

Circular No. 5

May 2012

THE NEW COMPANIES ACT : COMPOSING THE BOARD OF DIRECTORS

This is the first of a series of short circulars which will highlight practical issues arising when applying and working with the Companies Act No. 71 of 2008 (“**Companies Act**”). The focus of this circular is on “how to” lawfully appoint the members of the board of a private company or a public company with a small number of shareholders.

APPOINTMENT BY SPECIFIC SHAREHOLDERS

It is common for a company’s Memorandum of Incorporation¹ or shareholders agreement, or both, to stipulate that certain shareholders will be entitled to appoint a certain number of directors on the board. Equally common is a stipulation that shareholders will be entitled to appoint one director for each block of a set percentage of the issued shares of the company (for example, one director per 12.5% of the issued ordinary shares held by a shareholder). Third party lenders may also demand a right to appoint one or more persons as directors of the company.

Directors appointed in this manner are usually appointed unilaterally by the party empowered to do so by the Memorandum of Incorporation or shareholders agreement and may be removed by that party without reference to the (other) shareholders of the company.

The Companies Act expressly provides for the direct appointment and removal of directors of a company by persons named in the Memorandum of Incorporation of that company. As will be explained below, there is a limit to the use of this provision.

AUTOMATIC APPOINTMENT BY OFFICE

Some companies may wish to stipulate that any person holding a particular office, whether in the business of the company or otherwise, will automatically have a place on the board of directors of the company.

¹ “Memorandum of Incorporation” is the name given to a company’s founding documents under the Companies Act. An existing company’s Memorandum and Articles of Association are now referred to as the “Memorandum of Incorporation”.

The Companies Act expressly provides for the appointment of directors *ex officio*, i.e. automatically, by virtue of the position or office which they hold. This provision also has limited use under the Companies Act, as will be seen below.

THE 50/50 REQUIREMENT

The limitation referred to above is this: only 50% of the board of a profit company (which includes private and public companies) may comprise directors appointed directly by persons named in the Memorandum of Incorporation of the company and/or of persons who are directors *ex officio*. The remaining 50% of the board has to be appointed by way of an election by shareholders.

ELECTION BY SHAREHOLDERS

By “election of shareholders” we mean appointed by way of an ordinary resolution of the shareholders (on a practical note, it is possible to conduct an election of directors in writing, sparing the company and shareholders the effort required to call and hold a meeting). The election of each person standing for appointment as a director is voted on separately and the shareholder with 50.01% of the voting rights will determine who is and who is not appointed as a director. In a company with different classes of shares, it is voting rights in the class(es) of securities which entitle their holders to vote in an election of directors which counts.

Where it is necessary to secure the rights of shareholders and/or third parties to have a particular number of representatives on the board, these rights can be recorded in a shareholders’ agreement or, if there is no shareholders’ agreement, in a separate voting pool agreement which compels all shareholders to exercise their voting rights so as to give effect to these “representation” rights.

Directors elected by the shareholders may resign at any point, but should they not do so when it is required by the shareholder or third party they represent, they may be removed by a vote of the shareholders but this time it has to be conducted at a properly constituted meeting where the director in line for removal has been given a chance to make representations before the vote is conducted.

FURTHER ADVICE

Should you require advice or assistance on the Companies Act, please contact any member of the commercial team at Cox Yeats: Michael Jackson (031 – 536 8512 mjackson@coxyeats.co.za), Keren Oliver (031 - 536 8518 koliver@coxyeats.co.za), Themba Zikhali (031 – 536 8529 tzikhali@coxyeats.co.za) or Jason Goodison (031 – 536 8517 jgoodison@coxyeats.co.za).

