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Review Article

Enlightened Shareholder Primacy Principle in South African Company Law

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Abstract: The question of whether the Company law protects minority shareholders' interests is answered comprehensively. Unlike the previous Companies Act of 1973, the Companies Act 2008 has introduced a company law that enlightens shareholders' value. The aim of this article is to outline minority shareholder protection under the 2008 Companies Act as shareholder primacy in South African Company law.

Keywords: Shareholder Primacy, South African Company Law, Minority Shareholders, Corporate Governance, Companies Act 2008

Introduction

The inexorable growth of companies has led to the Companies Act, which enlightens shareholder primacy in South African Company law. This is due to increased sophistication, shareholders' strong demand for protection as investors. South African company operated under the shareholder primacy principle from the 1973 Companies Act 61 to the 2008 Companies Act 71. The South African Company law entrusts directors with the management of the affairs of a company[1] while shareholders retain ownership. The introduction of section 76 is somewhat perceived as the most controversial and challenging to the duties of a director, given the scope of the functionary. This section codified common law duties into statute.

This article explains and analyses the nature of the enlightened shareholder value principle in the context of minority shareholders and its contribution to corporate governance while being consistent with the existing theory of shareholder value principle.

[1] Section 66(1) of the Companies Act

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The company directors have to act in good faith and for a proper purpose[2] in the best interest of the company[3] with reasonable care, skill and diligence.[4] The principle of shareholders 'value is taken up by the South African government and requires that the directors of the companies as a whole to act in the best interest of the shareholders as a whole. Hence, any resolution by the board of directors to issue shares must be approved by a special resolution of the shareholders, when shares are issued to a current or future director or prescribed officer of the company.[5] In cases of issuing shares by a private company, the shareholders have a pre-emptive right before shares are given to an outsider.[6] The theory provides that directors are to manage the company to ensure wealth maximisation to the fullest.[7] It is the principle in the important domain of developing corporate governance. It embodied what directors are determined to consider when managing the affairs of the companies. This theory was embraced by the likes of Jonathan Macey, as he foresaw that directors then were acting inconsistently with wealth maximisation. The only reason why shareholder value is argued for is that the shareholders have residual claims in the company, which means that if the company's fortunes increase, they will receive healthy dividends, but they will lose out if the company is liquidated.[8] Because a company is a juristic person, it can only act through its directors and employees on behalf of shareholders. Therefore, shareholders' meetings and board meetings are the centre point of running the day-to-day activities of a company. The procedures of running a company are determined by the Companies Act 71 of 2008 and the memorandum of incorporation of the company.

Shareholders are also entitled to demand a meeting by signing a demand of at least 10% of the voting rights entitled to vote at the meeting. All shareholders entitled to vote in a meeting will receive a notice of meeting as of the record date.[9] The voting rights are the rights of shareholders in a profit company. The same voting rights may not be available to some shareholders. The MOI may specify that ordinary shareholders do not have the same voting rights. The debt instruments may pave a way for the right to vote at general meetings. The company meetings are governed by the principle of majority rule. Meaning, when an individual is a minority shareholder in a company, that person is bound by the decisions of the majority.[10] The imbalance raises a question: what remedies are available

[2] See section 76 (3)(a) of the Companies Act
[3] Section 76(3)(b). of the Companies Act
[4] Section 76 (3(c) of the Companies Act
[5] See section 41 of the companies Act.
[6] Section 39 of the Companies Act
[7] See Friedman, M. 'The social responsibility of business is to Increase its profits' *New York Times*, September 13, 1970, section 13, 1970, section 6 (Magazine) 32 at 33.
[8] Andrew Keay The Enlighened Shareholder Value Principle and corporate Governance. Routledge, London and New york 2013. pp18.
[9] See section 1 of the companies Acthet
[10] See *Sammel v President Brand Gold Mining Co Ltd 1969 (3) SA 629 (A).* However, there are exceptions to this rule: In a profit company with one shareholder, that shareholder may exercise all voting rights. At the same time, if a profit company has only one director, that director may exercise all such functions of the board, unless the MOI states otherwise. In a company where every shareholder is also a director, shareholder may decide on any matter required to be referred by the board at any time, without compliance with internal procedures, unless MOI states otherwise.

for minority shareholders when matters become oppressive under a shareholder value primacy company law?

The only available protection for minority shareholders is section 161 for declaratory relief, 163 for oppressive conduct or prejudicial conduct, 164 for appraisal right and section 165 for derivative action.

Section 161-Decleratory Relief

This section provides shareholders with the right to approach a court for a declaratory order regarding rights. The order confirming or setting out rights is warranted when the action of the majority shareholders infringes upon the rights of the minority shareholder in terms of the MOI, shareholders' agreement, company rules or Companies Act. To protect minority shareholder rights in terms of the Companies Act or company rules, the director must rectify the harm caused by omission or act in contravention of the Companies Act, the company rules or the MOI.

The shortcoming of section 161 is in the interpretation of rights by the court. The interpretation of rights could be broad, protecting rights in a capacity other than as a shareholder. The narrow approach distinguishes between personal and corporate rights, including shareholders' personal rights, but excludes provisions of the MOI.

Section 163- Relief on Oppressive Conduct/Prejudice.

Prior to the 2008 Companies Act 71, prejudicial conduct was regulated under section 252 of the Companies Act 61 of 1973. The court confirmed in *Grancy*[11] case that section 163 of the 2008 Act is in all material respects the same at the 1973 section 525 of the 1973Act. The only difference is that the former accommodates the interest of the shareholders rather than just the rights of the shareholders.

Section 163(1) of the 2008 Act provides that a director or shareholder may apply for relief proving prejudicial or unfair conduct. The director may apply on behalf of the minority shareholder. The proceeding must follow unfair or prejudicial conduct that does not need to be unlawful, but unfair and prejudicial. This section of the Companies Act has heavy reliance on English cases, as the Act itself is derived from the English law, the Companies Act of 2006. One of the English cases in *Re a Company (No 00709 of 1992) O'Neill and Another v Phillips and Others*,[12] the court held that the concept of fairness is wider than conduct merely affecting rights and that it rather involves a consideration of what is just and equitable.

For section 163, the minority shareholder may approach the court for relief or an appropriate remedy for unfair, prejudicial, and oppressive conduct of the majority shareholder in cases of disregard of minority shareholders' interests. The prejudicial conduct can be objectively proved if it had the effect of adversely or materially affecting financial statements and market prices.[13] This case suggests the active involvement of the

[11] See paragraph 22 in *Grancy Property Ltd v Manala and Others* 2015 (3) SA 313 (SCA).
[12] [1999] 2 All ER 961
[13] See *Geffen and Others v Martin and Others* [2018] 1 All SA 21 (WCC) paragraph 78.

shareholder in the management decisions of the company.[14] This case further clarifies what a problem in *De Sousa* was that the applicant was excluded from the activities and management of the company by the majority, who refused to engage in any good faith negotiation to buy him out at a fair value.[15] Therefore, the court used the reasonable bystander test to allege the applicant was unfairly and prejudicially treated.[16] This brings us back to the determination of what constitutes unfair or prejudicial conduct, that the focus must be on the motive of the conduct rather than the objective, looking at the act itself and its effect on the company shareholder.[17]

Minority shareholders may approach a court when a director's act or omission relates to the business of the company conducted in an unfair manner, prejudicial and disregards the interest of the minority shareholder.

The shortcomings: there must be evidence or proof of the director's conduct, business exercise, or powers that are prejudicial or unfair held by the majority shareholder. There must be a material dispute so that the court may order a trial. The court proceeding might burden the minority shareholder and increase due to delays by the majority shareholder.

Section 164-Appraisal right

In the event the minority shareholder does not agree with the action of the majority shareholders, the dissenting shareholder is entitled to exercise appraisal rights, allowing exit from the corporation by demanding payment of fair value shares rather than remaining in a structure not supporting him or her. The disagreement may stem from the majority shareholder's resolution to amend the MOI, changing shareholder rights, terms and preference of class of shares, the company consider merger or amalgamation. The right given by this section to the minority shareholder is that it may approach the company to buy back its shares at a fair value.

The share value may be influenced negatively by publicity around the debacle in the resolution. The court's intervention in the determination of share value is uncertain. The procedure for taking this route is complicated and technically, subsequently, the minority shareholder may lose the appraisal right by failure to comply with procedures, which require that he or she must be present at the meeting and object at the meeting. The exercise of this section is very difficult without a legal assistant and is draining financially. Litigation in the Companies Act is inherently complex and intensive. The moment a minority shareholder sends a demand to the company to have his share back, the shares get frozen, losing all other rights associated, and the fair value demanded is only paid at the end of the appraisal process, which can be a lengthy exercise.

[14] See *Geffen and Others v Martin and Others* [2018] 1 All SA 21 (WCC) paragraph 30.
[15] See *De Sousa and Another v Technology Corporate Management Pty Ltd and Others* 2017 (5) SA 577 (GJ) at paragraph 44-45.
[16] See *De Sousa and Another v Technology Corporate Management Pty Ltd and Others* 2017 (5) SA 577 (GJ) at paragraph 35.
[17] See *Grancy Property Ltd v Manala and Others* 2015 (3) SA 313 (SCA). at paragraph 27.

Section 165-Derivative Action

The derivative claims refer to the minority shareholder's right to institute legal action for and on behalf of the company to protect the company's interests. This action is warranted when the wrong is against the company, and the board of directors are the wrongdoer. Before legal action can be pursued, certain requirements are to be satisfied, including a demand to the company to institute proceedings, unless such a demand would be futile or not acted upon. The minority shareholder may take action in good faith, and the legal action is in regard to a matter that is material to the company's best interests. The court may only grant leave where it would be in the company's best interest. The rebuttable presumption that would be contrary to the company's best interest is when the proceedings are instituted against a third party in cases where the company decided not to proceed with legal action or where all directors acted in good faith with no personal interest properly informed or reasonably believed that the decision was in the company's best interests.

Since minority shareholders have a statutory right to information to take informed decisions, the dispute often arises where majority shareholders limit transparency by restricting access to financial statements, shareholder resolutions, and records of meetings and company records.

The court is not quick to intervene in company business. The court is believed to be less knowledgeable than directors. The courts recognise meaningful participation of a shareholder as subject to information access, a nd in particular, complete information. The application in an individual capacity is a hassle with one's own legal costs. What is burdensome, the evidence or information required to win the case, is generally under the control of the directors who wrongly acted.

Conclusion

The Companies Act impose the duties of a director as inter alia to act in good faith and in the best interest of the company as contemplated in section 76(3). These duties are wholly owed to the company alone. Shareholders may claim damages from anyone who intentionally, fraudulently or through negligence caused the company to contravene the Companies Act or act contrary to limitation, restriction or qualification.[18] "A company must not carry on its business recklessly, with gross negligence, with intent to defraud any person or for any fraudulent purpose."[19]

In the event of wrongdoing against the company, it is the only company that can sue for damages. The company would be the proper plaintiff. This is said to be the proper plaintiff rule.[20] The proper plaintiff rule affirms that a company may institute legal proceedings through its organs in relation to the breach of an obligation owed to it. The prima facie is the company itself. However, derivative Claims can be brought in relation to

[18] Section 20(1) of the Companies Act
[19] Section 22(1) of the Companies Act
[20] See *Foss v Harbottle* (1843) 2 Hare 461, 67 ER 189.

the breaches of duty which injured the company and benefited the directors personally.[21] Section 77(2)(a) states that a director of a company may be held liable for breaches of fiduciary duties for any loss or damages sustained by the company. Hence, in section 77(2)(b), liability could arise in accordance with the principles of common law of delicts for any loss or damages or cost sustained by the company as a result of any breach by the director as an obligation imposed in section 75(3)(b). Liability also arises when any person contravenes any provision of the Companies Act that results in a loss or damage due to contravention.[22] "A shereholder…cannot recover damages merely because the company in which he is interested has suffered damage. He cannot recover a sum equal to the diminution in the market value of his shares, or equal to the likely diminution in dividend because such a loss is merely a reflection of the loss suffered by the company."[23] "A [shareholder claim for reflective loss] would subvert the rule in *Foss v Harbottle,* and the rule is not merely a tiresome procedural obstacle placed in the path of a shareholder by a legalistic judiciary. The rule is a consequence of the fact that a corporation is a separate legal entity."[24]

A company is deemed to have a distinct legal personality. A wrong to a company is not a wrong to a shareholder. This was outlined in *Itzikowitz*. The court confirmed that a shareholder cannot recover a sum equal to the diminution in the market value of the shares, as this loss is a mere reflection of the loss suffered by the company as the shareholder does not suffer any personal loss.[25] This principle is known as reflective loss.

In *Hlumisa v Kirkinis*, the court confirmed that directors owe fiduciary duties to the company and not to the members or shareholders individually, not even to the majority shareholder. Directors have a fundamental duty to act in the best interest of the company as the collective body of shareholders and not to shareholders individually. In the *Hlumisa* case, the court ruled over section 218(2) that shareholders did not suffer a loss separate and distinct from that suffered by the company.[26]

[21] See D. Kershaw, The Rule in Foss v Harbottle is dead; Long live the Rule in Foss v Harbottle, LSE Law, Society and Economy Working paper 5/2013, London School of Economics and Political Science Law Dept. See also D. Kershaw, Company Law in Context and Materials (1st Ed, 2009) 551.
[22] See section218 of the companies Act 71; *Venata Africa (Pty) Ltd v Watts and Another* (4) SA (SCA); *Robinowitz v Van Graan and Other* (5) SA 315 (GSJ); *De Bruyn v Steinhoff International Holdings N.V. and Others* (1) SA 442 (GJ).
[23] *Prudential Assurance Co Ltd v Newman Industries Ltd* (No 2) 1982] 1 All ER 354 [1982] Ch 222-223
[24] *Prudential Assurance Co Ltd v Newman Industries Ltd* (No 2) 1982] 1 All ER 354 [1982] Ch 224; see *Johnson v Gore Wood & Co (a firm)* [2001] 1All ER 481; [2002] 2 AC 1 HL) Lord Bingham.
[25] *Itzikowitz v Absa Bank Ltd* (20729/2014) [2016] ZASCA 43 (31 March 2016).
[26] *Hlumisa Investment Holdings (RF) Ltd v Kirkinis* 2019 (4) SA 569 (GP) paragraph 101.