FEATURE

Termination Of Director In A Time Of Retrenchments

How & Implications

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Overview

The world that we are in is one of great economic uncertainty currently; this despite the fact that there are a number of green shoots in a multiple of business arenas. We have at least moved from a state of a world worst than the 1929 great depression to early signs of recovery. The end of 2008 into the first half of 2009 saw a large numbers of business operations nose-diving, with many pulling the brakes on unbridled expenditures. With this came retrenchments across large multinationals operating in various jurisdictions as well as within small and medium sized companies operating just in Singapore. What we usually read about are retrenchment exercises which affect the rank and file and employees as well as middle management. Rarely does one hear about retrenchment of directors. Yet, this is not an oxymoron and directors can be asked to leave their positions as well, or have their appointments shortened.

This article briefly explores how directors can be terminated, and what, if any at all, compensation they would be entitled to. The article also very briefly touches on the benefits that a terminated director will be entitled to.

Removing Directors

Directors Not Like Other Employees

Directors occupy a unique position in the corporate structure. Whilst the executive directors are employed by the company and ought to have proper employment contracts, this is not the case with the non-executive and independent directors. Whilst all directors, whether

executive, non-executive or independent, have to be elected at an annual general meeting, the latter two categories of directors are treated differently from the former category when it comes to employment issues and termination. The simple reason for this is that the executive director is after all an employee of the company whilst the other directors are appointed to their position. It follows, therefore, that if and when a retrenchment exercise is planned, the position of directors must be carefully considered.

The following factors must at least be reviewed:

(a) First, the benefits of reducing the number of directors must be studied and the pros and cons ascertained. Less may not always mean better and the impact of a reduced number of directors on the business must be carefully ascertained.

(b) Second, the existence or otherwise of employment contracts with each of the different types of directors must be ascertained.

(c) Third, having identified the executive directors with employment contracts, determine if these are indeed the people to let go. There are occasionally good reasons for wanting to let even a CEO go, for example.

(d) Fourth, study the contracts very carefully to ascertain whether it is a fixed term contract and the implications that could flow from removing the director, thus resulting in early termination of the contract. It is also necessary to study other terms of the contract, including the notice periods for termination, the continuing rights that may exists, and entitlements to any options or other long term incentive plans that the director may be entitled to.

(e) Fifth, review the articles of association of the company to ascertain whether there are restrictions or otherwise for terminating a director. In this regard, there are differences as to how directors of public companies and of private companies are to be treated

(f) Sixth, recall that non-executive and independent directors are typically not paid very much, and their removal may not result in much cost savings for the company. On the contrary, having their continued presence could have considerable benefits for the company as it goes through the difficult economic times.

(g) Seventh, bear in mind that a simple letter of termination may not be sufficient to remove the director, and that a proper general meeting must be called to remove them. In this regard, differences between public company and private company directors must be noted.

(h) Eighth, review carefully what and whether any compensation can be paid to the director being terminated, and what sort of approvals must be obtained.

(i) Finally, manage confidentiality and non-compete provisions carefully.

As a preliminary point, do note that the removal of non-executive and independent directors is a function of shareholders, unless this power has been abdicated, by contract or otherwise, to the board of directors or some other person. Such abdication, however, is not possible as regards public and public listed companies.

Removal Of Public Company Directors

Removal of a public company director is governed by section 152 of the Singapore Companies Act. Section 152 of the Companies Act enables the shareholders by way of an ordinary resolution to remove a director, arguably even though such removal is against the articles of association or any agreement between the director and the company. The reason for enabling this is to prevent the position of directors in a public company from becoming entrenched. In Scottish & Colonial v APG [2007], the Court noted that the rationale of the provision was to serve a principal purpose of preventing entrenchment, and another purpose of affording procedural fairness to directors who are under challenge.

Interestingly, this also means that the position of executive and non-executive directors alike in a public company (including a listed company) cannot be terminated without a resolution to that effect being carried at a shareholder meeting. The rationale for this flip side can be explained on the basis that shareholders, as ultimate owners of the company in a public sphere, must be empowered to have ultimate control over who manages their company.

Procedurally, in brief, a special notice proposing an ordinary resolution to remove the director must be given to the company. A special notice is a notice of intention to move a resolution, which must be given to the company not less than 28 days before the meeting at which it is moved. However, if the company convened a general meeting after the notice of intention was given, the resolution to remove the director may still be passed at that meeting, even though the meeting took place less than 28 days after the notice of intention was given, as long as such notice was given at least 14 days before the meeting. In other words, the requisitionist cannot expect the company to convene a general meeting in less than 28 days. However, if the company so chooses, it can call for a general meeting in less than 28 days but nevertheless complying with the provision of the articles to call for a general meeting with 14 days' notice. This is permissible also because the resolution to be passed is an ordinary resolution.

The company must, as soon as practicable after receiving the notice of intention to move the resolution, send a copy of the notice to the director concerned. The director is given the right to be heard at the meeting, and may make representations.

Removal Of Private Company Directors

There is no statutory provision dealing with the removal of directors of private companies. The office of such directors can only be vacated if the articles of association provide accordingly, and his exact form of removal can be expressly stipulated. Depending thus on how the articles are drafted, it is possible that a director, so long as he does not become disqualified and is not due to retire by rotation, can only be removed by an extraordinary resolution of the company; or that a director, who is also a shareholder, may be given weighted voting rights where a resolution for his removal has been tabled.

Where there is no contractual power to remove a director and the articles are also silent on this, then the articles must first be altered to give such a power before he can be removed. There is case law which shows that the court will not necessarily compel a company to employ a director against its will, notwithstanding it may have contracted to do so, but may leave him to his remedy in damages for breach of contract.

There is suggestion that where the directors of a private company are named in the memorandum of the company, then such directors cannot be removed by an amendment of the articles of association. Their positions become entrenched as such, because the memorandum can only be altered as provided for in the Companies Act.

Implications Post Termination

For an article of this length, only two key issues are worth mentioning. The first concerns the scope of remuneration that an exiting director will be entitled to, and the second concerns the directors duties of confidentiality and managing restraint provisions.

Entitlement To Remuneration

The general rule of law is that directors are not entitled to any remuneration for serving a company in that capacity. However, if the director enters into a contract with the company that expressly provides for remuneration, or if the articles of a company expressly allows for remuneration, then the director will be entitled to the stated remuneration and would be able to sue for that amount as and when it accrues and becomes due. This is typically for executive directors. In the absence of contract or a provision in the articles, a director will only be entitled to paid compensation if a resolution to that effect is passed at a general meeting of shareholders.

Apart from just the remuneration, section 168(1) of the Companies Act provides that a director who has been removed from office either through dismissal or retirement is prima facie not entitled to compensation for the loss of his office, unless the requisite approval for the same has been obtained from the company's shareholders. The Singapore Court of Appeal in *Grinstead v Britannia Brands (Holdings) Pte Ltd* [1996] considered the scope of section 168 of the Companies Act and concluded that the section was wide enough to cover compensation not only for the loss of directorship, but also for the loss of an executive position that may accompany the loss of directorship.

Although section 168 requires shareholder approval prior to granting compensation for the loss of office, *Fasi v Specialty Laboratories Asia Pte Ltd (No 2)* [1999] held that if the director has been promised compensation not

for loss of office but for other reasons such as in exchange for a non-compete provision, then such compensation will not be prohibited by section 168.

Further, section 152(7) permits a director to claim 'compensation or damages payable to him in respect of the termination of his appointment or of any appointment terminating with that as director'. In other words, the director may bring an action for breach of his Directorship contract in the form of damages. However, where a Director holds a fixed term service contract with a company, his removal resulting in breach of contract does not give the right to be reinstated against the company's will. In other words, the Director does not have a remedy in specific performance for his Directorship contract.

Maintaining Confidentiality & Managing Non-Compete

The sensitive role that a director assumes in running the affairs of the company requires him to not act in conflict with the company even when preparing to leave the company, whether of his own accord or as a consequence of a termination. One must remember that a director is and remains, until his tie with the company is severed, a director of that company. In Singapore, the courts have held directors to be in breach of their fiduciary duty when they acted to promote the interests of a new company, which was established to compete with their current company, by diverting business to this new company. The key is whether a maturing or ripening business opportunity has arisen and it is this that the director is exploiting.

The incidence of directors being taken to task has increased over the years. Most recently, in *ABB Holdings Pte Ltd and Others v Sher Hock Guan Charles* [2009] an individual, after ceasing to act as director of ABB, joined another firm in a foreign country that effectively competed with his former company. The foreign company was set-up to develop a product that was similar to that being sold by the former company. The Singapore High Court held that although the defendant had not committed a breach by developing a product similar to and in competition with that of the former company, he had breached his fiduciary duty by not disclosing the new company's intention to develop and market a competing product and by contacting an ex-employee of the former company to serve as a consultant for the new company.

The essence of the issue lies in the duty of undivided loyalty and ensuring no conflict. Where a conflict does arise, because the director's services has been terminated and he is looking for alternative position, then it is incumbent on the director, unpleasant as the situation may be, to disclose the conflict. Such disclosure will shield the director from potential liability.

Conflicts aside, some directors may be subjected to non-compete and other forms of restraint of trade provisions. This is more common fro executive directors. Whether such non-compete or other restraint of trade clauses can be upheld or otherwise will very much depend on the reasonableness of such clauses.

Conclusion

This short article has touched only briefly on some of the considerations one must look into when directors are being removed. There is no one size fits all even in termination; but nevertheless certain key considerations will always apply. ■

(The writer thanks Ajinkya Tulpule, Senior Legal Executive, Rajah & Tann LLP for his assistance in this article.)