act’) distinguished between the rights and duties of executive and non-executive directors. The relationship between the company and its executive directors was regulated by their employment or service agreements and by prevailing corporate laws. Under the old Act, executive directors are employees of the company, while non-executive directors are not.

This distinction created many practical problems. One issue was that directors who have decision-making powers would be responsible for regulating matters that directly influence employment policies and remuneration. This is a clear contradiction because the executive directors are also employees of the company. The conflict could affect the notion of division of power and transparency in company structures. The other issue was that if an executive director was not formally appointed as a director, then they could not be held accountable for their actions.

The new Companies Act 71 of 2008 (the ‘new Act’) makes no distinction between directors, and in the new Act, the concept has been broadened extensively to include executive and non-executive directors, prescribed officers and directors ex officio. The board of directors also has more power in terms of the new Act. If this power is not limited by shareholders in the company’s memorandum of incorporation, there is a real risk that power could potentially be abused. This risk exists despite the amendments to company law.

2. Shareholder limitation — general meetings

Besides the division of power inherent in the company structure, it has always been important to maintain the division between ownership and management to promote corporate accountability and transparency. The old Act promoted this distinction and the associated institutional transparency.

Under the old Act, decisions that affect ownership were always taken at shareholders’ meetings, and not just by management. The old Act stipulated that a general meeting is convened for the general body of shareholders, regardless of class of shares held. By contrast, the annual general meeting (AGM) is a compulsory meeting with specifically defined discussion items described by statute. In other words, the decision-making power does not lie in the hands of the board at a general meeting.
This is also a prime example of where the inherent distinction between ownership and management is historically personified in companies.

Although the provisions relating to the general meeting have remained constant in the new Act, the AGM is only compulsory for public companies (under section 61(7)), and not for all companies.

3. The memorandum of incorporation and other contracts with directors

The articles and memorandum make provision for certain rights and duties of directors. Under the old Act, these rights were not seen as a contract between the director and the company and were not legally enforceable. This meant that the articles only guided the rights of directors regarding various aspects such as their rights, terms and conditions of service, termination of service and remuneration. In reality, the directors’ rights and duties were determined by the existing contracts between the company and the directors, such as the contract of employment or service agreement.

Section 15(6) of the new Act has amended this position. The new Act makes the memorandum of incorporation and the governance rules legally binding between the company, its shareholders and its directors. This change may make the contents legally enforceable if the service contract with a director is poorly drafted. But issues may arise where the contracts are contradictory. In such cases, it would be advisable to review service agreements and to align the memorandum of incorporation (previously known as the articles and memorandum of the company) with the new Act. The alignment must be done within two years of commencement of the new Act.

4.1 Remedy: dismissal employment contracts

Because executive directors were also employees of the company, their contracts and service agreements and termination of employment conditions should comply with the prevalent labour legislation. In addition, in terms of the prevailing labour legislation — specifically the Labour Relations Act 66 of 1995 (referred to here as the ‘LRA’), and the Constitution of the Republic of South Africa\(^1\) — every employee has the right to fair labour practices and not to be unfairly dismissed.\(^2\)

In terms of section 192 of the LRA where the company seeks to terminate a director’s contract of employment, it must follow a fair procedure which is in terms of the law. It is generally accepted that a disciplinary hearing is regarded as a pre-dismissal procedure.\(^3\) This is further reiterated as a legal right by the common law rule \textit{audi alteram partem} which translates into to ‘hear the other side’.

\(^1\) Act 108 of 1996.
\(^2\) Section 23 of Chapter 2 – the Bill of Rights.
\(^3\) 
\textit{Tubecon (Pty) Ltd v NUMSA 1991 ILJ 126 (LAC) 437.}
Even though LRA does not expressly prescribe form or process for disciplinary hearings, the code of
good practice does require that the employee has an opportunity to state his case.⁴ The new Act has
not overridden this principle, although there is now no distinction between executive and non-
executive directors. Accordingly, the employment relationship is terminated by following the
provisions of labour law.

4.2 Remedy: removal as director

Under the legislation cited above, and also under section 71 of the new Act, it is clear that the
termination of the employment relationship is just that. It does not result in the termination the office
of director. This means that both aspects of the relationship must be terminated: the office of director
and the employee contract.

In terms of section 220 of the old Act, a company may remove a director from office by ordinary
resolution at a general meeting, before the termination of his office. In addition, section 220(7)
explicitly provides that this shall not detract from any power to remove a director which may exist
apart from section 220. The company may elect which procedure to follow. However, if he or she is
removed from office, a director may institute action for breach of contract (section 220(7)) or for any
losses or damages suffered as consequence.

Section 71 of the new Act replaced the old section 220. Section 71 of the new Act states that the
directors may be removed by ordinary resolution. Both the board and the director involved must be
served notice, giving directors sufficient time to prepare a defence against the issues raised, which
should be heard at the specified time. After the director has made representations to the board, the
board shall vote on the resolution. As in the case of a disciplinary hearing for an employment
relationship, the *audi alteram partem* common law rule provides the right to be heard and has now
also been included in our Company law. If he is removed from office, a director may institute action
for breach of contract (section 71(9)) or for any losses or damages suffered as a consequence.

It should be noted that — under the transitional provisions of schedule 5 of the new Act — a person
has the right to seek a remedy occurring before the effective date of the new Act, unless proceedings
have commenced in a court of law. Many feel this provision implies that the new Act is retrospective.
This is purely based on interpretation and there is no precedent to support this contention. These
changes are immediately effective.

4.3 Remedy: damages for breach of director’s duties

⁴ *Semenya & others v/s NUMSA & others (2006) 15 LAC 1.11.1 and schedule 8 of the LRA.*
Where a director’s conduct breaches their fiduciary duties and/or their duty of care and skill and they have been removed as employee and director, in terms of section 77 and 218 of the new Act or common law, it is possible to institute a damages claim against them.

Conclusion

When terminating the relationship with its directors, it is crucially important that companies appoint an attorney to help ensure absolute compliance with the relevant labour legislation and corporate laws.