

Short notes on:

THE “BAD APPLE” DIRECTOR HOW TO STEP BACK IN LINE OR SAY YOUR GOODBYES

Introduction

Unfortunately, the “bad apple” director is not as fictitious a person as many companies would like to think.

Let me clarify... A director who fails to comply with certain standards, or fails to honour certain agreements, has, in my view, deviated from what is reasonably expected and therefore, for purposes of this article, may be guilty of misconduct.

According to the IODSA,¹ *“any action by a director that is in breach of his/her role, responsibilities, function, duties or the standard of conduct expected of that director, whether stipulated in terms of legislation, common law or board, company policies, is misconduct. Whether or not the action was wilful, intentional or unintentional will merely affect the degree of sanction required for such misconduct.”*

It is thus essential for the board and/or the company to clearly define the standard of conduct (i.e. behaviour) expected of directors, and standards or actions that will and will not be acceptable.

Companies Act

It is true that legislation regulates the standards reasonably expected from directors, but this is not enough, particularly not in isolation.

Companies should bear in mind that directors are usually broadly categorised as either executive or non-executive directors. The first being in essence a combined role where the director concerned is also an employee of the company. This means that executive directors should be held to a higher standard (as opposed to other employees who are not directors) appropriate to their role and responsibilities associated thereto. In the case of non-executive directors, the relationship is synonymous to that of an independent contractor.

¹ Institute of Directors of Southern Africa – Directorship Magazine March 2017: 32 - 34

As such, the need for the internal regulation of standards expected of directors, including the regulation in the overlap in the employment relationship, is crucial.

Be that as it may, Section 76 of the Companies Act 71 of 2008, as amended (the “Act”) sets out the standard of conduct expected of a director. This is in addition to duties outlined in common law, other sections of the Act, and the King Report on corporate governance for South Africa IV (“King IV”). Section 77 of the Act deals with directors’ liability.

Allegations of director misconduct can have serious ramifications for both the company and the director concerned. Not only can this result in the removal of a director or the prevention of taking office in future, but it also affects the director’s reputation. As such, allegations of misconduct are serious and should be treated with care, particularly until there is certainty regarding the accuracy thereof.

Some examples of director misconduct that we see most often are:

- Disclosing confidential information (including information relating to boardroom discussions)
- Failing to disclose conflict of interests and acting upon such conflict
- Competing with the business of the company
- Failing to abide by the rules of the company and board policies (such as code of conduct and ethics)

Contract

We recommend that companies update their Memorandum of Incorporation (“MOI”) so as to include disqualifying factors to serve as a director.

Under Section 69 of the Act includes the following factors:

1. Insolvency;
2. If guilty of a crime involving dishonesty, fraud or misrepresentation, and have either been imprisoned without the option of a fine or fined more than the prescribed amount;
3. Prohibition by court to act as director or declaring him/her delinquent;
4. Prohibition in terms of any public regulation to be a director;

5. If removed from an office of trust on the grounds of misconduct involving dishonesty.

In addition, it is as important as Human Resources Policies, to include board policies and director service level agreements. The IODSA further recommends establishing a Directors Code of Conduct (that sets out the ethical values, conduct and behaviour expected as well as how breaches of the code will be dealt with) applicable to both executive and non-executive directors.

Some other useful arrangements include:

- A policy detailing the process and procedure for lodging complaints/allegations of director misconduct, and the investigation of such allegations etc.;
- Appropriate whistle-blowing policies or procedures to be created;
- Adequate training and induction programmes should be provided to all directors on their roles, responsibilities and duties, so as to raise awareness of the conduct and standards expected; and
- Regular performance measurement tools and evaluations of the board, individual directors and chairman of the board, should be conducted.

Recourse

In the case of a complaint, the following options broadly exist:

1. Follow the complaints procedure as outlined in company policies,
2. If the director is the member of a professional regulatory body and the potential misconduct may also be a breach of professional duties, such as the law society in case of attorneys, lay a complaint with the professional body, or
3. Take legal action to remove the director in terms of the Act.

In terms of the Act, a director may be removed by court application if the director's misconduct falls within the circumstances provided under Section 162(5), (7) and (8) and this would warrant legal action in order to remove the director from the board in the best interest of the company –

“A company, a shareholder, director, company secretary or prescribed office of a company, a registered trade union that represents employees of the company or another representative of the employees of a company’, the Companies and Intellectual Property Commission or Takeover Regulation Panel’, and ‘any organ of state responsible for the administration of any legislation”

The company may apply to court for an order declaring a director a delinquent.

On the other hand, in terms of Section 71 of the Act, the shareholder (by way of ordinary resolution) and/or the board (by way of resolution) has recourse to remove a director who has been found to be negligent or not performing in terms of his/her duties or functions.

Conclusion

Prevention is always better than cure, so we recommend ensuring that all the contractual, policy and legislative arrangements available are suitably leveraged to avoid director misconduct in the first place. It also holds true that not everything can be avoided, however, if the contractual and policy aspects are in place, there is a framework within which to address complaints and resultant issues. Applying to court should be a last resort due to it being a public forum, the cost, and the time involved. Contact an expert at SchoemanLaw Inc for assistance today.