AN ANALYSIS OF DIRECTORS' FIDUCIARY DUTIES IN THE REMOVAL OF A DIRECTOR FROM OFFICE*

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1 Introduction

The relationship between a director and his company is one of the entrenched examples of commercial fiduciary relationships accepted in South African law.[1] The directors' fiduciary duties are derived from the Companies Act 71 of 2008 ("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]

The Companies Act introduced a provision into South African law, contained in section 71(3), which for the first time permits the board of directors to remove a fellow director from office. This may be done in instances where,

- a company has more than two directors and a shareholder or director alleges that
  - o the director in question has become ineligible or disqualified to be a director, or
  - o has become 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, or
- that he has neglected or has been derelict in the performance of the functions of a director.

* This article is based on parts of the author's LLD thesis.

1 See M Havenga "Breach of Directors' Fiduciary Duties: Liability on what Basis" (1996) 8 *SA Merc LJ* 366 366; *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168; *S v De Jager* 1965 2 SA 616 (A); *S v Hepker* 1973 1 SA 472 (W) 475; *Bellairs v Hodnett* 1978 1 SA 1109 (A); *Atlas Organic Fertilizers (Pty) Ltd v Pikkewyn Ghwano (Pty) Ltd* 1981 2 SA 173 (T); *Sibex Construction (SA) (Pty) Ltd v Injectaseal CC* 1988 2 SA 54 (T); *Howard v Herrigel & Another NNO* 1991 2 SA 660 (A) 678; *Da Silva v CH Chemicals (Pty) Ltd* 2008 6 SA 620 (SCA); *Omar v Inhouse Venue Technical Management (Pty) Ltd* 2015 3 SA 146 (WCC) paras 59-61; *Mthimunye-Bakoro v Petroleum and Oil Corporation of South Africa (SOC) Ltd* 2015 6 SA 338 (WCC).

2 *Mthimunye-Bakoro v Petroleum and Oil Corporation of South Africa (SOC) Ltd* 2015 6 SA 338 (WCC) para 61; *Omar v Inhouse Venue Technical Management (Pty) Ltd* 2015 3 SA 146 (WCC) para 61; *CDH Invest NV v Petrotank South Africa (Pty) Ltd* 2018 1 All SA 450 (GJ) para 61.

Under section 71(3) of the Companies Act the board of directors, other than the director concerned, must determine the matter by resolution, and may remove a director who it has determined to be ineligible or disqualified, incapacitated, negligent, or derelict, as the case may be.

This article argues that when the board of directors exercises its power under the Companies Act to remove a director from office it must not breach its fiduciary duties to the company in doing so. This article explores the specific 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 is restricted to 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 in this article. The discussion also includes whether such a director runs the risk of incurring personal liability for removing a director from office in breach of his fiduciary duties. In addition, the controversial question whether an improperly removed director may be reinstated to office is also canvassed. The pivotal and contentious English case of *Lee v Chou Wen Hsien* ("*Lee*"),[3] in which the court did not reinstate a director who had been wrongly removed by the board of directors as the latter had ulterior motives and acted in breach of its fiduciary duties, is critically analysed. In light of section 5(2) of the Companies Act, which provides that a court interpreting or applying the Companies Act may consider foreign law to the extent that this is appropriate, this article analyses whether the decision in *Lee*[4] would be of persuasive authority in South African law. It further considers whether any distinctions may be drawn between the applicable company law principles in the United Kingdom ("UK") on the removal of company directors, and the Companies Act. Thereafter recommendations are made relating to the fiduciary duties of directors in removing fellow board members from office.

2 Application of fiduciary duties in the removal of directors by shareholders and by the board of directors

It is trite that the right of shareholders to vote is a proprietary right.[5] As Lord Jessel MR in *Pender v Lushington*[6] 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, on that ground

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3 1984 1 WLR 1202.

4 1202.

5 *Pender v Lushington* 1877 46 ChD 317 321; *Re HR Harmer Ltd* 1959 1 WLR 62 82; *Sammel v President Brand Gold Mining Co Ltd* 1969 3 SA 629 (A) 680; *Kuwait Asia Bank EC v National Mutual Life Nominees Ltd* 1991 1 AC 187 (PC) 221.

6 1877 46 ChD 317 321.

he cannot be restrained from voting in whichever way he pleases.[7] In *Desai v Greyridge Investments (Pty) Ltd*[8] the Appellate Division (as it then was) likewise emphasised that a shareholder's right to vote, being a proprietary right of their shareholding, can ordinarily be exercised by them in any way they please.

Walton J concisely enunciated the difference between voting by shareholders and voting by directors in *Northern Counties Securities Ltd v Jackson & Steeple Ltd*[9] 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 in 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 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."

Under section 71(1) of the Companies Act, despite anything to the contrary in a company's Memorandum of Incorporation ("MOI") or rules, or any agreement between a company and a director, or between any shareholders and a director, a director may be removed from office. This takes place by an ordinary resolution adopted at a shareholders' meeting by the persons entitled to exercise voting rights in an election of that director.[10] It follows that when the shareholders of a company vote to remove a director from office under this provision, they may exercise their vote in any way they see fit. 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.[11] In contrast, when the board of directors exercises the power to remove a director from office it must comply with its fiduciary duties to the company.[12] In *Murray v Conseco Inc* ("*Murray*")[13] the Supreme Court of Indiana differentiated between the removal of directors by the shareholders and the removal of directors by the board of directors. The court proclaimed that shareholders may validly remove a director for any reason or for no

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7 Para 319. See also *Sammel v President Brand Gold Mining Co Ltd* 1969 3 SA 629 (A) 680; *CDH Invest NV v Petrotank South Africa (Pty) Ltd* 2018 1 All SA 450 (GJ) para 44.

8 1974 1 SA 509 (A) 519.

9 1974 2 All ER 625 635.

10 Section 71(1) of the Companies Act is subject to s 71(2), which sets out the procedural requirements that must be complied with before the shareholders of a company may vote on an ordinary resolution to remove a director from office.

11 *CDH Invest NV v Petrotank South Africa (Pty) Ltd* 2018 1 All SA 450 (GJ) para 44. See *also Steenkamp v Central Energy Fund SOC Ltd* 2018 1 SA 311 (WCC) para 31 where the court affirmed that shareholders have a wider discretion or power to remove directors from office than the board of directors.

12 *Murray v Conseco Inc.* 795 NE2d 454 (Ind. 2003) 461; *Liwszyc & Anor v Smolarek & Ors* 2005 ACSR 38 47; *Jackson v Dear* 2013 WL 617163 para 3.

13 795 NE2d 454 (Ind 2003) 461.

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 would 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 v CH Chemicals (Pty) Ltd*[14] 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 directors' overarching and paramount fiduciary duty from which all the other fiduciary duties flow.[15] 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.[16]

The duty of good faith is a subjective duty.[17] As laid down in *Re Smith & Fawcett Ltd*[18] 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.[19] It is not for the courts to review the merits of a decision that the directors arrived at in honesty.[20] While the test for good faith is subjective, there must nevertheless be reasonable grounds for the directors' belief that they were acting in the best interests of the company.[21] Both executive and non-executive directors owe these duties to the company.[22]

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[14] 2008 6 SA 620 (SCA) para 18.

[15] *Fisheries Development Corporation of SA Ltd v Jorgensen; Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd* 1980 4 SA 156 (W) 163; *Liwszyc v Smolarek* 2005 55 ACSR 38 46; *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty)* 2014 5 SA 179 (WCC) para 80; *CDH Invest NV v Petrotank South Africa (Pty) Ltd* 2018 1 All SA 450 (GJ) para 47; Havenga (1997) *SA Merc LJ* 311-312; FHI Cassim "The Duties and the Liability of Directors" in FHI Cassim et al (ed) *Contemporary Company Law* 2 ed (2012) 505 523.

[16] *Parke v The Daily News Ltd* 1962 2 All ER 929 948; *South African Fabrics Ltd v Millman NO* 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.

[17] *Shuttleworth v Cox Brothers & Co (Maidenhead) Ltd* 1927 2 KB 9; *Re Smith & Fawcett Ltd* 1942 Ch 304, 306; *Hogg v Cramphorn Ltd* 1967 Ch 254; *Regentcrest plc (in liquidation) v Cohen* 2001 2 BCLC 80 105; *Extrasure Travel Insurances Ltd v Scattergood* 2003 1 BCLC 598 ChD 618-619; *Liwszyc v Smolarek* 2005 55 ACSR 38 46-47; *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd* 2014 5 SA 179 (WCC) para 74.

[18] 1942 Ch 304 306.

[19] See also *Regentcrest plc (in liquidation) v Cohen* 2001 2 BCLC 80 105.

[20] *Hogg v Cramphorn Ltd* 1967 Ch 254.

[21] *Shuttleworth v Cox Brothers & Co (Maidenhead) Ltd* 1927 2 KB 9; *Regentcrest plc (in liquidation) v Cohen* 2001 2 BCLC 80 105; *Extrasure Travel Insurances Ltd v Scattergood* 2003 1 BCLC 598 ChD 618-619; *Liwszyc v Smolarek* 2005 55 ACSR 38 46-47; *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd* 2014 5 SA 179 (WCC) para 74.

[22] *Howard v Herrigel NNO & Another* 1991 2 SA 660 (A) 678.

In *Murray*[23] 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 best interests of the corporation in removing a board member from office. In *Liwszyc v Smolarek*[24] 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*[25] 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 of good faith is 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.[26] 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.

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 generally 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.[27] While the duty of good faith is subjective, the test of proper purpose is objective.[28]

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[23] 795 NE2d 454 (Ind. 2003) 461.

[24] 2005 ACSR 38 47.

[25] 2013 WL 617163 para 33.

[26] M Havenga *Fiduciary Duties of Company Directors with Specific Regard to Corporate Opportunities* LLD thesis, University of South Africa (1995) 333.

[27] Cassim "The Duties and Liability of Directors" in *Contemporary Company Law* 525.

[28] *Extrasure Travel Insurances Ltd v Scattergood* 2003 1 BCLC 598 ChD 619; *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd* 2014 5 SA 179 (WCC) para 80; *Companies and Intellectual Property Commission v Tshelane* ZAGPPHC 13-11-2017 case no 99920/2015 paras 67, 69; *CDH Invest NV v Petrotank South Africa (Pty) Ltd* 2018 1 All SA 450 (GJ) para 67. Contrary to earlier authority, in *Eclairs Group Ltd v JKX Oil & Gas plc* 2015 UKSC 71 para 15 Lord Sumption of the UK SC stated that the test for proper purpose is subjective. This statement was supported only by Lord Hodge and not by the three other Lords who presided in this case. Langford and Ramsay submit that what Lord Sumption meant by this statement is that the proper purpose rule has both subjective and objective aspects, and that his Lordship's statement should be interpreted in this way (RT Langford & IM Ramsay "The Proper Purpose Rule as a Constraint

Where there are dual purposes for the exercise of a power, case law suggests that 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.[29] 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.[30] 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 that were proper.[31]

Notably, Lord Sumption of the UK Supreme Court ("UKSC") in *Eclairs Group Ltd v JKX Oil & Gas plc* ("*Eclairs*")[32] adopted a different test to determine whether the exercise of power by directors is proper in instances where the power is exercised for dual or mixed purposes. This test is the "but for" test of causation. It states that the exercise of power will be invalidated if the impermissible purpose was causative, in the sense that "but for" its presence, the power would not have been exercised.[33] In other words, a decision would be considered flawed only if it would not have been taken "but for" the improper purpose.[34] Lord Mance of the UKSC (with whom Lord Neuberger agreed) was of the opinion that it was not appropriate to decide whether a "but for" test, as opposed to a dominant purpose test, should be adopted as this issue had not been the subject of full argument before the court.[35] The UKSC did not, therefore, conclusively decide whether a dominant purpose test or a "but for" test is to be applied in instances where directors exercise their power for multiple purposes. The matter thus remains unsettled. Until this matter is conclusively determined, it is submitted that the weight of authority points to the dominant purpose test being regarded as the appropriate test to be applied when the directors are motivated to act by dual or multiple purposes.

In *Extrasure Travel Insurances Ltd v Scattergood* ("*Extrasure*")[36] the Chancery Division laid down a four-part test that a court should apply in ascertaining whether directors had acted for a proper purpose. This test requires that a court must:

(i) identify the power the exercise of which is in question;

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on Directors' Autonomy – *Eclairs Group Limited v JKX Oil & Gas plc*" (2017) 80 *MLR* 110117). This view is influenced by the fact that Lord Sumption supported the *dicta* in earlier jurisprudence that in order to determine the purpose for which directors acted it is necessary to understand their subjective motivations (see para 15 of the judgment). The learned judge thereafter applied an objective test in order to determine whether the directors' purpose for acting was proper. See *Eclairs Group Ltd v JKX Oil & Gas plc* 2015 UKSC 71 para 15; Langford & Ramsay (2017) *MLR* 117-118.

29 *Mills v Mills* 1938 CLR 150 (HC of A) 165 186; *Hogg v Cramphorn Ltd* 1967 Ch 254; *Lindgren v L&P Estates Ltd* 1968 Ch 572 (CA); *Howard Smith Ltd v Ampol Petroleum Ltd* 1974 AC 821 (PC) 835; *Whitehouse v Carlton Hotel Proprietary Limited* 1987 162 CLR 285.

30 *Hogg v Cramphorn Ltd* 1967 Ch 25; *Howard Smith Ltd v Ampol Petroleum Ltd* 1974 AC 821 (PC).

31 *Hogg v Cramphorn Ltd* 1967 Ch 25; *Howard Smith Ltd v Ampol Petroleum Ltd* 1974 AC 821 (PC).

32 2015 UKSC 71.

33 *Eclairs Group Ltd v JKX Oil & Gas plc* 2015 UKSC 71 para 22. See further *Whitehouse v Carlton Hotel Proprietary Limited* 1987 162 CLR 285 294 for a discussion of this test.

34 PL Davies & S Worthington *Gower Principles of Modern Company Law* 10 ed (2016) 493.

35 *Eclairs Group Ltd v JKX Oil & Gas plc* 2015 UKSC 71 para 53.

36 2003 1 BCLC 598 ChD 619.

(ii) identify the proper purpose for which the power was delegated to the directors;
(iii) identify the substantial purpose for which the power was in fact exercised; and
(iv) decide whether the purpose was proper.

In *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd*[37] 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, one has to ascertain the actual purpose for which the power was exercised. Thereafter it must be determined whether the actual purpose falls within the purpose for which the power was conferred.[38]

In *Extrasure*[39] 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 purpose or motive, even if such act falls within the scope of the directors' powers.[40] In *Eclairs*[41] the UKSC endorsed the dictum in *Hindle v John Cotton Ltd*[42] in the context of the proper purpose rule that the "state of mind of those who acted, and the motive on which they acted, are all important".

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 a director from office who it has determined to be ineligible, disqualified, incapacitated, negligent 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.

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.[43] This duty, as a general rule, prohibits directors from contracting, undertaking or otherwise agreeing in advance to exercise their discretionary

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37 2014 5 SA 179 (WCC) para 80.
38 See further *Cook: Geoffrey v Hesber Impala (Pty) Ltd* (2014/45832) 2016 ZAGPJHC 23 (19 February 2016) paras 47-48 where the GJ agreed with and applied this test.
39 2003 1 BCLC 598 ChD 619.
40 *Piercy v Mills* 1920 1 Ch 77; *Mears v African Platinum Mines* 1922 WLD 57 61; *S v Berliner* 1966 4 SA 535 (W) 536; *Hogg v Cramphorn Ltd* 1967 Ch 254 268-269; Havenga *Fiduciary Duties of Company Directors* 341.
41 2015 UKSC 71 para 15.
42 1919 56 Sc LR 625 630.
43 *Fisheries Development Corporation of SA Ltd v Jorgensen; Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd* 1980 4 SA 156 (W) 163; *Mthimunye-Bakoro v Petroleum and Oil Corporation of South Africa (SOC) Ltd* 2015 6 SA 338 (WCC) para 340.

powers in a particular way.[44] 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.[45] In contrast, section 173(1) of the UK Companies Act of 2006 explicitly states, 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.[46] The duty to exercise an unfettered discretion is a critical element in the proper and effective discharge of a director's functions generally.[47] 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.[48] As mentioned above, 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.[49] 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.

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 fellow director also applies when the director votes against the resolution to remove the fellow director. Section 71(3) of the Companies Act states that the board of directors "may" remove a director who it has determined to be ineligible or disqualified, incapacitated, negligent or derelict. In light of the word "may" in section 71(3), the board of directors has a discretion whether or not to remove the director from office.

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[44] *Kregor v Hollins* 1913 109 LT 225 (CA); *Boulting 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) 163; *John Crowther Group plc v Carpets International plc* 1990 BCLC 460; *Fulham Football Club Ltd v Cabra Estates Plc* 1992 BCC 863; *Regentcrest plc (in liquidation) v Cohen* 2001 2 BCLC 80. See further TB Courtney "Fettering Director's Discretion" (1995) 16 *CoLaw* 227-236 and A Keay "The Duty of Directors to Exercise Independent Judgment" (2009) 29 *CoLaw* 290-296.

[45] See Keay (2009) *CoLaw* 290; Cassim "The Duties and Liability of Directors" in *Contemporary Company Law* 529.

[46] *Kregor v Hollins* 1913 109 LT 225 (CA); Havenga *Fiduciary Duties of Company Directors* 334.

[47] Keay (2009) *CoLaw* 293.

[48] 292.

[49] Havenga *Fiduciary Duties of Company Directors* 333.

It is arguable that the board of directors would not, in fact, have a discretion whether or not to remove a director who it has found to be ineligible or disqualified to be a director. Section 69(3) of the Companies Act states that a company must not knowingly permit an ineligible or disqualified person to serve or act as a director. Under section 69(4) of the Companies Act a person who becomes ineligible or disqualified while serving as a director of a company, immediately ceases to be entitled to continue to act as a director (subject to section 70(2) of the Companies Act regarding when the vacancy on the board would arise). If the board of directors was to choose not to remove a director who it has factually determined to be ineligible or disqualified, it would infringe sections 69(3) and 69(4) of the Companies Act, in addition to breaching its fiduciary duty to take decisions in the best interests of the company. However if the board of directors decides not to remove a director from office who it has found to be incapacitated, negligent, or derelict in the performance of his functions, it 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 satisfies one of the grounds listed in 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.[50] It follows that an agreement between two directors to vote in a particular way in the future would not be enforced by a court because such an agreement would infringe the fiduciary duty of directors to exercise an independent judgment and not to fetter their discretion.[51] This is so even if there is no improper motive or personal advantage gained by the directors under the agreement.[52] Accordingly, an agreement under which two or more directors undertake to vote against the removal of the other director to frustrate a threshold for the removal resolution would be neither valid nor 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.[53]

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[50] Courtney (1995) *CoLaw* 233.

[51] *Fisheries Development Corporation of SA Ltd v Jorgensen; Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd* 1980 4 SA 156 (W) 163.

[52] Davies & Worthington *Gower Principles of Modern Company Law* 499.

[53] Cassim "The Duties and Liability of Directors" in *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. In *Fulham Football Club Ltd v Cabra Estates Plc* 1992 BCC paras 863 875 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."

5 Consequences of a breach of fiduciary duties in removing a director from office

A director breaching his fiduciary duties when voting to remove a fellow board member from office, may have various consequences. These consequences are discussed below.

5 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*[54] 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.[55] 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),[56] 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

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In making this finding, the UK Court of Appeal in *Fulham Football Club Ltd v Cabra Estates Plc* 1992 BCC 863 relied heavily on and drew support from the decision of the HC of A in *Thorby v Goldberg* 1964 112 CLR 597 605-606. As seen in Courtney (1995) *CoLaw* 228: 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. 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. See further A Griffiths "The Best Interests of Fulham F.C.: Directors' Fiduciary Duties in Giving Contractual Undertakings" (1993) *JBL* 576-585. The legal principle laid down in *Fulham Football Club Ltd v Cabra Estates Plc* 1992 BCC 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".

54 1984 1 WLR 1202.

55 1206.

56 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.

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."[57]

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 director – in removing a fellow board member – would not vitiate the removal or leave in office the director whose removal was sought.

In *Murray*,[58] a director, Murray, 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 had 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.[59] The Court of Appeals accordingly held that Murray did not have any cause of action to be reinstated to the board of directors.[60] 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 claim 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.[61] This resulted in rendering as *obiter dictum* the decision of the court *a quo*.

Section 5(2) of the Companies Act provides that a court interpreting or applying the Companies Act may consider foreign law to the extent that this is appropriate. Based on section 5(2), the *dicta* in *Lee*[62] and *Murray*[63] could have persuasive authority in South African company law. This implies that a director who has 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.

The circumstances of the removal of the director in *Lee*[64] and *Murray*[65] are, however, distinguishable from the circumstances of the removal of directors in terms of section 71(3) of the Companies Act in two respects. The first is that removal of a director by the board of directors in both these cases did not have to be for cause. "For cause" means that there must be a justifiable reason for the removal, while "without cause" means removal for any reason

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57 *Lee v Chou Wen Hsien* 1984 1 WLR 1202 1206-1207.
58 766 N.E.2d 38 (Ind. Ct. App. 2002).
59 46.
60 46.
61 *Murray v Conseco Inc.* 795 N.E.2d 454 (Ind. 2003) 461.
62 1984 1 WLR 1202.
63 766 N.E.2d 38 (Ind Ct App 2002).
64 1984 1 WLR 1202.
65 766 N.E.2d 38 (Ind Ct App 2002).

whatsoever.[66] To remove a director without cause, all that is needed are sufficient votes for the removal.[67] In *Lee*[68] 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".[69] It is clear from this article that the board did not have to provide any reason for removing a director. A director could simply have been removed from office without cause. Similarly, in *Murray*[70] 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 specific 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 ground for distinguishing section 71(3) of the Companies Act from *Lee*[71] and *Murray*[72] is that under section 71(3) a challenge by a director to his removal would not result in the management of the company coming to a standstill. This was of significant concern to the Privy Council in *Lee*.[73]

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66 KS Ferber *Corporation Law* (2002) 40-41. In *Minister of Defence and Military Veterans v Motau* 2014 5 SA 69 (CC) para 54 the CC defined the concept of "good cause" 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."

67 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 *Fla Law Rev.* 232 234; JC Cox & TL Hazen *Corporations* 2 ed (2003) 168). For instance, cause will lie if a director accepts a managerial or executive position with a direct competitor of the corporation or engages in a competing business (*Eckhaus v Ma* 635 F.Supp 873 (SDNY 1986) 874; *Fells v Katz* 175 N.E. 516 (NY 1931)), or harasses fellow officers and employees in the transaction of the company's business (*Markovitz v Markovitz* 8 A.2d 46 (Pa. 1939) 48; *Campbell v Loew's Inc.* 134 A.2d 852 1957 860-861). According to Bolling (1959) *Fla Law Rev.* 234, on the other hand, a desire to change corporate policy or a mere difference of opinion is not sufficient cause, nor is a desire to take control of the corporation (*Campbell v Loew's Inc.* 134 A.2d 852 1957 860). 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 (*Fuller v the Trustees of the Academic School in Plainfield* 6 Conn. 532 1827 546).

68 1984 1 WLR 1202.

69 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 provide additional grounds for the removal of directors. The position is the same under s 168(5)(b) of the UK Companies Act of 2006, which permits shareholders to remove directors by an ordinary resolution. This provision states that s 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; further see Davies & Worthington *Gower Principles of Modern Company Law* 499.

70 766 N.E.2d 38 (Ind. Ct. App. 2002).

71 1984 1 WLR 1202.

72 766 N.E.2d 38 (Ind. Ct. App. 2002).

73 1984 1 WLR 1202.

As discussed, in *Lee*[74] 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 or 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 Companies Act, the provisions of sections 71(5) and 70(2) could overcome this concern, as is discussed below.

Section 71(5) of the Companies Act provides that where 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. Alternatively, a person who appointed that director in terms of section 66(4)(*a*)(i)[75] may apply to a court within twenty business days to review the determination of the board. Section 71(5) does not specify when the period of twenty business days commences but, presumably, this period would commence from the date that the board of directors makes the decision to remove the director from office. 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 section 71(5) of the Companies Act. 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 the following: 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 is 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, it is submitted that the director would not be regarded as being a board member pending the resolution of the dispute. While this matter has not been authoritatively decided by a court, a director who has been removed from office and who has consequently been suspended from office pending the resolution of any dispute regarding his removal, should logically and practically not be treated as a member of the board of directors. On this basis, the management of the company would not be at a standstill pending the resolution of the dispute.

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[74] 1202, 1207.

[75] Section 66(4)(*a*)(i) of the Companies Act states that a company's MOI 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 MOI.

Consequently, the concern of the court in *Lee*[76] 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 section 71(3) of the Companies Act. 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*[77] and *Murray*,[78] 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. Further, the improperly removed director must be reinstated to the board of directors, if it is appropriate to do so in the circumstances.

In *Minister of Defence and Military Veterans v Motau* ("*Motau*")[79] the Minister of Defence and Military Veterans ("the Minister") terminated the membership of two members of the board of directors of the Armaments Corporation of South Africa SOC Limited ("Armscor"). This was done in terms of section 8(*c*) of the Armaments Corporation of South Africa Limited Act 51 of 2003 ("the Armscor Act"), instead of section 71(2) of the Companies Act, which sets out the relevant procedural requirements that must be complied with, in order to remove a director from office. The Armscor Act governs the affairs of Armscor, which is a state-owned entity.[80] The State is the sole shareholder of Armscor and exercises ownership control of Armscor through the Minister.[81] Its board of directors, consisting of nine non-executive members and two executive members, manages Armscor's affairs.[82] Section 8(*c*) of the Armscor Act provides that a member of the board must vacate office if the Minister – on good cause shown – terminates their services. The membership of two board members was terminated after they had failed to attend various board meetings arranged by the Minister. The two directors who had been removed from office applied to court to set aside the Minister's decision on the ground that it was unlawful, unconstitutional and invalid, and that it had not complied with the provisions of the Promotion of Administrative Justice Act 3 of 2000 ("PAJA"). The court *a quo* granted judgment in favour of the two directors on the ground that the Minister's dismissal power had constituted administrative action, and that the Minister had failed to comply with PAJA.[83] On appeal, the Constitutional Court ("CC") held that the Minister's power to dismiss directors was more executive, rather

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76 1984 1 WLR 1202.
77 1984 1 WLR 1202.
78 766 N.E.2d 38 (Ind. Ct. App. 2002).
79 2014 5 SA 69 (CC).
80 Armscor was incorporated primarily to provide South Africa's armed services with military material, equipment, facilities and services. It is the armaments and technology procurement agency of the Department of Defence. Also see *Minister of Defence and Military Veterans v Motau* 2014 5 SA 69 (CC) para 3.
81 Section 2(2) of the Armscor Act.
82 Section 6(1).
83 See *Motau v Minister of Defence and Military Veterans*, unreported case no 51258/13, North Gauteng High Court, Pretoria, 18 September 2013.

than administrative, in nature.[84] Accordingly, it held that the failure of the Minister to comply with the procedural requirements of section 71(2) of the Companies Act in terminating the membership of the board members had rendered her actions unlawful.

It is noteworthy that the CC did not order the reinstatement of the two directors. The circumstances surrounding the removal of the directors in this case are, however, distinguishable from the removal of a director by the board of directors in breach of its fiduciary duties. The CC 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 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.[85]

The court found that the relationship between the Minister and the two board members in question had irreparably disintegrated and that there had been substantively good and compelling reasons for the Minister to remove the two directors from office.[86] The vital difference between removing a director without following the proper procedures, 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 *Motau*)[87] while in the latter case the director may be removed without there being any substantive basis for his removal. Section 71(3) of the Companies Act requires a director to be removed from office based on one of the specific grounds set out in that section. These grounds are that the director in question has become ineligible or disqualified to be a director, or has become 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. Alternatively, that he has neglected or has been derelict in the performance of the functions of a director. If the board of directors removes a director from office in breach of its fiduciary duties, without any one of these grounds being applicable, it would be very difficult to justify not reinstating the improperly removed director.

As discussed earlier, 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 a director from office who satisfies 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, under section 71(6) of the Companies Act, to review the board's

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[84] *Minister of Defence and Military Veterans v Motau* 2014 5 SA 69 (CC) paras 47, 49 & 51. An analysis whether the Minister's dismissal power constitutes administrative action or executive action is beyond the scope of this article, but see A Konstant "Administrative Action and Procedural Fairness – *Minister of Defence and Military Veterans v Motau*" 2016 133(3) *SALJ* 491 492-498 for a discussion of this point.

[85] *Minister of Defence and Military Veterans v Motau* 2014 5 SA 69 (CC) para 86.

[86] Para 89.

[87] 2014 5 SA 69 (CC).

determination. 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.[88] 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 was 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 should nevertheless be a time limit 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 the sake of consistency and harmony with section 71(5) of the Companies Act, it is proposed 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. The period of twenty business days should commence from the date of the board's decision not to remove the director from office.

5 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.[89]

The duties referred to in section 77(2) are owed to the company. Consequently, it is the company that must proceed against the offending directors.[90] 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

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[88] 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).

[89] 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).

[90] Cassim "The Duties and Liability of Directors" in *Contemporary Company Law* 584.

loss, damages or costs sustained by the improperly removed director or by a third party.[91]

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 Companies Act. This is because section 78(2) of the Companies Act renders void any provision in a company's MOI 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 believe 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.[92]

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*[93] the court held that section 248 of the Companies Act 61 of 1973,[94] the predecessor to section 77(9) of the Companies Act, did not empower a 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

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91 *Sanlam Capital Markets (Pty) Ltd v Mettle Manco (Pty) Ltd* 2014 3 All SA 454 (GJ) para 41; *Blue Farm Fashion Limited v Rapitrade 6 (Pty) Ltd* 2016 JOL 35613 (WCC) paras 11-12; *Viraland Inc v Ole Media Group (Pty) Ltd* (9699/2015) [2016] ZAWCHC 10 (18 February 2016) para 62.

92 Section 77(10) of the Companies Act. In *AWA Ltd v Daniels t/a Deloitte Haskins & Sells* 1992 7 ACSR 759 855 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. For this reason, the court held that a court may grant relief from liability for damages for breach of contract under this provision.

93 1989 3 SA 71 (T) 107.

94 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. See further Cassim "The Duties and Liability of Directors" in *Contemporary Company Law* 579.

of *Customs and Excise Commissioners v Hedon Alpha Ltd*[95] 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.[96] 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. In this regard, it appears that section 77(9) would apply only to proceedings between the company and its directors. 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.[97]

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. With regard to the meaning of the term "honestly" in section 1318 of the Australian Corporations Act of 2001,[98] which is the equivalent provision to section 77(9) of the Companies Act, in *Australian Securities and Investments Commission v Macdonald (No 12)* ("*Australian Securities*")[99] the New South Wales Supreme Court stated that:

> "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."

In light of the meaning of the term "honestly" as enunciated in *Australian Securities*,[100] 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

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[95] 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* 1981 2 All ER 697 (CA).

[96] P Delport *Henochsberg on the Companies Act 71 of 2008* 1 (RS 18 2018) 308.

[97] *Ex parte Lebowa Development Corporation Ltd* 1989 3 SA 71 (T) 107.

[98] 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 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."

[99] 2009 NSWSC 714 para 22.

[100] 2009 NSWSC 714.

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.[101] 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.[102]

5 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.[103] The reference to "any person" in section 218(2) of the Companies Act would include a director of a company.[104]

As affirmed in *Grancy Property Limited v Gihwala*,[105] *Sanlam Capital Markets (Pty) Ltd v Mettle Manco (Pty) Ltd*[106] and *Viraland Inc v Ole Media Group (Pty) Ltd*,[107] 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

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[101] Section 77(6) of the Companies Act.

[102] 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. It is noteworthy that in *O'Keefe & Anor (In Their Capacity As Joint Liquidators of Level One Residential (Jersey) Ltd and Special Opportunity Holdings Ltd) v Caner & Ors* 2017 EWHC 1105 (Ch) (15 May 2017) para 127 the UK High Court held that the prescription period for claims against directors of Jersey companies for breach of their duties under arts 74(1)(a)), 74(1)(b) of the Companies (Jersey) Law 1991 is ten years. The ten-year period applies to claims for breach of a director's fiduciary duty to act honestly and in good faith with a view to the best interests of the company and to a breach of the duty of care, skill and diligence.

[103] *Chemfit Fine Chemicals (Pty) Ltd v Maake* 2017 JDR 1473 (LP) para 30.

[104] *Grancy Property Limited v Gihwala* 2014 JDR 1292 (WCC) para 104. In *Hlumisa Investment Holdings (RF) Limited v Kirkinis* (100390/2015) 2018 ZAGPPHC 676 (31 August 2018) para 29-30 91 the court held that shareholders may not institute an action against directors for a breach of their fiduciaries duties set out in s 76(3) under the auspices of s 218(2) of the Companies Act. The court held that shareholders must instead rely on s 77(2) of the Companies Act since this provision specifically creates liability for any loss or damages sustained by the company as a consequence of a breach by directors of a duty contemplated in s 76(3) of the Companies Act. In coming to this conclusion the court relied on the principle of interpretation that where there is a special remedy provided in a statute that special remedy must be used in preference to a general remedy. Further see *Gentiruco AG v Firestone SA (Pty) Ltd* 1972 1 SA 589 (A) 603.

[105] 2014 JDR 1292 (WCC) para 104.

[106] 2014 3 All SA 454 (GJ) para 42.

[107] (9699/2015) 2016 ZAWCHC 10 (18 February 2016) para 62.

loss in consequence thereof.[108] 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. As the court emphasised in *Rabinowitz v Van Graan*[109] 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 itself. It follows that section 218(2) of the Companies Act would not apply 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 was removed from office by the board of directors with ulterior motives – is regarded as being an aspect of the section 76(3)(*b*) duty to act in the best interests of the company.[110] 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.[111] 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*[112] 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

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[108] See also *Blue Farm Fashion Limited v Rapitrade 6 (Pty) Ltd* 2016 JOL 35613 (WCC) para 12. It is of interest that in *McCracken v Phoenix Constructions (Qld) Pty Ltd* 2012 QCA 129 the Supreme Court of Queensland held that s 1324(10) of the Australian Corporations Act of 2001 may be seen as conferring power on a court to award damages only as a substitute remedy or a supplementary remedy. Section 1324(10) of the Australian Corporations Act of 2001 permits creditors to claim damages against directors in addition to or in substitution for the grant of an injunction, as a consequence of a contravention of s 182(1) of the Australian Corporations Act of 2001. Section 182(1) prohibits a director from using his position to improperly gain an advantage or to cause detriment to the corporation. In light of this decision Delport expresses the view that in the South African context s 218(2) of the Companies Act does not create a primary remedy to creditors (Delport *Henochsberg on the Companies Act 71 of 2008* 642). It is, however, submitted that the difference between s 218(2) of the Companies Act and s 1324(10) of the Australian Corporations Act of 2001 is that the former does not confer power on a court to award damages as a substitute or supplementary remedy for an injunction. Section 218(2) applies regardless of whether or not an injunction is sought by a third party.

[109] 2013 5 SA 315 (GSJ) para 9.

[110] See Keay (2009) *CoLaw* 356; Cassim "The Duties and Liability of Directors" in *Contemporary Company Law* 529.

[111] *Rabinowitz v Van Graan* 2013 5 SA 315 (GSJ) para 11.

[112] 2017 JOL 39331 (GP) para 47.

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.[113] 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.[114]

6 Conclusion

When the board of directors exercises its power to remove a director from office it must comply with its fiduciary duties to the company. Directors must exercise their power to remove a fellow board member under section 71(3) of the Companies Act in good faith and in the best interests of the company, and for the proper purpose for which the power was given to them, and not for a collateral or ulterior purpose. In addition, directors must exercise an unfettered discretion and an independent judgment when removing directors from office. They must consider the proposed resolution to remove a fellow board member in an unbiased and objective manner. It is submitted that 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.

Contrary to the *dicta* in *Lee*[115] and *Murray*,[116] if the directors remove a fellow director from office under section 71(3) of the Companies Act in breach of their fiduciary duties, a court must set aside the decision, and the improperly removed director must be reinstated to the board of directors, if it is appropriate to do so in the circumstances. It is contended that the removal of directors under section 71(3) of the Companies Act is distinguishable from the removal of directors in the circumstances that applied in *Lee*[117] and *Murray*,[118] in two respects. First, the removal 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. 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. Secondly, it is submitted that if a removal of a director by the board of directors in breach of its 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

[113] Para 47. See also *Motor Industry Bargaining Council v Botha* (34198/2013) 2016 ZAGPPHC 615 (10 June 2016) para 61 where the HC stated that the element of causation is required in s 218(2) of the Companies Act, and in *Hlumisa Investment Holdings (RF) Limited v Kirkinis* (100390/2015) 2018 ZAGPPHC 676 (31 August 2018) para 48.

[114] The prescription period under the Prescription Act 68 of 1969 for the prescription under s 218(2) of the Companies Act is three years.

[115] 1984 1 WLR 1202.

[116] 766 N.E.2d 38 (Ind. Ct. App. 2002).

[117] 1984 1 WLR 1202.

[118] 766 N.E.2d 38 (Ind. Ct. App. 2002).

Lee.[119] It is contended that the provisions of sections 71(5) and 70(2) of the Companies Act would 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.

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). 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. Finally, it is submitted that a director who has contravened sections 76(3)(*a*) or (*b*) of the Companies Act in removing a fellow board member from office or in failing to remove a director 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. In order for directors to avoid the risk of these consequences and the risk of personal liability being imposed on them, it is imperative for them to take cognisance of their fiduciary duties when voting in favour of or against a resolution to remove a fellow board member, and to be guided by their fiduciary duties when casting their vote.

SUMMARY

The Companies Act 71 of 2008 ("the Companies Act") introduced a provision into South African law that for the first time permits the board of directors to remove another director from office. This provision is contained in section 71(3). This article argues that when the board of directors exercises its power under the Companies Act to remove a director from office it may not breach its fiduciary duties to the company. The directors' specific fiduciary duties which may apply when the board removes a director from office are explored. This article further examines the consequences of a director breaching his fiduciary duties in removing a board member from office. The question whether such a director runs the risk of incurring personal liability for removing a director in breach of his fiduciary duties is discussed. In addition, the controversial question whether an improperly removed director may be reinstated to office, is also canvassed. The pivotal and contentious English case of *Lee v Chou Wen Hsien* ("*Lee*"), in which the court did not reinstate a director who had been wrongly removed by the board – with ulterior motives and in breach of their fiduciary duties – is critically analysed. In light of section 5(2) of the Companies Act, which provides that a court interpreting or applying the Companies Act may consider foreign law to the extent that it is appropriate, this article analyses whether the decision in *Lee* would be of persuasive authority in South African law. In addition, the article investigates whether any distinctions may be drawn between the applicable company law principles in the United Kingdom ("UK") on the removal of company directors, and the Companies Act. Finally, this article makes some recommendations relating to the fiduciary duties of directors in removing fellow board members from office.

[119] 1984 1 WLR 1202.