

Resignation or removal of a director

Board composition

As a general rule, a company's constitution will deal with resignations and removal of directors, as well as the procedures for filling casual vacancies caused by a director leaving the company. Reading the constitution is always an excellent starting point for a director or board faced with this situation.

In addition, sections 203A – 203F of the *Corporations Act 2001* (Cth) provides for the resignation, retirement and removal of directors. Following are some general observations as well as some requirements for specific types of companies.

How does a director resign?

Directors resign by giving written notice to the company's registered office (*Corporations Act 2001*, s 203A (a replaceable rule)). Alternatively, they can give written notice of the resignation to the Australian Securities and Investments Commission (ASIC). However, this must be accompanied by the letter of resignation given to the company (s 205A (1), (2)). The company must give notice to ASIC of a director's resignation within 28 days unless the director has given the notice to ASIC discussed above (s 205B).

It is very important for a director seeking to resign to follow the formalities. Otherwise, for example, if the company becomes insolvent while the director's name is still on the record, then the director may face legal action for insolvent trading or other provisions under the *Corporations Act 2001*.

There are a number of ways in which a director can leave or be removed from office.

- Resignation
- Rotation of directors in listed companies
- Invalid appointment
- Removal by members (or directors in proprietary companies)
- A breach of provisions set out in the company's constitution, for example:
 - Not turning up to meetings for a prescribed period of time (commonly three to six months)
 - Becoming of unsound mind
 - Failing to declare an interest in a contract with the company
- Disqualification from managing a corporation
- Undischarged bankruptcy or failing to comply with insolvency procedures
- Death

What is the rule as to rotation of directors in listed companies?

A director of a listed public company (other than a managing director) must not hold the position of director (without re-election) past the third annual general meeting following the director's appointment or three years (whichever is longer) (ASX Listing Rule 14.4). However, a director may be required to stand for re-election more frequently than three years, if this is set out in the company's constitution. There is a debate within corporate governance globally as to whether the entire board should stand for election each year as a demonstration of accountability or whether staggered boards are desirable with directors standing for re-election every second or third year. The argument in favour of staggered boards is that this promotes continuity of the corporate memory.

How is a director removed in a public company?

Members (shareholders) can remove a director by resolution (s 203D (1)). This is despite anything in the company's constitution, an agreement between the company and the director or an agreement between any or all members of the company and the director. If a director is the representative of a particular class of shareholders or debenture holders, the resolution to remove the director does not take effect until a replacement representative has been appointed.

The board or other directors cannot remove a director. This prevents a majority of public company directors from removing a director without the agreement of shareholders. Any resolution, request or notice of any of the directors of a public company which purports to remove another director is void (s 203E). This means that so called 'pre-nuptial agreements', where it is said that a director will resign if other directors request it, are not legally effective.

Notice of intention to move the resolution must be given to the company at least two months before the meeting is to be held (s 203D(2)). However, if the company calls a meeting after the notice of intention is given, the resolution can still be passed even if less than two months' notice is given. The director in question must be given a copy of the notice as soon as practicable after it is received (s 203D (3)).

The director is entitled to put his or her case to members (s 203D (4)). A director can do this by:

- (a) giving the company a written statement which the company must circulate to members, and
- (b) speaking to the motion at the meeting.

The written statement is to be circulated to the members by:

- sending a copy to everyone to whom notice of the meeting is sent if there is time to do so; or
- if there is not time to send a copy as above – having the statement distributed to members attending the meeting and read out at the meeting before the resolution is voted on.

The written statement does not have to be circulated if it is more than 1,000 words long or defamatory.

The removal of a director who is not performing is a difficult task and can be damaging to the organisation. In general, it will be the chair's task to ask that director to consider their position on the board. However, there have been high profile cases of a director refusing to leave a board even though this was the wish of the remaining directors. In some of those cases, large shareholders have become involved and the director has left. In the end, if there can be no resolution reached on the board, then it is a decision for the shareholders and a general meeting must be called.

Board evaluations are a means by which the performance of both the entire board and individual directors can be assessed and feedback provided for directors who are under-performing. In particular, peer evaluations of each director by all other directors can be an excellent form of feedback for every director. These can provide a structured methodology for the chair to discuss their performance with each director and, when necessary, recommend to a director that they may wish to resign or that they will not be supported by the board in any future election.¹

¹ Kiel G C, Nicholson G J and Barclay M A, *Board, Director and CEO Evaluation*, McGraw-Hill Australia, 2005.

How is a director removed in a proprietary company?

A proprietary company may by resolution remove a director from office and may by resolution appoint another person as a director instead (s 203C, *Corporations Act 2001*).

A director may also be removed by a majority of directors, if the constitution allows it. In doing this, and if the person is an executive director, the company needs to be mindful of the terms of employment for that director, unfair dismissal laws and natural justice requirements.

Are there any special rules for charities?

The Australian Charities and Not-for-profits Commission (ACNC) can also disqualify a person from being a responsible person. The ACNC provides a list Register of Disqualified Persons on their website.

The ACNC's Governance Standard four requires that board or committee members or trustees are not disqualified from managing a corporation nor disqualified by the ACNC from being a responsible person.² In addition to being disqualified by the ACNC, disqualification includes disqualification by ASIC or the courts as set out below.

What is the effect of disqualification from managing a corporation?

A person ceases to be a director of a company if the person becomes disqualified from managing corporations under Part 2D.6 of the *Corporations Act 2001* unless ASIC or the court allows them to manage the company (s 203B). A person who is disqualified from managing corporations commits an offence if:

- they make, or participate in making, decisions that affect the whole, or a substantial part, of the business of the corporation; or
- they exercise the capacity to affect significantly the corporation's financial standing; or
- they communicate instructions or wishes (other than advice given by the person in the proper performance of functions attaching to the person's professional capacity or their business relationship with the directors or the corporation) to the directors of the corporation:
 - knowing that the directors are accustomed to act in accordance with the person's instructions or wishes; or
 - intending that the directors will act in accordance with those instructions or wishes.

There are basically three kinds of disqualification

Automatic disqualification

Where a person is convicted of certain serious offences

ASIC disqualification

ASIC can disqualify a person for up to seven years

Court disqualification

A court may disqualify a person for any period it considers appropriate

What is the effect of bankruptcy?

A person is disqualified from managing corporations if the person is an undischarged bankrupt under the law of Australia or the person has not fully complied with the terms of a personal insolvency agreement (s 206B (3), (4), *Corporations Act 2001*).

² Australian Charities and Not-for-profits Commission Regulation 2013 (Cth), s 45.20.

Can a court allow a disqualified director to manage a corporation?

Section 206G of the *Corporations Act 2001* provides that a person who is disqualified from managing corporations may apply to the court for leave to manage corporations, a particular class of corporations or a particular corporation if the person was not disqualified by ASIC.

In practice, courts will very rarely grant this leave to manage corporations to a disqualified person. However, it does happen. In a decision by Justice Barker of the Federal Court of Australia, a bankrupt person was able to obtain permission to become involved in the management of an important pro-bono organisation.³

What are ‘casual vacancies’?

Casual vacancies are created by directors leaving for reasons other than retirement at the end of a term (for example if a director dies, resigns or is otherwise unable to continue to serve as a director). A constitution may allow the board to appoint a director to fill the vacancy even where there are fewer than the statutory minimum or quorum of directors. A director appointed to fill a casual vacancy or as an addition to the board of a listed public company can hold office only until the next annual general meeting of the company and is then eligible for re-election (s 201H (3) of the *Corporations Act 2001* and ASX Listing Rule 14.4). In the case of a proprietary company, a general meeting must confirm the appointment within two months after the appointment is made (s 201H (2) – a replaceable rule).

Are there any special considerations for executive directors?

Executive directors are company employees as well as directors. Their dismissal as employees is governed by employment law. Information regarding termination should be included in their employment contract. It is common for a constitution and an executive’s employment contract to state that where a person occupies the position of director in addition to their position specified in their employment contract (for example CEO), then if the executive ceases to hold that position they must resign from their position as a director of the company.

³ Carey, in the Matter of Carey [2011] FCA 235.

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