



GENERAL GUIDANCE NOTE

The Non-executive Director Agreement or Appointment letter

Purpose

Having a Non-Executive Director (“NED”) agreement or appointment letter is fundamental in order to ensure proper governance of the relationship between the NED and the organisation - particularly taking into account that the Companies Act 71 of 2008 (“Companies Act”) makes no distinction between Executive Directors and NEDs. NEDs are therefore as equally liable as Executive Directors regarding the conduct and liability of the organisation. The NED agreement or appointment letter ensures that both parties are clear on the rights and obligations of the NED therefore providing clarity of expectations and supporting a successful working relationship, as well as allowing the parties to critically set the contractual basis upon which the NED’s performance will be measured.

This guideline illustrates what components should be considered when drafting the NED agreement or appointment letter, based on best practise and the recommendations of the King Report on Corporate Governance for South Africa 2009 (“**King III**”).

King III recommendations

Principle 2.19 of King III provides that “*Directors should be appointed through a formal process.*” This principle is expanded upon and it is recommended that: “*The appointment of a non-executive director should be formalised in an agreement between the company and the director.*” Based on the collective recommendation of King III we have prepared the below recommended clauses to be included in an NED agreement or appointment letter.

The Agreement or Appointment Letter

Set out below are specific clauses that practise has shown are salient to an NED agreement or appointment letter. The intention is that they provide clarity between the parties in relation to role, responsibilities and expectations of the NED and clarity as to the purpose for such clause in the agreement or appointment letter. We have also provided a drafting example in order to assist with getting the clause started.

The NED agreement or appointment letter specific clauses are the following:

1. Preamble

This clause sets out that the organisation requires an NED to sit on their board and that the NED confirms he/she accepts the appointment and furthermore confirms that this document will contain the terms and conditions that govern their relationship.

Drafting Example:

“The Company requires a non-executive director to serve on its Board and the NED accepts the appointment as same. The parties hereby reduce to writing all arrangements regarding the NED’s appointment.”

2. Duration

This clause provides for the commencement of the NED appointment, the period/duration of the appointment and should provide for the instances upon which the NED will be required to vacate the position of NED for the organisation. Many of such instances are derived from legal provisions but examples are that the NED:

- resigns from his/her appointment as NED in the organisation;
- becomes disqualified from being a director or is declared a delinquent director or is placed on probation as a director, in terms of the Companies Act;
- breaches his director duties in terms of the common law or as legally required;
- commits a criminal offence prohibiting him/her from being a director in an organisation; and/or
- is not re-elected, retires or is removed from the board by way of a shareholders or board resolution.

The termination or re-election of an NED needs to be in line with the Company’s Board charter and Memorandum of Incorporation (“MOI”) and any notice periods (i.e. 90 days or immediate effect) must be determined by the Company and included in the agreement or appointment letter accordingly. . If the NED is appointed as an independent non-executive director, the agreement should state that his/her independence will be regularly monitored and assessed, and should he/she no longer be perceived to be independent, he/she may be asked to step down.

Drafting Example:

“The agreement commences on the x-date and remains in force until y-date or until terminated as provided hereunder. The NED will cease to hold office as a non-executive director of the Company on the occurrence of any of the following instances, namely ...”

3. Role of the NED

The role of the NED is different to that of the Executive director and due to the fact that the NED is not involved in the day to day management there is an expectation of objectivity and unbiased clarity. Core to this is that the NED is expected to actively participate on the board and bring his/her personal experience, skills and knowledge.

In doing so the NED should assist in constructively driving strategy within the organisation, monitoring the management's performance, setting values and standards within the organisation. The NED may be independent and therefore bring new insightful input which is fresh and new

Drafting Example:

"The NED is expected to participate on the Board in that he/she must:

- *At all times comply with and uphold all of his director duties as a director of the board as required in terms of both the common law and the Companies Act;*
- *..... "*

4. Rights and Obligations

This clause is specific to what the organisation affords and requires of the NED, which should be made clear at the outset. Included herein can be the NED's right to seek Independent advice at the organisations expense in connection with the discharge of his/her responsibilities or requiring the organisation to have and maintain D&O Insurance or to access company documents.

Drafting Example:

"With the approval of the chairman or the lead independent director of the board, the NED may seek independent advice at the expense of the Company on any matter connected with the discharge of his/her responsibilities. Copies of this advice must be made available to, and for the benefit of, all board members, unless the chairman of the board agrees otherwise"

5. Director Duties

This may deal with the requirement for an NED to comply with and adhere to his/her statutory and common law director duties, which is inclusive of the fiduciary duties. Key is to mention that a breach of these duties is a breach of trust unto the organisation. Therefore mention may be made of the expectation of the organisation that the NED must exercise good faith, honesty and integrity in all his/her dealings for the organisation

This clause may also address the duty of the NED to commit to a certain amount of expected time in relation to the attendance of board, committee, site and general meetings, input of time and knowledge in relation to additional roles, and the required preparation before any of the aforesaid meetings.

Drafting Example:

"A key component of the NED's director duties is that he/she must have sufficient time to devote to the appointment and that he/she must be able to properly carry out his/her responsibilities and duties to the Company. The Company anticipates that the NED's duties as a non-executive director of the Company shall involve a commitment of..."

6. Board Papers

This may deal with any arrangements regarding circulation of board papers, such as, whether board papers must be returned to the company after board meetings or if electronic versions of board papers are acceptable and so forth.

Drafting Example:

“The Company undertakes to circulate an electronic copy of the board papers 7 (seven) calendar days before the anticipated board meeting.”

7. Conflicts of Interests

This links in with director duties, however there is merit in making it a separate clause in that the organisation may include mention of any insider trading prohibitions and the result of such conduct. Mention may also be made to the Companies Act and the obligations it imposes on all directors regarding personal financial interests and declaration of any possible conflicts of interest.

Drafting Example:

“The NED must not permit a conflict of interests to prevail as required in terms of the Companies Act. The NED must immediately disclose to the board any and all potential conflicts of interest as soon as he/she becomes aware of such potential conflict of interests.”

8. Remuneration

This clause should deal with all matters relating to NED remuneration and if the NED will receive an annual remuneration or a fee per meeting attended or whichever structure the organisation determines. Some NEDs are not remunerated and mention of this needs to also be included.

Drafting Example:

“Each non-executive director is paid a base retainer fee which currently is R..... per annum. The shareholders or the board may change these amounts or the nature of the benefit in accordance with the provisions of the Companies Act or its MOI”

9. Induction

Any requirements for induction training of NEDs by the organisation are addressed here. This clarifies any expectations between the parties regarding same. Induction packs are highly supported in practise.

Drafting Example:

“The NED must participate in an induction programme agreed with the chairman of the board which shall include but not be limited to the following, namely, ...”

10. Ongoing Training

If the NED is required to fulfil any ongoing training this clause deals with all matters surrounding this, which includes the payment thereof by the company (if agreed). Ongoing training includes training, memberships or personal development.

Drafting Example:

“The NED is required to maintain the required ongoing training as a member of the board of directors as required in the Company’s board charter.”

Boiler plate clauses

The NED agreement or appointment letter should contain standard boiler plate clauses or provisions. Boiler plate clauses are the standard contractual clauses which generally find a home in all agreements, they are material and significant as they generally address potential contentious issues and which is why they are advised to be in most contractual agreements.

The NED agreement or appointment letter boiler plate clauses are the following:

1. Definitions clause – defining words or terms in order to avoid repetition and excessive length of the agreement;
2. Interpretation clause – provides clarity on salient aspects open to interpretation in an agreement;
3. Confidentiality clause – this ensures clarity on what information is confidential and sets out the confirmation of such information remaining confidential between the parties. There is normally a survival provision ensuring this clause remains in force despite the agreement coming to an end;
4. Intellectual Property clause – provides clarity as to what is considered intellectual property between the parties and how ownership of such intellectual property is retained, maintained or shared;
5. Breach clause – generally sets out what is a breach of the agreement and what the breach process is in the instance of a breach;
6. Dispute Resolution clause – this is important in avoiding unnecessary litigation and allows the parties to resolve the dispute by other methods internally first before proceeding with other legal options;
7. Termination clause – provides clarity as to how the agreement may be terminated in the ordinary course without a fault instance;
8. Force Majeure clause – this clause is salient in it allows consideration for failed performance due to circumstances beyond both parties control and therefore keeps the agreement reasonable;
9. Notices clause – provides clarity as to how the parties will accept service of notice in terms of the agreement and is important to ensure proper notice is given between the parties;
10. General clause – this clause allows all this loose end provisions to be included in the agreement and normally contains your governing law, provision can be included if other legislation is applicable such as the JSE Rules or PFMA, jurisdiction of the courts may be included, etc. This clause is not limited to anything in particular but may add value in tying up the loose ends.