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**GTNANT001**

**Master of Law: Commercial Law**

**IS THE 'LITTLE MAN' FINALLY PROTECTED? AN EXPLORATION OF  
MINORITY SHAREHOLDER PROTECTION IN SOUTH AFRICA  
UNDER THE COMPANIES ACT OF 2008**

**Supervisor: Associate Professor Tshepo Mongalo**

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University of Cape Town

**DEDICATION**

To my parents, Dr Fredrick G. Rinkanya and Eng Rosemary K. Gitonga

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## ABBREVIATIONS

ERISA	-Employee Retirement and Income Security Act
OECD	-Organisation for Economic Cooperation and Development
SALC	-South Africa Law Commission
SEC	-Securities and Exchange Commission
UK	-United Kingdom

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## A. INTRODUCTION AND BACKGROUND

The position of the minority shareholder is not an enviable one due to the fact that his rights and interests are at the disposal of the majority.<sup>1</sup> This general principle is set out in the rule in *Foss v. Harbottle*,<sup>2</sup> which has proved a formidable obstacle to relief. It elaborates that only the company can bring proceedings for wrongs done to the company.<sup>3</sup> The company is a legal person distinct from its shareholders. It follows that a wrong to the company is not a wrong to each shareholder.<sup>4</sup>

The company, it is argued, cannot function efficiently as a group unless the will of the majority generally prevails.<sup>5</sup> Minority shareholders would be held to have minimal rights if these concepts were ruthlessly applied<sup>6</sup> and could leave the oppressed with no option but to sell his shares.<sup>7</sup>

The minority shareholder will however be allowed to sue if he can convince the court that his case falls under the exceptions to the rule in *Foss v. Harbottle*.<sup>8</sup> A minority shareholder can only sue if the wrong is, or involves, the breach of some personal right and where the simple majority is not in a position to regularise or to do regularly what has been done irregularly.<sup>9</sup>

Minority shareholders should be protected from abusive actions by, or in the interest of, controlling shareholders acting either directly or indirectly,

<sup>1</sup>Peter G. Xuereb *The Rights of Shareholders* (1989) 163; L.M. Schaef 'The Oppression Remedy for Minority Shareholders' (1985) 23 *Alberta Law Review* 512 at 512.

<sup>2</sup>[1843] 2 Hare 461.

<sup>3</sup>Robin Hollington *Shareholders' Rights* 4ed (2004) 93; *Salomon v. Salomon & Co Ltd* [1987] AC 22.

<sup>4</sup>Robin Hollington *Shareholders' Rights* 4ed (2004) 6; Peter G. Xuereb *The Rights of Shareholders* (1989) 165.

<sup>5</sup>Robin Hollington *Minority Shareholders' Rights* 2ed (1994) 1; *Samuel & Others v. President Brand Gold Mining Co Ltd* 1963 (3) SA 629 (A); D Davis *et al Companies and other Business Structures in South Africa* (2009) 68.

<sup>6</sup>Robin Hollington *Minority Shareholders' Rights* 2ed (1994) 1.

<sup>7</sup>L.M. Schaef 'The Oppression Remedy for Minority Shareholders' (1985) 23 *Alberta Law Review* 512 at 512.

<sup>8</sup>[1843] 2 Hare 461; Peter G. Xuereb *The Rights of Shareholders* (1989) 164.

<sup>9</sup>Peter G. Xuereb *The Rights of Shareholders* (1989) 166.

and should have effective means of redress.<sup>10</sup> Restraints must therefore be put in place to protect against the dangers of majority rule to the detriment of the minority shareholder and the interests of the company as a whole. Key to protecting minority shareholders is the right to full disclosure and a clearly articulated duty of loyalty by board members to the companies and to all shareholders.<sup>11</sup>

Common provisions to protect minority shareholders, which have proven effective, include pre-emptive rights in relation to share issues, qualified majorities for certain shareholder decisions and the possibility to use cumulative voting in electing members of the board. Other means of improving minority shareholder rights are derivative and class action law suits.<sup>12</sup>

## **B. Approach to the Topic**

### **1. The Companies Act No 71 of 2008**

The new Companies Act was signed by the President of South Africa on the 8<sup>th</sup> of April 2009 and gazetted in gazette No 32121 (Notice 421). It comes into operation on a date still to be fixed by the President by proclamation in the gazette, which may not be earlier than one year following the date on which the President assented to this act.<sup>13</sup>

This thesis will examine the protection of the minority shareholder under the new Companies Act of 2008. It will begin by examining the

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<sup>10</sup>OECD Principles of Corporate Governance (2004) Part One III A (2) Available at <http://www.oecd.org/dataoecd/32/18/31557724.pdf> [Accessed on 7th June 2009].

<sup>11</sup>OECD Principles of Corporate Governance (2004) Part Two III A (2) Available at <http://www.oecd.org/dataoecd/32/18/31557724.pdf> [Accessed on 7th June 2009].

<sup>12</sup>OECD Principles of Corporate Governance (2004) Part Two III A (2) Available at <http://www.oecd.org/dataoecd/32/18/31557724.pdf> [Accessed on 7th June 2009].

<sup>13</sup>Available at [http://www.acts.co.za/companies\\_act\\_2008/whnjs.htm](http://www.acts.co.za/companies_act_2008/whnjs.htm) [Accessed on 15 August 2009].

common law position as encapsulated in the rule of *Foss v Harbottle*<sup>14</sup> and the exceptions to the rule thereto. It will then examine the current provisions for minority shareholder protection under the old Companies Act No. 61 of 1971 in comparison to those under the new Companies Act No 71 of 2008. It will seek to determine whether the new Companies Act improves the position of the minority shareholder.

The thesis will then make a comparison of minority shareholder protection under the United Kingdom Companies Act of 2006 against that offered by the new Companies Act No 71 of 2008. Finally the thesis will look at the recommendations for minority shareholder protection under the King Report on Corporate Governance for South Africa (2002) and the OECD principles of corporate governance and identify how far the new Companies Act No 71 of 2008 has incorporated them.

It will finally conclude with an examination of the level of protection offered to the minority shareholder under the new Companies Act No 71 of 2008 compared to the old Companies Act No 61 of 1973, the United Kingdom Companies Act of 2006, the King Report and the OECD principles of corporate governance with recommendations as to ways in which the act could be improved to enhance minority shareholder protection and thus encourage better corporate governance.

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<sup>14</sup>[1843] 2 Hare 461.

## CHAPTER ONE

### A. THE RULE IN FOSS V HARBOTTLE

#### 1. Introduction

It is an elementary principle of law relating to joint stock companies that the court will not interfere with the internal management of companies acting within their powers, and in fact has no jurisdiction to do so. Again it is clear law that in order to redress a wrong done to the company, or to recover money or damages alleged to be due to the company, the action should *prima facie* be brought by the company itself.<sup>15</sup> These cardinal principles were laid down in the well known cases of *Foss v Harbottle*<sup>16</sup> and *Mozley v Alston*<sup>17</sup> and are compositely referred to as “the Rule in *Foss v Harbottle*”.<sup>18</sup>

The reasons provided for the existence of the rules in *Foss v Harbottle* are that the principle avoids double jeopardy. In *McLelland v Hulett and Others*,<sup>19</sup> the court held that the real reason why the rule exists is linked to the separate existence of the company. The court indicated that if the shareholder is allowed to sue it will result in a multiplicity of actions, ‘double jeopardy’, against the wrongdoer for the same wrong.<sup>20</sup>

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<sup>15</sup>As per Lord Davey in *Burland v. Earle* [1902] A.C. 83 at 93 (P.C).

<sup>16</sup>[1843] 2 Hare 461.

<sup>17</sup>[1847] 1 Ph. 790.

<sup>18</sup>K. W Wederburn ‘Shareholders Rights and the Rule in *Foss v. Harbottle*’ (1957) 15 (2) *Cambridge Law Journal* 194 at 195.

<sup>19</sup>1992 (1) SA 456 (D); D Davis *et al Companies and other Business Structures in South Africa* (2009) 188; JT Pretorius *et al Hahlo’s South African Company law through the cases* 6ed (1999) 381; *MacDougall v. Gardiner* (1875) 1 ChD 12; *Goodall v. Hoogendoorn Ltd* 1926 AD 11 at 16.

<sup>20</sup>1992 (1) SA 456 (D); D Davis *et al Companies and other Business Structures in South Africa* by (2009) 188; JT Pretorius *et al Hahlo’s South African Company law through the cases* 6 ed (1999) 381; *MacDougall v. Gardiner* (1875) 1 ChD 12; *Goodall v. Hoogendoorn Ltd* 1926 AD 11 at 16; *Mozley v. Alston* [1847] 1 Ph. 799; *Lord v. Copper Miners Co* (1848) 2 Ph. 740 at 752; L Griggs ‘The statutory derivative action: lessons that may be learnt from the past!’ *University of Western Sydney Law review* [2002] 4 par 1.2.

It would serve no purpose to allow a shareholder to litigate on a matter that could be legally ratified by the majority of shareholders.<sup>21</sup> Allowing such an action will result in a return of corporate assets to shareholders without first paying the creditors of the company.<sup>22</sup>

## 2. The two parts of the rule and their point of contact

The corporation principle states that the proper plaintiff in an action in respect of a wrong alleged to be done to a company or association of persons is *prima facie* the company or association of persons itself.<sup>23</sup> This principle springs naturally from the treatment in law of the corporation as a person separate from the members of whom it is composed. Individual members of a corporation are quite distinct from the metaphysical body called the corporation.<sup>24</sup> Thus, injuries allegedly caused to the corporation, not only by outsiders, but also by its own directors where their duties are owed to the corporation alone not its members, must be remedied not by the members but by corporate action.<sup>25</sup>

The second principle springs from a partnership doctrine which was already marcescent at the time when it was taken over.<sup>26</sup> In the early years of the nineteenth century the courts of equity were averse to interfering at all between one partner and another, unless it was for the purposes of dissolving the partnership, it being no duty of the courts to settle all

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<sup>21</sup>JT Pretorius *et al Hahlo's South African Company law through the cases* 6 ed (1999) 381.

<sup>22</sup>JT Pretorius *et al Hahlo's South African Company law through the cases* 6 ed (1999) 381; Lindi Coetzee 'Comparative Analysis of the Derivative Litigation Proceedings under the 1973 Act and the New Companies Act' (2009) Nelson Mandela Metropolitan University Unpublished Journal Article 5.

<sup>23</sup>*Edwards v. Halliwell* [1950] 2 All E.R. 1064, at 1066.

<sup>24</sup>*Salomon v. Salomon & Co Ltd* [1897] AC 22(HL); *Bligh v. Brent* [1837] 2Y & C. Ex 268 at 295; *Soc of Practical Knowledge v. Abbott* [1840] 2 Beav 559; *Coach v. Goodman* (1842) 2 Q.B. 580.

<sup>25</sup>*Foss v. Harbottle* [1843] 2 Hare 461; *Burland v. Earle* [1902] A.C. 83 at 93 (P.C); *Dominion Cotton Mills co Ltd v Amyot* [1912] A.C. 546.

<sup>26</sup>K. W Wederburn 'Shareholders Rights and the Rule in *Foss v. Harbottle*' (1957) 15 (2) *Cambridge Law Journal* 194 at 196.

partnership squabbles.<sup>27</sup> This rule was extended to companies to ensure that courts of equity would not interfere between members of the company for the purpose of enforcing duties arising out of matters which are properly the subject of internal regulation.<sup>28</sup> This was the unsatisfactory origin of Lord Davey's proposition to the effect that the court has no jurisdiction on matters of internal management.<sup>29</sup> Once established, however, the principles were rigorously applied to the many irregularities committed by those managing joint stock companies. Individual members could not complain of calls made within the directors' powers but allegedly unfairly made; of an irregular quorum at a directors meeting or of alleged improprieties in the conduct of meetings, which were considered matters of internal regulation and under the control of the majority.<sup>30</sup> The law had long recognised majority rule as a fundamental principle concerning corporations,<sup>31</sup> so there was no problem in expressing majority rule as the justification for refusal to interfere in internal management.<sup>32</sup> The majority which decided disputes about internal management was also the traditional authority for deciding whether or not the corporation should bring an action in order to remedy a wrong committed against it.<sup>33</sup>

### 3. Exceptions to the rule in *Foss v. Harbottle*

The rule in *Foss v. Harbottle* is however, not without its exceptions.

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<sup>27</sup>Lindley *Law of Partnerships* 1 ed(1860) 2 752-753.

<sup>28</sup>Lindley *Law of Partnerships* 11ed (1950) 573.

<sup>29</sup>K. W Wederburn 'Shareholders Rights and the Rule in *Foss v. Harbottle*' (1957) 15 (2) *Cambridge Law Journal* 194 at 197.

<sup>30</sup>K. W Wederburn 'Shareholders Rights and the Rule in *Foss v. Harbottle*' (1957) 15 (2) *Cambridge Law Journal* 194 at 197.

<sup>31</sup>*R v Varlo* (1775) 1 Cowp 248 at 250, *Attorney General v Davy* (1741) 2 Atk 212.

<sup>32</sup>K. W Wederburn 'Shareholders Rights and the Rule in *Foss v. Harbottle*' (1957) 15 (2) *Cambridge Law Journal* 194 at 198.

<sup>33</sup>K. W Wederburn 'Shareholders Rights and the Rule in *Foss v. Harbottle*' (1957) 15 (2) *Cambridge Law Journal* 194 at 198.



**a. *Ultra vires***

A simple majority of members cannot ratify an act by the company which is illegal or *ultra vires*. It is plain that the majority can sue in this case because the majority cannot ratify an act *ultra vires* the company; and a *fortiori* the same reasoning will be applied to acts which are not merely outside the powers of one company,<sup>34</sup> but illegal in the sense of impossible for any registered company, or prohibited under general law.<sup>35</sup>

**b. Special majorities**

The second is the special majorities exception that states, where the matter is one “which could validly be done or sanctioned not by a simple majority but by a simple majority of the members...but only by some special majority,” the rule is ousted.<sup>36</sup>

**c. Personal rights**

The third is the personal rights exception that, “where the personal and individual rights of membership of (the plaintiff) have been invaded,” the rule has no application at all.<sup>37</sup>

**d. Fraud by those in control**

The final exception is fraud by those in control. Where what has been done amounts to what is generally called a fraud on the minority and the wrong doers are themselves in control of the company, the rule is relaxed in favour of the aggrieved minority who are allowed to bring a minority shareholders’ action on behalf of themselves and all others, because, otherwise, the wrong

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<sup>34</sup>*Hope v. International Financial Soc.* [1876] 4 Ch.D 327 (Purchase of company’s own shares); *Ooregum Gold Mining Co v. Roper* [1892] A.C. 125 (Shares at a discount).

<sup>35</sup>*Powell v Kempton Park Racecourse Co* [1897] 2 Q.B. 242.

<sup>36</sup>*Edwards v. Halliwell* [1950] 2 All E.R 1064 at 1067; *Quin and Axtens Ltd v. Salmon* [1909] 1 Ch. 31; K. W Wederburn ‘Shareholders Rights and the Rule in *Foss v. Harbottle*’ (1957) 15 (2) *Cambridge Law Journal* 194 at 207.

<sup>37</sup>*Edwards v. Halliwell* [1950] 2 All E.R 1064; K. W Wederburn ‘Shareholders Rights and the Rule in *Foss v. Harbottle*’ (1957) 15 (2) *Cambridge Law Journal* 194 at 209; Peter G. Xuereb *The Rights of Shareholders* (1989) 166; Robin Hollington *Shareholders’ Rights* 4ed (2004) 125.

doers themselves being in control, would not allow the company to sue.<sup>38</sup> The only possible form of action here is a derivative action because the wrong against which relief is sought is always a wrong to the company. The action is brought by a shareholder formally on behalf of himself and all other shareholders except the alleged wrongdoers and is brought against the latter and the company.<sup>39</sup> The essence of this exception, as viewed traditionally, is that the wrong is of a type which the company may not ratify and that the wrongdoers are in control of the powers of corporate litigation.<sup>40</sup> The requirements are those of wrongdoer control and fraud on the majority.

(i) *Wrongdoer Control*

Control usually means majority voting control.<sup>41</sup> This can be personal ownership of shares carrying voting rights or indirect through voting shares held by nominees.<sup>42</sup> It also applies where the directors whom it is sought to sue can influence the vote by casting votes attached to shares held by another company on whose board they sit.<sup>43</sup> The shareholder must be able to show that the company will be prevented from suing and must therefore have attempted to mobilise the appropriate company organ in which the power of decision has been vested.<sup>44</sup> If there are any doubts as to the ability of the wrongdoer to control litigation through control of the majority of the votes in the general meeting, the court will direct the holding of a general meeting to decide the issue and the burden will fall on the Plaintiff to show that control was exercised.<sup>45</sup>

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<sup>38</sup>*Burland v. Earle* [1902] A.C. 83 at 93; *Dominion Cotton Mills Co Ltd v. Amyot* [1912] A.C. 546; A.J. Boyle *Minority Shareholders' Remedies* (2002) 25; K. W Wederburn 'Shareholders Rights and the Rule in *Foss v. Harbottle*' (1957) 15 (2) *Cambridge Law Journal* 194 at 203.

<sup>39</sup>Peter G. Xuereb *The Rights of Shareholders* (1989) 169.

<sup>40</sup>Peter G. Xuereb *The Rights of Shareholders* (1989) 169.

<sup>41</sup>Peter G. Xuereb *The Rights of Shareholders* (1989) 169.

<sup>42</sup>*Pavlides v. Jensen* [1965] Ch 565.

<sup>43</sup>*Pavlides v. Jensen* [1965] Ch 565.

<sup>44</sup>Peter G. Xuereb *The Rights of Shareholders* (1989) 169.

<sup>45</sup>*Prudential Assurance Co. Ltd v. Newman Industries Ltd (No. 2)* [1982] Ch 204 at 222, CA.

(ii) *Fraud on the Majority*

Fraud in this context includes more than fraud at common law. It also covers fraud in the equitable sense of the term, as in the equitable concept of fraud on a power, an abuse or misuse of power.<sup>46</sup> In the case of *Prudential Assurance Co. Ltd v. Newman Industries Ltd (No. 2)*,<sup>47</sup> the Court of Appeal affirmed that 'Whatever may be the properly defined boundaries of the exception to the rule in *Foss v. Harbottle*, the plaintiff ought at least to be required to establish a *prima facie* case that the company is entitled to the relief claimed and that the action falls within the proper boundaries of the exception.' This means that in a preliminary motion to strike out the action on the basis of *Foss v. Harbottle*, a *prima facie* case must be made out as to fraud and control.

Applying the traditional 'non-ratifiability' criterion, some wrongs appear to be 'non-ratifiable' (and therefore are 'frauds') while others are not. The question is where to draw the line.<sup>48</sup> Ratification has been explained as the process by which "those to whom duties are owed may release those who owe the duties from their legal obligations prospectively or retrospectively."<sup>49</sup> The generally accepted position, as approached on the traditional ratifiability analysis is as follows:

(aa) *Non-ratifiable*

Misappropriation of corporate assets and *mala fide* exercise of power.

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<sup>46</sup>*Estmanco (Kilner House) Ltd v. GLC* [1982] 1 All ER 437 at 445.

<sup>47</sup>[1982] Ch 204.

<sup>48</sup>Peter G. Xuereb *The Rights of Shareholders* (1989) 171.

<sup>49</sup>Jennifer Payne 'A Re-Examination of Ratification' 1999 58(3) *Cambridge Law Journal* 604 at 605.

In *Cook v. Deeks*,<sup>50</sup> the directors diverted a contract, which the company was actively perusing, to themselves and then purported as majority shareholders to ratify their conduct by a resolution declaring that the company had no interest in the contract. It was held that the majority could not be allowed to ratify their own breach of duty and that a derivative action lay.<sup>51</sup> The case of *Meiner v. Hooper's Telegraph Works*<sup>52</sup> established that this type of fraud also extends to the abuse of power by the majority in a general meeting. In this case a derivative action lay where the majority compromised an action in which the company was involved, in return for the grant by the other party of a cable-laying contract to themselves in another guise. This approach was also followed in the *Estmanco (Kilner House) Ltd v. GLC* case<sup>53</sup> where Majoriry J held, that a majority resolution ordering the board to discontinue an action brought by the company against the majority, amounted to just such a fraud on a power as constituted a fraud on the majority.<sup>54</sup>

#### *Self-serving negligence*

In *Daniels v Daniels*,<sup>55</sup> the directors sold a corporate asset to one of their number for 4,250 pounds. Four years later he sold it for 120,000 pounds. Lord Templeman said:

“In *Pavides v. Jensen*,<sup>56</sup> it was alleged that directors had been guilty of gross negligence in selling a valuable asset of the company at a price greatly below its true market value. Danckerwerts J struck out the statement of claim as disclosing no cause of action because no fraud was pleaded. The authorities which deal with simple fraud on one hand and gross negligence

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<sup>50</sup>[1916] AC 554.

<sup>51</sup>Peter G. Xuereb *The Rights of Shareholders* (1989) 172.

<sup>52</sup>(1874) 9 Ch App 350.

<sup>53</sup>[1982] 1 All ER 437.

<sup>54</sup>Peter G. Xuereb *The Rights of Shareholders* (1989) 172.

<sup>55</sup>[1978] Ch 406.

<sup>56</sup>[1957] Ch 565.

on the other do not cover the situation which arises where, without fraud, the directors and majority shareholders are guilty of breach of duty which not only harms the company but benefits the directors. If minority shareholders can sue if there is a fraud, there is no reason why they cannot sue where the action of the majority and the directors, though not fraud, confer some benefit on those directors and majority shareholders themselves. To put up with foolish directors is one thing but to put up with directors who are so foolish that they make a profit of 115,000 pounds at the expense of the company is something entirely different."<sup>57</sup>

The principle which may be gleaned is that a minority shareholder who has no other remedy may sue where directors use their powers intentionally or unintentionally, fraudulently or negligently in a manner which benefits themselves at the expense of the company.<sup>58</sup>

*(bb) Ratifiable (albeit by the votes of the wrong doers)*

Mere negligence is ratifiable.<sup>59</sup> A bona fide exercise of power for collateral purpose appears to be ratifiable.<sup>60</sup> The making of an incidental secret profit out of one's position as a director in the absence of mala fides is ratifiable.<sup>61</sup>

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<sup>57</sup>Peter G. Xuereb *The Rights of Shareholders* (1989) 172.

<sup>58</sup>Peter G. Xuereb *The Rights of Shareholders* (1989) 172.

<sup>59</sup>*Pavides v. Jensen* [1957] Ch 565.

<sup>60</sup>*Bamford v. Bamford* [1970] Ch 212; *Hogg v. Cramphorn Ltd* [1967] Ch 254.

<sup>61</sup>*Regal Hastings Ltd v. Gulliver* [1967] 2 AC 134n.

## CHAPTER TWO

### STATUTORY REMEDIES FOR MINORITY SHAREHOLDERS

#### A. THE DERIVATIVE ACTION

##### 1. Introduction

The derivative action refers to wrongs done to the company.<sup>62</sup> The origins of the derivative action can be found in abuses of management occurring in associations and corporations. The courts were required to develop a process that would allow a shareholder or a member of the corporation or association to complain about malfeasance by the controllers of the entity. If the courts had not developed this process, the matter would then have gone without remedy, leaving the controllers with a free hand to divert the assets of the corporation to their own use.<sup>63</sup>

It is described as a unique remedy because it allows a person to bring an action that belongs to the company<sup>64</sup>. If the company cannot or will not act against those who wronged it, a derivative action on behalf of the company may be instituted in certain circumstances. Such an action will have to be instituted against the wrongdoers by somebody acting on his own behalf and all the shareholders other than the wrongdoers.<sup>65</sup> The company, being unable to act as plaintiff, must be joined as a nominal defendant so it is party to the proceedings and an order can be made applicable to it. It is generally accepted that a derivative action may be instituted if an unratifiable wrong has been done to the company and where the company

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<sup>62</sup>Cilliers *et al* *Cilliers & Benade Corporate Law* 3ed (2000) 302.

<sup>63</sup>L Griggs 'The statutory derivative action: lessons that may be learnt from the past!' *University of Western Sydney Law review* [2002] 5 part 2.

<sup>64</sup>L Griggs 'The statutory derivative action: lessons that may be learnt from the past!' *University of Western Sydney Law review* [2002] 4 par 1.1.; D Davis *et al* *Companies and other Business Structures in South Africa* (2009) 187.

<sup>65</sup>Cilliers *et al* *Cilliers & Benade Corporate Law* 3ed (2000) 303.

cannot or will not institute the action because the wrong doers control the company.<sup>66</sup>

## 2. Distinction between a personal claim and derivative claim

The derivative action must be distinguished from the personal action. A member would have the right to institute the personal action where the member's rights in terms of the contract created between the company and its members by virtue of the provisions of the memorandum and articles of association<sup>67</sup> have been infringed.<sup>68</sup> In the case of *Goldex Mines v Revill*<sup>69</sup> there was a fight for control of Probes Mines Ltd. At issue was alleged misconduct by the directors and defendant shareholders, including misleading proxy solicitation. However, it was not clearly stated whether the claim was personal or derivative and leave to bring an action had not been sought. The central issue was whether leave was acquired. The Ontario Court of Appeal ultimately concluded that the endorsement was deficient as it failed to differentiate between personal claims and derivative claims. The case is authority for the proposition that, while derivative and personal actions may be joined in the one writ, it is necessary to distinguish each cause of action in the statement of claim.<sup>70</sup>

The biggest difference between the derivative action and the personal action is that any damages awarded in a successful personal action will

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<sup>66</sup>Cilliers *et al* *Cilliers & Benade Corporate Law* 3ed (2000) 303.

<sup>67</sup>Section 65(2) Companies Act 61 of 1973; Cilliers *et al* *Cilliers & Benade Corporate Law* 3ed (2000) 300.

<sup>68</sup>Lindi Coetzee 'Comparative analysis of the derivative litigation proceedings under the 1973 Act and the new Companies Act' [2009] Nelson Mandela Metropolitan University Unpublished Journal Article 5.

<sup>69</sup>[1973] 32 DLR (3d) 129 (Ont HC).

<sup>70</sup>L Griggs 'The statutory derivative action: lessons that may be learnt from the past!' *University of Western Sydney Law review* [2002] 11 part 3.

accrue to the shareholder personally whereas any damages awarded in a derivative action will accrue to the company.<sup>71</sup>

### 3. Derivative Action in South Africa

Common law derivative action in South Africa has received little attention and the procedure to be followed in such an action is unclear.<sup>72</sup> Common law derivative action is negatively affected by the serious defect that a member has to conduct the case at personal risk, especially with respect to cost.<sup>73</sup> On one hand, should he be successful, the benefits accrue to the company. While on the other hand should he fail he will be liable for all costs.<sup>74</sup> The plaintiff must also join action, while all information regarding company matters is in the hands of the controllers, who are usually the wrongdoers or sympathisers.<sup>75</sup> It was also unclear as to precisely what conduct could not be ratified by simple majority hence the scope of the remedy was unclear.<sup>76</sup>

The problems attached to the common law derivative action and the virtual disguise into which it had fallen in South Africa led to the creation of the Van Wyk de Vries Commission, which proposed the introduction of section 266<sup>77</sup> which provided for statutory derivative action.<sup>78</sup> According to Blackman the purpose of the statutory derivative action was to overcome the disadvantages of the common law derivative action. The statutory

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<sup>71</sup>Lindi Coetzee 'Comparative analysis of the derivative litigation proceedings under the 1973 Act and the new Companies Act' [2009] Nelson Mandela Metropolitan University Unpublished Journal Article 5.

<sup>72</sup>Cilliers *et al* Cilliers & Benade *Corporate Law* 3ed (2000) 303; *Prudential Assurance Co. Ltd v. Newman Industries Ltd (No. 2)* [1980] 2 All ER 841 (Ch) 874-875.

<sup>73</sup>D Davis *et al* *Companies and other Business Structures in South Africa* (2009) 188.

<sup>74</sup>Cilliers *et al* Cilliers & Benade *Corporate Law* 3ed (2000) 305.

<sup>75</sup>Cilliers *et al* Cilliers & Benade *Corporate Law* 3ed (2000) 306; D Davis *et al* *Companies and other Business Structures in South Africa* (2009) 188.

<sup>76</sup>D Davis *et al* *Companies and other Business Structures in South Africa* (2009) 188.

<sup>77</sup>Companies Act No 61 of 1973.

<sup>78</sup>Cilliers *et al* Cilliers & Benade *Corporate Law* 3ed (2000) 306; Van Wyk de Vries Commission Commission of Enquiry into the Companies Acts: Main Report (RP 45 of 1970) par 42.10-42.18.



derivative action could satisfy the need to prevent frivolous and vexatious proceedings.<sup>79</sup> This section seemed over to overlap with the common law derivative action to a large extent. Important differences however existed. They are that, the statutory derivative action is only available in respect of a delict or breach of trust or faith, while, no such limitation attaches to the common law action; and that in the case of the statutory derivative action the cause of action cannot be neutralised by any act of ratification or condonation on the part of the company while in the case of the common law action, such condonation or ratification could quite conceivably neutralise the cause of action.<sup>80</sup>

In effect statutory derivative action applies even in respect of ratifiable wrongs, thereby obviating the necessity of distinguishing between wrongs which can be ratified and those which cannot be ratified.<sup>81</sup>

#### **4. Derivative Action under the old Companies Act No 61 of 1973**

In terms of section 266(1)<sup>82</sup> initiation of proceedings on behalf of company by a member may be instituted where a company has suffered damages or loss or has been deprived of any benefit as a result of any wrong, breach of trust or breach of faith committed by any director or officer of that company or by any past director or officer while he was a director or officer of that company and the company has not instituted proceedings for the recovery of such damages, loss or benefit. Any member of the company may initiate proceedings on behalf of the company against such director or officer or past director or officer in the manner prescribed by the section notwithstanding

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<sup>79</sup>Lindi Coetzee 'Comparative analysis of the derivative litigation proceedings under the 1973 Act and the new Companies Act' [2009] Nelson Mandela Metropolitan University Unpublished Journal Article 5; Blackman in Joubert (ed) *The law of South Africa* vol 4 part 2 (1<sup>st</sup> reissue) par 210 footnote 2, *TWK Agriculture Ltd v NCT Forestry Co-Operative Ltd and Others* 2006 (6) SA 20 (N) par 15.

<sup>80</sup>Cilliers *et al* *Cilliers & Benade Corporate Law* 3ed (2000) 306.

<sup>81</sup>Cilliers *et al* *Cilliers & Benade Corporate Law* 3ed (2000) 306.

<sup>82</sup>Companies Act No 61 of 1973.

that the company has in any way ratified or condoned any such wrong, breach of trust or breach of faith or any act or omission relating thereto.<sup>83</sup>

Cilliers and Benade<sup>84</sup> make general remarks about section 266<sup>85</sup> stating that:

(a) The section appears to cover only wrongs as a result of which the company has suffered damages or has been deprived of a benefit are covered by this section. Wrongs to members or minority shareholders are not included.<sup>86</sup>

(b) Only certain types of wrongs are covered by section 266.<sup>87</sup> In respect of wrongs not covered by this section, shareholders should resort to the common law derivative action.<sup>88</sup>

(c) The action is only available where the company has not instituted proceedings. In this respect it is important to note that the proceedings can be initiated, notwithstanding the fact that the company has ratified or condoned the cause of action or any conduct or omission relating thereto.<sup>89</sup> The institution of proceedings is in no way affected by the fact that the conduct can be ratified. If ratification has taken place the court may in terms of section 266(4)<sup>90</sup> order that any resolution ratifying or condoning the wrong shall be of no force or effect if it deems it desirable to proceed against the wrongdoer.<sup>91</sup>

(d) The action is only available if damages or losses have been caused by a director or officer of that company or by any past director or officer while he

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<sup>83</sup>S 266(1) Companies Act No 61 of 1973.

<sup>84</sup>Cilliers *et al* Cilliers & Benade Corporate Law 3ed (2000) 307.

<sup>85</sup>Companies Act No 61 of 1973.

<sup>86</sup>Cilliers *et al* Cilliers & Benade Corporate Law 3ed (2000) 307.

<sup>87</sup>Cilliers *et al* Cilliers & Benade Corporate Law 3ed (2000) 307; Companies Act No 61 of 1973.

<sup>88</sup>Cilliers *et al* Cilliers & Benade Corporate Law 3ed (2000) 307 footnote 46.

<sup>89</sup>Cilliers *et al* Cilliers & Benade Corporate Law 3ed (2000) 307.

<sup>90</sup>Companies Act No 61 of 1973.

<sup>91</sup>Cilliers *et al* Cilliers & Benade Corporate Law 3ed (2000) 307 footnote 47.

was a director or officer of that company.<sup>92</sup> The statutory derivative action is not available in respect of wrongs committed by other persons and members will have to resort to the common law derivative action. It would appear that the statutory action would not even be available where the wrong committed was committed by directors and officers of other companies within the same group.<sup>93</sup> A contradiction appears since section 37(3)(b)<sup>94</sup>, allows for statutory derivative action in particular circumstances in the case of loans and security in respect of directors and officers of a holding company.<sup>95</sup>

#### a. Procedure

If the company has suffered damages or has been deprived of any benefit as a result of the wrong, breach of trust or breach of faith, a member of the company<sup>96</sup> may initiate proceedings against the wrongdoer in the prescribed way.<sup>97</sup>

Any such member shall serve a written notice on the company calling on the company to institute such proceedings within one month from the date of service of the notice and stating that if the company fails to do so, an application to the court will be made.<sup>98</sup> If the company fails to institute such proceedings within the said period of one month, the member may make application to the court for an order appointing a *curator ad litem* for the company for the purpose of instituting and conducting proceedings on

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<sup>92</sup>Cilliers *et al* Cilliers & Benade Corporate Law 3ed (2000) 307.

<sup>93</sup>This follows from the use of the words "of that company".

<sup>94</sup>Companies Act No 61 of 1973.

<sup>95</sup>Cilliers *et al* Cilliers & Benade Corporate Law 3ed (2000) 307 footnote 48.

<sup>96</sup>*Thurgood v. Dick Kruger Traders (Pty) Ltd* 1990 (2) SA 44 (E) 46; Cilliers *et al* Cilliers & Benade. Corporate Law 3ed (2000) 307 footnote 49.

<sup>97</sup>Cilliers *et al* Cilliers & Benade Corporate Law 3ed (2000) 307.

<sup>98</sup>S 266(2)(a) Companies Act No 61 of 1973.

behalf of the company against such director or officer or past director or officer.<sup>99</sup>

The court on such application, if it is satisfied that the company has not instituted such proceedings;<sup>100</sup> that there are *prima facie* grounds for such proceedings;<sup>101</sup> and that an investigation into such grounds and into the desirability of the institution of such proceedings is justified, may appoint a provisional *curator ad litem* and direct him to conduct such investigation and to report to the court on the return day of the provisional order.<sup>102</sup>

On the return day the court may discharge the provisional order or confirm the appointment of the *curator ad litem* for the company.<sup>103</sup> The court may issue directions regarding the institution of proceedings in the name of the company by the *curator ad litem* as the court thinks necessary.<sup>104</sup> The court may further order that any resolution ratifying or condoning the wrong, breach of trust or breach of faith shall be of no force and effect.<sup>105</sup>

**(i) Powers of *curator ad litem***

A provisional *curator ad litem* appointed by the court<sup>106</sup> and a *curator ad litem* whose appointment is confirmed by the court<sup>107</sup> shall, in addition to the powers expressly granted by the court in connection with the investigation, proceedings and enforcement of a judgment, have the same powers as an inspector under section 260,<sup>108</sup> and the provisions of that section shall, apply *mutatis mutandis* to the provisional *curator ad litem* and to the *curator ad litem*

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<sup>99</sup>S 266(2)(b) Companies Act No 61 of 1973.

<sup>100</sup>S 266(3)(a) Companies Act No 61 of 1973.

<sup>101</sup>S 266(3)(b) Companies Act No 61 of 1973.

<sup>102</sup>S 266(3)(c) Companies Act No 61 of 1973.

<sup>103</sup>S 266(4) Companies Act No 61 of 1973

<sup>104</sup>S 266(4) Companies Act No 61 of 1973.

<sup>105</sup>S 266(4) Companies Act No 61 of 1973.

<sup>106</sup>S 266(3) Companies Act No 61 of 1973.

<sup>107</sup>S 266(3) Companies Act No 61 of 1973.

<sup>108</sup>Companies Act No 61 of 1973.

and to the directors, officers, employees, members and agents of the company concerned.<sup>109</sup>

The provisional *curator ad litem* and the *curator ad litem* also have powers with regard to documents and evidence during the investigation. Any director, officer or agent of a company or other body corporate whose affairs are being investigated by an inspector, shall at the request of the *curator ad litem* produce to him all books and documents of or relating to the company or other body corporate, in his custody or under his control, and afford him such assistance within his power in connection with the investigation as the he may require.<sup>110</sup>

An *curator ad litem* may for the purpose of any investigation conducted by him summon any director, officer, employee, member or agent of the company or other body corporate to appear before him at a time and place specified in the summons, to be interrogated or to produce any book or document so specified;<sup>111</sup> administer an oath to or accept an affirmation from any person appearing before him in pursuance of a summons, and interrogate such person and require him to produce any such book or document;<sup>112</sup> retain for examination any book or document produced to him in pursuance of a summons for a period not exceeding two months or for such further period or periods as the registrar may on good cause shown, permit.<sup>113</sup>

A summons for the attendance of any person before the *curator ad litem* or for the production to him of any book or document may be in such form

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<sup>109</sup>S 267(1) Companies Act No 61 of 1973; Subject to the provisions of S 267(2) Companies Act No 61 of 1973.

<sup>110</sup>S 260(1) Companies Act No 61 of 1973.

<sup>111</sup>S 260(2)(a) Companies Act No 61 of 1973.

<sup>112</sup>S 260(2)(b) Companies Act No 61 of 1973.

<sup>113</sup>S 260(2)(c) Companies Act No 61 of 1973.

as he may determine, shall be signed by him, and shall be served in the same manner as a subpoena in a criminal case issued by a magistrate's court.<sup>114</sup>

Any person duly summoned to appear before an *curator ad litem*, who without sufficient cause fails to attend at the time and place specified in the summons or to remain in attendance until excused by the *curator ad litem* from further attendance;<sup>115</sup> or refuses upon being required to do so by the *curator ad litem*, to take an oath or to affirm as a witness or refuses or fails to produce any book or document which he has been required to produce or to answer fully and satisfactorily to the best of his knowledge and belief all questions put to him by the *curator ad litem* concerning the affairs of the company or other body corporate whose affairs are being investigated, whether or not the answer is likely to incriminate him, shall be guilty of an offence.<sup>116</sup> If the *curator ad litem* considers it necessary for the purposes of his investigation that a person whom he has no power to examine on oath should be so examined, he may apply to the court for an order calling upon such person to appear before it.<sup>117</sup>

If the disclosure of any information about the affairs of a company to a provisional *curator ad litem* or a *curator ad litem* would in the opinion of the company be harmful to the interests of the company, the court may on an application for relief by that company, if it is satisfied that the said information is not relevant to the investigation, grant such relief.<sup>118</sup>

The court may, if it appears that there is reason to believe that the applicant in respect of an application under section 266 (2)<sup>119</sup> will be unable to pay the costs of the respondent company if successful in its opposition,

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<sup>114</sup>S 260(3) Companies Act No 61 of 1973.

<sup>115</sup>S 260(4)(a) Companies Act No 61 of 1973.

<sup>116</sup>S 260(4)(b) Companies Act No 61 of 1973; Provided that, the law relating to privilege does not apply.

<sup>117</sup>S 260(5) Companies Act No 61 of 1973.

<sup>118</sup>S 267(2) Companies Act No 61 of 1973.

<sup>119</sup>Companies Act No 61 of 1973.

require sufficient security to be given for those costs and costs of the provisional *curator ad litem* before a provisional order is made.<sup>120</sup>

## 5. Derivative action under the new Companies Act No 71 of 2008

Section 165 starts by stating that any right at common law of a person other than a company to bring or prosecute any legal proceedings on behalf of that company is abolished and the rights in that section are in substitution for any such abolished right.<sup>121</sup> While section 165 of the Companies Act 71 of 2008 abolishes any common law right of a person other than a company to bring or prosecute any legal proceedings on behalf of that company, section 266 of the Companies Act 61 of 1973 did not abolish the common law derivative action. Where the wrong is not covered by section 266 the shareholder had to institute the common law derivative action against the wrongdoers.<sup>122</sup> The abolishment of the common law in the Companies Act 71 of 2008 will exclude the 'fraud on the company' cases.<sup>123</sup>

Section 165<sup>124</sup> provides that the action may be used to protect the legal interests of the company. The section does not specify the causes of action for which the derivative action can be used but provides a wide description that allows use of the action to protect legal interests. The Act does not define the term legal interest and it could consequently be interpreted very widely.<sup>125</sup> Section 266 of the Companies Act 61 of 1973 was limited to instances of delict, breach of trust or breach of faith by a director or officer of

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<sup>120</sup>S 268 Companies Act No 61 of 1973.

<sup>121</sup>S 165(1) Companies Act No 71 of 2008.

<sup>122</sup>Lindi Coetzee 'Comparative analysis of the derivative litigation proceedings under the 1973 Act and the new Companies Act' [2009] Nelson Mandela Metropolitan University Unpublished Journal Article 13.

<sup>123</sup>*Company Law Seminar Manual* by PA Delport (2008); Lindi Coetzee 'Comparative analysis of the derivative litigation proceedings under the 1973 Act and the new Companies Act' [2009] Nelson Mandela Metropolitan University Unpublished Journal Article 13.

<sup>124</sup>Companies Act No 71 of 2008.

<sup>125</sup>Lindi Coetzee 'Comparative analysis of the derivative litigation proceedings under the 1973 Act and the new Companies Act' [2009] Nelson Mandela Metropolitan University Unpublished Journal Article 13.

the company, whereas the provision in section 165 of the Companies Act 71 of 2008 is much wider. The reason for the wider application it could be argued was to make provision for the type of cases that would have fallen outside the ambit of section 266 of the Companies Act 61 of 1973 but still within the ambit of the common law derivative action.<sup>126</sup>

**a. Persons who may institute proceedings**

A person may serve a demand upon a company to commence or continue legal proceedings, or take related steps, to protect the legal interests of the company if the person:<sup>127</sup>

- (a) is a shareholder or a person entitled to be registered as a shareholder, of the company or of a related company;<sup>128</sup>
- (b) is a director or prescribed officer of the company or of a related company;<sup>129</sup>
- (c) is a registered trade union that represents employees of the company, or another representative of employees of the company;<sup>130</sup> or
- (d) has been granted leave of the court to do so, which may be granted only if the court is satisfied that it is necessary or expedient to do so to protect a legal right of that other person.<sup>131</sup>

This is different from the section 266(1) of Companies Act 61 of 1973 which only allowed a member to initiate proceedings on behalf of the company. Section 165(2) the Companies Act 71 of 2008 provides for wider

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<sup>126</sup>Lindi Coetzee 'Comparative analysis of the derivative litigation proceedings under the 1973 Act and the new Companies Act' [2009] Nelson Mandela Metropolitan University Unpublished Journal Article 13.

<sup>127</sup>S 165(2) Companies Act No 71 of 2008.

<sup>128</sup>S 165(2) (a) Companies Act No 71 of 2008.

<sup>129</sup>S 165(2) (b) Companies Act No 71 of 2008.

<sup>130</sup>S 165(2)(c) Companies Act No 71 of 2008.

<sup>131</sup>S 165(2) (d) Companies Act No 71 of 2008.



range of people to take related steps, to protect the legal interests of the company.

#### **b. Procedure**

A company that has been served with a demand in terms of section 165(2) the Companies Act 71 of 2008 may apply within 15 business days to a court to set aside the demand, only on the grounds that it is frivolous, vexatious or without merit.<sup>132</sup>

If the company does not make an application to set aside the demand or the court does not set aside the demand, the company must<sup>133</sup> appoint an independent and impartial person or committee to investigate the demand, and report to the board<sup>134</sup> any facts or circumstances that may give rise to a cause of action contemplated in the demand<sup>135</sup> or that may relate to any proceedings contemplated in the demand.<sup>136</sup> The independent and impartial person or committee must further report to the board the probable costs that would be incurred if the company pursued any such cause of action or continued any such proceedings<sup>137</sup> and whether it appears to be in the best interests of the company to pursue any such cause of action or continue any such proceedings.<sup>138</sup>

Within 60 business days after the company is served with the demand, or within a longer time as a court, on application by the company<sup>139</sup>, may allow, either initiate or continue legal proceedings, or take related legal steps to protect the legal interests of the company, as contemplated in the

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<sup>132</sup>S 165(3) Companies Act No 71 of 2008.

<sup>133</sup>S 165(4) Companies Act No 71 of 2008.

<sup>134</sup>S 165(4)(a) Companies Act No 71 of 2008.

<sup>135</sup>S 165(4)(a)(i)(aa) Companies Act No 71 of 2008.

<sup>136</sup>S 165(4)(a)(i)(bb) Companies Act No 71 of 2008.

<sup>137</sup>S 165(4)(a)(ii) Companies Act No 71 of 2008.

<sup>138</sup>S 165(4)(a)(iii) Companies Act No 71 of 2008.

<sup>139</sup>S 165(4)(b) Companies Act No 71 of 2008.

demand<sup>140</sup> or serve a notice on the person who made the demand, refusing to comply with it.<sup>141</sup>

A person who has made a demand may apply to a court for leave to bring or continue proceedings in the name and on behalf of the company<sup>142</sup>. The court may grant leave only if the company:

- (a) has failed to apply to have the demand set aside or the company failed to appoint an independent and impartial person to investigate the matter or where the company failed to institute the legal proceedings or has not notified the person making the demand that it will not comply with the demand<sup>143</sup> or;
- (b) where the company appointed an investigator or committee who was not independent and impartial<sup>144</sup> or;
- (c) accepted a report that was inadequate in its preparation, or was irrational or unreasonable in its conclusions or recommendations<sup>145</sup> or;
- (d) acted in a manner that was inconsistent with the reasonable report of an independent, impartial investigator or committee<sup>146</sup> or;
- (e) has served a notice refusing to comply with the demand.<sup>147</sup>

The court must be satisfied that the applicant is acting in good faith<sup>148</sup>, the proposed or continuing proceedings involve the trial of a serious question of material consequence to the company<sup>149</sup> and it is in the best

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<sup>140</sup>S 165(4)(b)(i) Companies Act No 71 of 2008.

<sup>141</sup>S 165(4)(b)(ii) Companies Act No 71 of 2008

<sup>142</sup>S165(5) Companies Act No 71 of 2008.

<sup>143</sup>S 165(5)(a)(i) Companies Act No 71 of 2008.

<sup>144</sup>S 165(5)(a)(ii) Companies Act No 71 of 2008.

<sup>145</sup>S 165(5)(a)(iii) Companies Act No 71 of 2008.

<sup>146</sup>S 165(5)(a)(iv) Companies Act No 71 of 2008.

<sup>147</sup>S 165(5)(a)(iv) Companies Act No 71 of 2008.

<sup>148</sup>S 165(5)(b)(i) Companies Act No 71 of 2008.

<sup>149</sup>S 165(5)(b)(ii) Companies Act No 71 of 2008.

interests of the company that the applicant be granted leave to commence the proposed proceedings or continue the proceedings.<sup>150</sup>

In exceptional circumstances, a person<sup>151</sup> may apply to a court for leave to bring proceedings in the name and on behalf of the company without making a demand or without affording the company time to respond to the demand<sup>152</sup> Such leave may only be granted if the court is satisfied that the delay may result in irreparable harm to the company<sup>153</sup>; where the delay may result in substantial prejudice to the interests of the applicant or another person<sup>154</sup> and where there is a reasonable probability that the company may not act to prevent that harm or prejudice, or act to protect the company's interests that the applicant seeks to protect.<sup>155</sup> The court must further be satisfied that the applicant is acting in good faith, the proposed or continuing proceedings involve the trial of a serious question of material consequence to the company and that it is in the best interests of the company that the applicant be granted leave to commence or continue the proposed proceedings<sup>156</sup>.

A rebuttable presumption that granting leave is not in the best interests of the company arises if it is established<sup>157</sup> that the proposed or continuing proceedings are by the company against a third party<sup>158</sup> or a third party against the company<sup>159</sup> and that the company has decided not to bring the proceedings,<sup>160</sup> nor defend them<sup>161</sup> or to discontinue, settle or compromise

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<sup>150</sup>S 165(5)(b)(iii) Companies Act No 71 of 2008.

<sup>151</sup>As contemplated in s165(2) Companies Act No 71 of 2008.

<sup>152</sup>S 165(6) Companies Act No 71 of 2008.

<sup>153</sup>Section 165(6)(a)(i) Companies Act No 71 of 2008.

<sup>154</sup>Section 165(6)(a)(ii) Companies Act No 71 of 2008.

<sup>155</sup>Section 165(6)(b) Companies Act No 71 of 2008.

<sup>156</sup>Section 165(6)(c) Companies Act No 71 of 2008; S 165(5)(b) Companies Act No 71 of 2008.

<sup>157</sup>S 165(7) Companies Act No 71 of 2008.

<sup>158</sup>S 165(7)(a)(i) Companies Act No 71 of 2008; As per s165(8) Companies Act No 71 of 2008 a person is a third party if the company and that person are not related or interrelated and proceedings by or against the company includes any appeal from a decision made in proceedings by or against the company.

<sup>159</sup>S 165(7)(a)(ii) Companies Act No 71 of 2008.

<sup>160</sup>S 165(7)(b)(i) Companies Act No 71 of 2008.

the proceedings.<sup>162</sup>It is also a requirement that all of the directors who participated in this decision must have acted in good faith and for a proper purpose; <sup>163</sup>must not have a personal financial interest in the decision, and were not related to a person who had a personal financial interest in the decision.<sup>164</sup> The directors should have informed themselves about the subject matter of the decision to the extent they reasonably believed to be appropriate<sup>165</sup> and reasonably believed that the decision was in the best interests of the company.<sup>166</sup>

When the court grants leave<sup>167</sup> to a person it must also make an order stating who is liable for the remuneration and expenses of the person appointed<sup>168</sup>and may further vary the order at any time.<sup>169</sup> Persons liable under the order, or the order as varied, are all or any of the parties to the proceedings or application<sup>170</sup>and the company itself.<sup>171</sup>If the order makes two or more persons liable, it may also determine the nature and extent of the liability of each of those persons<sup>172</sup> and the person to whom leave has been granted is entitled, on giving reasonable notice to the company, to inspect any books of the company for any purpose connected with the legal proceedings.<sup>173</sup> This is an improvement from the old act since it enables the shareholder to have access to information that will be necessary in the litigation process. However this access is not automatic and leave of the court is required.

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<sup>161</sup>S 165(7)(b)(ii) Companies Act No 71 of 2008.

<sup>162</sup>S 165(7)(b)(iii) Companies Act No 71 of 2008.

<sup>163</sup>S 165(7)(c)(i) Companies Act No 71 of 2008.

<sup>164</sup>S 165(7)(c)(ii) Companies Act No 71 of 2008.

<sup>165</sup>S 165(7)(c)(iii) Companies Act No 71 of 2008.

<sup>166</sup>S 165(7)(c)(iv) Companies Act No 71 of 2008.

<sup>167</sup>S 165(9) Companies Act No 71 of 2008.

<sup>168</sup>S 165(9)(a) Companies Act No 71 of 2008.

<sup>169</sup>S 165(9)(b) Companies Act No 71 of 2008.

<sup>170</sup>S 165(9)(c)(i) Companies Act No 71 of 2008.

<sup>171</sup>S 165(9)(c)(ii) Companies Act No 71 of 2008.

<sup>172</sup>S 165(9)(d) Companies Act No 71 of 2008.

<sup>173</sup>S 165(9)(e) Companies Act No 71 of 2008.

In the initial stages when approaching the court for permission to institute legal proceedings, the applicant has to rely on the provisions of the Promotion of Access to Information Act<sup>174</sup> to obtain access to the required information.<sup>175</sup> In *Davis v Clutchco (Pty) Ltd*<sup>176</sup> the fact that a shareholder had no right to information does not prevent an application for access to the company's records in terms of the provisions of the Promotion of Access to Information.<sup>177</sup> In order to obtain access to the required information the person will have to prove that the information is required for the exercise or protection of any rights<sup>178</sup> and that without the information the person will be unable to exercise his right in terms of section 165.<sup>179</sup> The applicant will also have to comply with the procedural requirements prescribed in the Promotion of Access to Information Act.<sup>180</sup> To avoid the procedure of an application for access to information, the legislature could have considered adding a provision that entitles the applicant to the rights of discovery prior to the initiation of proceedings.<sup>181</sup>

The court may at any time, make an order it considers appropriate about the costs<sup>182</sup> of the person who applied for or was granted leave,<sup>183</sup> the company,<sup>184</sup> or any other party to the proceedings or application.<sup>185</sup> This order may require security for costs.<sup>186</sup> A person may apply to a court for an

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<sup>174</sup>Act No 2 of 2000.

<sup>175</sup>Lindi Coetzee 'Comparative analysis of the derivative litigation proceedings under the 1973 Act and the new Companies Act' [2009] Nelson Mandela Metropolitan University Unpublished Journal Article 20.

<sup>176</sup>2004 (1) SA 75 (C).

<sup>177</sup>Iain Currie and Johan De Waal *The Bill of Rights Handbook* 5ed (2005) 698; Act No 2 of 2000.

<sup>178</sup>S32(1)(b) Promotion of Access to Information Act 2 of 2000.

<sup>179</sup>Iain Currie and Johan De Waal *The Bill of Rights Handbook* 5ed (2005) 696-697.

<sup>180</sup>S 32(1)(b) Promotion of Access to Information Act 2 of 2000.

<sup>181</sup>Arad Reisburg 'Promoting the Use of Derivative Actions' (2003) 24 (250) *Company Lawyer* Available at SSRN <http://ssrn.com/abstract=502864> [Accessed on 13 August 2009]; Lindi Coetzee 'Comparative analysis of the derivative litigation proceedings under the 1973 Act and the new Companies Act' [2009] Nelson Mandela Metropolitan University Unpublished Journal Article 20.

<sup>182</sup>S 165(10) Companies Act No 71 of 2008.

<sup>183</sup>S 165(10)(a) Companies Act No 71 of 2008.

<sup>184</sup>S 165(10)(b) Companies Act No 71 of 2008.

<sup>185</sup>S 165(10)(c) Companies Act No 71 of 2008.

<sup>186</sup>S 165(11) Companies Act No 71 of 2008.

order that they be substituted for the person to whom leave was originally granted, and the court may make the order applied for<sup>187</sup> if it is satisfied that it is in good faith<sup>188</sup> and appropriate under the circumstances.<sup>189</sup> The substitution order has the effect that the grant of leave is taken to have been made in favour of the substituting person,<sup>190</sup> and if the person originally granted leave has already brought the proceedings, the substituting person is taken to have brought those proceedings or to have made that intervention.<sup>191</sup>

If the shareholders of a company have ratified or approved any particular conduct of the company it does not prevent a person from making a demand, applying for leave, or bringing or intervening in proceedings with leave of the court,<sup>192</sup> and further, does not prejudice the outcome of any application for leave, or proceedings brought or intervened in.<sup>193</sup> The court may take the ratification or approval into account in making any judgement or order.<sup>194</sup> Proceedings brought or intervened in must not be discontinued, compromised or settled without the leave of the court.<sup>195</sup>

The right of a person to serve a demand on a company, or apply to a court for leave, may be exercised by that person directly, or by the commission or panel, or another person on behalf of that first person.<sup>196</sup>

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<sup>187</sup>S 165(12) Companies Act No 71 of 2008.

<sup>188</sup> S 165(12)(a) Companies Act No 71 of 2008.

<sup>189</sup> S 165(12)(b) Companies Act No 71 of 2008.

<sup>190</sup> S 165(13)(a) Companies Act No 71 of 2008.

<sup>191</sup> S 165(13)(b) Companies Act No 71 of 2008.

<sup>192</sup> S 165(14)(a)(i) Companies Act No 71 of 2008.

<sup>193</sup> S 165(14)(a)(ii) Companies Act No 71 of 2008.

<sup>194</sup> S 165(14)(b) Companies Act No 71 of 2008.

<sup>195</sup> S 165(15) Companies Act No 71 of 2008.

<sup>196</sup>S 165(16) Companies Act No 71 of 2008; it must be done in a manner provided for in s 157 of the Companies Act No 71 of 2008, which provides that the commission or panel, acting on its own motion and in its absolute discretion may commence any proceedings in a court in the name of a person who made a written request to the commission or panel and may apply for leave to intervene in any court proceedings in order to represent any interest that would not otherwise be adequately represented in those proceedings.

## 6. Conclusion

The key difference that arises is that, section 165 of the Companies Act 71 of 2008, revokes the common law derivative action, while section 266 of the Companies Act 61 of 1973, did not revoke common law. The next is that derivative action as provided for in section 266 of the Companies Act 61 of 1973 was only available to members of the company whereas the provisions of section 165 of the Companies Act 71 of 2008, extend the right to a broader category of persons. This has the effect of increasing access to justice to other people who may adversely affected by the actions of the wrongdoers in control.

Other differences are that under Section 266 of the Companies Act 61 of 1973, the derivative action could only be instituted against a director or past director to recover damage suffered by the company as a result of wrongful acts, breach of faith and trust, while Section 165 of the Companies Act 71 of 2008, entitles the person to initiate proceedings to protect the legal rights of the company. The section does not specify the causes of action for which the derivative action is available and may be criticized as being too wide.<sup>197</sup> Section 165 of the Companies Act 71 of 2008, compels the company to notify the person if it refuses to comply with the demand whereas such responsibility does not exist in section 266 of the Companies Act 61 of 1973.

It is argued that one of the most difficult things to achieve in any litigation is to gather the facts.<sup>198</sup> This can be critical in a derivative action as the relevant information is probably in the hands of the controllers of the company. These are the persons who would normally be the focus of the litigation. It may well be that the member needs to get access to the company's records in order to determine whether or not an action should be

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<sup>197</sup> Lindi Coetzee 'Comparative analysis of the derivative litigation proceedings under the 1973 Act and the new Companies Act' [2009] Nelson Mandela Metropolitan University Unpublished Journal Article 23.

<sup>198</sup> Darryl D. McDonough 'Proposed new statutory derivative action -does it go far enough?' (1996)8(1) *Bond Law Review* Article 3 45 at 51.

instituted, but this is inaccessible to him.<sup>199</sup> Rights of discovery prior to the initiation of litigation are therefore very important. Any amendments to the Act should therefore introduce measures to remedy this disadvantage.<sup>200</sup>

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<sup>199</sup>Darryl D. McDonough 'Proposed new statutory derivative action -does it go far enough?' (1996)8(1) *Bond Law Review* Article 3 45 at 51.

<sup>200</sup>Arad Reisburg 'Promoting the Use of Derivative Actions' (2003) 24 (250) *Company Lawyer* Available at SSRN <http://ssrn.com/abstract=502864> [Accessed on 13 August 2009].



## CHAPTER THREE

### A. REMEDY FROM UNFAIRLY PREJUDICIAL OR OPPRESSIVE CONDUCT

#### 1. Introduction

In the case of *Ebraihimi v. Westbourne Galleries Ltd*<sup>201</sup>, Lord Wilberforce stated that:

“The foundation of it all lies in the words “just and equitable” ...the words are a recognition of the fact that a limited company is more than a mere legal entity, with a personality in law by its own: that there is room in company law for recognition of the fact that behind it, or amongst it, there are individuals with rights expectations and obligations *inter se* which are not submerged in the company structure.”<sup>202</sup>

This was an example of the courts interpretation of the oppression remedy. In this case great faith is placed on the proposition that the interest of shareholders should not be trammelled by those in a position of advantage.<sup>203</sup>

#### 2. Oppressive or unfairly prejudicial conduct under the old Companies Act No 61 of 1973

Section 252 of the Companies Act of 1973 was aimed at providing a statutory remedy to minority shareholders who were the victims of oppressive conduct by the majority in their control of the company.<sup>204</sup> In terms of Section 252 of the Companies Act of 1973 any member of a company who complains that any particular act or omission of a company is unfairly prejudicial, unjust or inequitable, or that the affairs of the company are being

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<sup>201</sup>[1973] AC 360

<sup>202</sup>*Ebraihimi v. Westbourne Galleries Ltd* [1973] AC 360 at 379

<sup>203</sup>L.M. Schaef ‘The Oppression Remedy for Minority Shareholders’ (1985) 23 *Alberta Law Review* 512 at 512

<sup>204</sup>D Davis *et al Companies and other Business Structures in South Africa* (2009) 189.

conducted in a manner unfairly prejudicial, unjust or inequitable to him or to some part of the members of the company, may make an application to the court for an order.<sup>205</sup>

The act complained should relate to an alteration of the memorandum of the company;<sup>206</sup> a reduction of the capital of the company;<sup>207</sup> a variation of rights in respect of shares of a company<sup>208</sup> and conversion of a private company into a public company or of a public company into a private company.<sup>209</sup> An application to the court shall be made within six weeks after the date of the passing of the relevant special resolution required in connection with the particular act concerned.<sup>210</sup>

#### **a. Procedure**

If on application it appears to the court that the particular act or omission is unfairly prejudicial, unjust or inequitable, or that the company's affairs are being conducted as aforesaid and it considers it just and equitable, it may, with a view to bringing to an end the matters complained of, make such order as it thinks fit, whether for regulating the future conduct of the company's affairs or for the purchase of the shares of any members of the company by other members thereof or by the company and in the case of a purchase by the company, for the reduction accordingly of the company's capital.<sup>211</sup>

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<sup>205</sup>S 252(1) Companies Act No 61 of 1973.

<sup>206</sup>S 252(2)(a) Companies Act No 61 of 1973; Any alteration of the memorandum of the company under s 55 or 56 of the Companies Act No 61 of 1973.

<sup>207</sup>S 252(2)(b) Companies Act No 61 of 1973; Any reduction of the capital of the company under s 83 of the Companies Act No 61 of 1973.

<sup>208</sup>S 252(2)(c) Companies Act No 61 of 1973; Any variation of rights in respect of shares of a company under s 102 of the Companies Act No 61 of 1973.

<sup>209</sup>S 252(2)(d) Companies Act No 61 of 1973; A conversion under s 22 of the Companies Act No 61 of 1973.

<sup>210</sup>S 252(2) Companies Act No 61 of 1973.

<sup>211</sup>S 252(3) Companies Act No 61 of 1973.

Where the order makes any alteration or addition to the memorandum or articles of a company, the alteration or addition shall have effect as if it had been duly made by special resolution of the company<sup>212</sup> and the company shall have no power, save as otherwise provided in the order, to make any alteration in or addition to its memorandum or articles which is inconsistent with the order except with the leave of the court.<sup>213</sup> A copy of any order shall within one month after the making thereof, be lodged by the company in the form prescribed with the registrar for registration.<sup>214</sup> Any company which fails to comply shall be guilty of an offence.<sup>215</sup>

### **3. Oppressive or unfairly prejudicial conduct under the new Companies Act No 71 of 2009**

Under Section 163 of the Companies Act No 71 of 2009 a shareholder or a director of a company may apply to a court for relief if any act or omission of the company, or a related person,<sup>216</sup> has had a result that is oppressive or unfairly prejudicial to, or that unfairly disregards the interests of the applicant.<sup>217</sup> Relief may also be sought if the business of the company, or a related person, is being or has been carried on or conducted in a manner that is oppressive or unfairly prejudicial to, or that unfairly disregards the interests of the applicant<sup>218</sup> or the powers of a director or prescribed officer of the company, or a person related to the company, are being or have been

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<sup>212</sup>S 252(4)(a)Companies Act No 61 of 1973.

<sup>213</sup>S 252(4)(b)Companies Act No 61 of 1973.

<sup>214</sup>S 252(5)(a)Companies Act No 61 of 1973.

<sup>215</sup>S 252(5)(b)Companies Act No 61 of 1973.

<sup>216</sup>As per s 2(1) of the Companies Act No 71 of 2008, an individual is related to another individual if they are married, or live together in a relationship similar to a marriage or are separated by no more than two degrees of natural or adopted consanguinity or affinity. An individual is related to a juristic person if the individual directly or indirectly controls the juristic person and a juristic person is related to another juristic person if either of them directly or indirectly controls the other or the business of the other either is a subsidiary of the other, or a person directly or indirectly controls each of them, or the business of each of them.

<sup>217</sup>S 163(1)(a) Companies Act No 71 of 2008.

<sup>218</sup>S 163(1)(b) Companies Act No 71 of 2008.

exercised in a manner that is oppressive or unfairly prejudicial to, or that unfairly disregards the interests of the applicant.<sup>219</sup>

In section 252 of the Companies Act of 1973 the remedy was only available to members while section 163 of the Companies Act No 71 of 2009 extends this remedy to apply to both members and directors. In section 163, the circumstances in which the remedy is available have been clearly and broadly defined.<sup>220</sup> It is clear that the remedy is available as the result of a single act or omission or as a result of a course of dealing.<sup>221</sup> The basis for oppressive conduct complained of, also extends to persons controlling the company as related persons. It is further clear that, the remedy is directed at relief for the aggrieved member or director and not the company itself.<sup>222</sup> It extends the relief to powers of a director or prescribed officer of the company, or a person related to the company which are exercised in a manner that is oppressive or unfairly prejudicial to the interests of the applicant. This ground is likely to be used particularly in the event of abuse of power by the managing director, an executive director or persons controlling the company, without it being necessary to show that the director's act constituted an act of the company.<sup>223</sup> The court appears to have less restricted discretion in that, the court could only intervene under section 252(2) of the Companies Act of 1973 if one of the grounds was established, and it was just and equitable to do so. Under section 163 of the Companies Act No 71 of 2009, the court may make an order if one of the grounds is proved without it being necessary to establish specifically that the latter factors are present, although in practice it is likely they will be.<sup>224</sup>

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<sup>219</sup>S 163(1)(c) Companies Act No 71 of 2008.

<sup>220</sup>D Davis *et al Companies and other Business Structures in South Africa* (2009) 190.

<sup>221</sup>D Davis *et al Companies and other Business Structures in South Africa* (2009) 190.

<sup>222</sup>D Davis *et al Companies and other Business Structures in South Africa* (2009) 190.

<sup>223</sup>D Davis *et al Companies and other Business Structures in South Africa* (2009) 190.

<sup>224</sup>D Davis *et al Companies and other Business Structures in South Africa* (2009) 190.

### a. Procedure

Upon considering an application in terms of section 163, the court may make any interim or final order it considers fit,<sup>225</sup> including:

- (a) an order restraining the conduct complained of;<sup>226</sup>
- (b) an order appointing a liquidator, if the company appears to be insolvent;<sup>227</sup>
- (c) an order placing the company under supervision and commencing business rescue proceedings;<sup>228</sup>
- (d) an order to regulate the company's affairs by directing the company to amend its memorandum of incorporation or to create or amend a unanimous shareholder agreement;<sup>229</sup>
- (e) an order directing an issue or exchange of shares;<sup>230</sup>
- (f) an order –
  - (i) appointing directors in place of or in addition to all or any of the directors then in office;<sup>231</sup> or
  - (ii) declaring any person delinquent or under probation;<sup>232</sup>
- (g) an order directing the company or any other person to restore to a shareholder any part of the consideration that the shareholder paid for shares, or pay the equivalent value, with or without conditions;<sup>233</sup>

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<sup>225</sup>S 163(2) Companies Act No 71 of 2008.

<sup>226</sup>S 163(2)(a) Companies Act No 71 of 2008.

<sup>227</sup>S 163(2)(b) Companies Act No 71 of 2008.

<sup>228</sup>S 163(2)(c) Companies Act No 71 of 2008; In terms of Chapter 6, if the court is satisfied that the circumstances set out in s131(4)(a) of the Companies Act No 71 of 2008 apply.

<sup>229</sup>S 163(2)(d) Companies Act No 71 of 2008.

<sup>230</sup>S 163(2)(e) Companies Act No 71 of 2008.

<sup>231</sup>S 163(2)(f)(i) Companies Act No 71 of 2008.

<sup>232</sup>S 163(2)(f)(ii) Companies Act No 71 of 2008; As contemplated in s 162 of the Companies Act No 71 of 2008.

<sup>233</sup>S 163(2)(g) Companies Act No 71 of 2008.

- (h) an order varying or setting aside a transaction or an agreement to which the company is a party and compensating the company or any other party to the transaction or agreement;<sup>234</sup>
- (i) an order requiring the company, within a time specified by the court, to produce to the court or an interested person financial statements in a form required by this Act, or an accounting in any other form the court may determine;<sup>235</sup>
- (j) an order to pay compensation to an aggrieved person, subject to any other law entitling that person to compensation;<sup>236</sup>
- (k) an order directing rectification of the registers or other records of a company;<sup>237</sup> or
- (l) an order for the trial of any issue as determined by the court.<sup>238</sup>

This is a more comprehensive description of the type of relief which the court may give compared to the old act which simply stated that the court, with a view to bringing to an end the matters complained of, make such order as it thinks fit.<sup>239</sup> The grounds for court intervention will be easier to establish and the court will also be able to intervene more effectively to put an end to the conduct complained of and to regulate the company's future conduct in a way to prevent a recurrence.<sup>240</sup> Due to this wide range of relief, the applicant should carefully motivate the relief which the applicant regards as appropriate in the circumstances.<sup>241</sup>

If the order directs the amendment of the company's memorandum of incorporation the directors must promptly file a notice of amendment to give

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<sup>234</sup>S 163(2)(h) Companies Act No 71 of 2008.

<sup>235</sup>S 163(2)(i) Companies Act No 71 of 2008.

<sup>236</sup>S 163(2)(j) Companies Act No 71 of 2008.

<sup>237</sup>S 163(2)(k) Companies Act No 71 of 2008.

<sup>238</sup>S 163(2)(l) Companies Act No 71 of 2008.

<sup>239</sup>S 252(3) Companies Act No 61 of 1973.

<sup>240</sup>D Davis *et al Companies and other Business Structures in South Africa* (2009) 191.

<sup>241</sup>D Davis *et al Companies and other Business Structures in South Africa* (2009) 191.

it effect,<sup>242</sup> and no further amendment altering, limiting or negating the effect of the court order may be made to the memorandum of incorporation until ordered otherwise.<sup>243</sup> Whenever the court, on application by an interested person, or in any proceedings in which a company is involved, finds that the incorporation of, or any act by or on behalf of, or any use of that company constitutes an unconscionable abuse of the juristic personality of the company as a separate entity, the court may declare that the company is to be deemed not to be a juristic person in respect of such rights, obligations or liabilities of the company, or of such member or shareholder thereof, or of such other person as specified in the declaration, and the court may give such further order or orders as it may deem fit in order to give effect to such declaration.<sup>244</sup>

#### **b. Conclusion**

In the old act this remedy was only available to members of the company while the new act extends this remedy to apply to both members and directors. The circumstances in which the remedy is available have been clearly and broadly defined. It is clear that the remedy is available as the result of a single act or omission or as a result of a course of dealing including persons controlling the company. It extends the relief to powers of a director or prescribed officer of the company which are exercised in a manner that is oppressive or unfairly prejudicial to the interests of the applicant.

The court appears to have less restricted discretion in that, the court could only intervene under section 252(2) of the Companies Act of 1973 if one of the grounds was established, and it was just and equitable to do so.

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<sup>242</sup>S 163(3)(a) Companies Act No 71 of 2008; The notice must be in accordance with s16(4) of the Companies Act No 71 of 2008.

<sup>243</sup>S 163(3)(b) Companies Act No 71 of 2008.

<sup>244</sup>S 163(4) Companies Act No 71 of 2008.

Under section 163 of the Companies Act No 71 of 2009, the court may make an order if one of the grounds is proved. There is a more comprehensive description of the type of relief which the court may give compared to the old act which simply stated that the court, with a view to bringing to an end the matters complained of, make such order as it thinks fit. The grounds for court intervention will be easier to establish and the court will also be able to intervene more effectively.

With a view to providing expeditious relief, section 163(1) of the Companies Act No 71 of 2009, provides for the shareholder or director to approach the court by way of application. Where the application is opposed it can easily happen that there will be conflicting evidence on affidavit which the court cannot resolve without oral evidence. It is therefore logical that section 163(2)(k) of the Companies Act No 71 of 2009, expressly empowers the court to make an order for the trial of any issue as determined by the court, where it cannot be decided by way of application proceedings.<sup>245</sup>

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<sup>245</sup>D Davis *et al Companies and other Business Structures in South Africa* (2009) 192.



## B. DISSENTING SHAREHOLDERS' AND APPRAISAL RIGHTS REMEDY

### 1. Introduction

The appraisal remedy was developed as protection for the minority against oppression by the majority.<sup>246</sup> It provides shareholders with the right to dissent from certain types of corporate transactions and obtain payment for their shares from the corporation.<sup>247</sup> Dissenters typically are entitled to the value or the fair value of their shares prior to the transaction being dissented from, which amount is determined in a judicial proceeding after certain procedural formalities are complied with.<sup>248</sup> Even developed countries have trouble defining market value. It has been stated that the market value of property shall mean a price at which a seller who is fully informed about the value of the property and is not obliged to sell the property would be willing to sell, and at which a buyer who is fully informed about the value of the property and is not obliged to buy the property would be willing to buy.<sup>249</sup>

The purpose and value of appraisal has long been in dispute. On one hand it has been argued that the appraisal remedy is of little practical benefit to dissenting shareholders and costly to the firm;<sup>250</sup> while on the other hand, the appraisal remedy has been defended as both a device that protects minority shareholders who do not want to invest in a different enterprise

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<sup>246</sup>Daniel R. Fischel 'The Appraisal Remedy in Corporate Law' (1983)8 *American Bar Foundation Research Journal* 875 at 877 Available at <http://www.jstor.org/stable/828331> [Accessed on 21st August 2009].

<sup>247</sup>Barry M. Wertheimer 'The Shareholders' Appraisal Remedy and how the Courts determine Fair Value' (1998) 47 *Duke Law Journal* 613 at 614.

<sup>248</sup>Barry M. Wertheimer 'The Shareholders' Appraisal Remedy and how the Courts determine Fair Value' (1998) 47 *Duke Law Journal* 613 at 614.

<sup>249</sup>Bernard Black and Reinier Kraakman 'A self enforcing model of corporate law' (1995-1996) 109 *Harvard Law Review* 1911 at 1957 and 1958.

<sup>250</sup>Bayless Manning 'The Shareholder's Appraisal Remedy: An Essay for Frank Coker' (1962)72 *The Yale Law Journal* 223.

from the arbitrariness of having to sell their shares in the market and a device that provides a check on management.<sup>251</sup>

In the absence of an appraisal remedy, a shareholder opposed to a fundamental corporate change could nonetheless be forced, by majority approval of the other shareholders, to remain an investor in an enterprise that no longer resembled the original investment made by that shareholder; it provides liquidity to a shareholder and a way out of an involuntarily altered investment.<sup>252</sup>

## **2. Dissenting Shareholders and Appraisal Rights under the old Companies Act No 61 of 1973**

Section 102(1) of the Companies Act of 1973, provides that in the case of a company of which the share capital is divided into different classes of shares, provision is made by the memorandum or articles for authorizing the variation of the rights attached to any class of shares of the company.<sup>253</sup> The holder of a share of that class, being a person who did not consent to or vote in favour of the resolution for the variation, may apply to the court for an order under section 252 of the Companies Act of 1973, which could include the purchase by a company of their shares. This provision had little success in reported cases; however, its existence discouraged abuse of power by controlling shareholders in the context of the variation of class rights.<sup>254</sup>

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<sup>251</sup>Melvin A. Eisenberg *The Structure of the Corporation: A Legal Analysis* (1976) 69-77; Daniel R. Fischel 'The Appraisal Remedy in Corporate Law' (1983) 8 *American Bar Foundation Research Journal* 875 at 876 Available at <http://www.jstor.org/stable/828331> [Accessed on 21st August 2009].

<sup>252</sup>Barry M. Wertheimer 'The Shareholders' Appraisal Remedy and how the Courts determine Fair Value' (1998) 47 *Duke Law Journal* 613 at 615.

<sup>253</sup>As per s 102(1) of the Companies Act of 1973, this is subject to the consent of any specified proportion of the holders of the issued shares of that class or the sanction of a resolution passed at a separate meeting of the holders of those shares.

<sup>254</sup>D Davis *et al Companies and other Business Structures in South Africa* (2009) 193.

### 3. Dissenting Shareholders and Appraisal Rights under the new Companies Act No 71 of 2009

#### a. Introduction

The Companies Act No 71 of 2009 introduces an independent remedy for dissenting shareholders unlike the Companies Act of 1973;<sup>255</sup> it is referred to as the dissenting shareholders and appraisal rights remedy. Section 164(1)<sup>256</sup> states that these rights do not apply to circumstances relating to a transaction, agreement or offer pursuant to a business rescue plan that was approved by shareholders of a company.<sup>257</sup> If the company has given notice to shareholders of a meeting to consider adopting a resolution, it must include a statement informing shareholders of their rights<sup>258</sup> and at any time before a resolution is to be voted on; a dissenting shareholder may give the company a written notice objecting to the resolution.<sup>259</sup>

The resolution must be either to amend its memorandum of incorporation by altering the preferences, rights, limitations or other terms of any class of its shares in any manner materially adverse to the rights or interests of holders of that class of shares, as contemplated in section 37(8) Companies Act No 71 of 2008;<sup>260</sup> or entering into a transaction as contemplated in section 112, 113, or 114 Companies Act No 71 of 2008.<sup>261</sup> It is argued that, it will be extremely difficult for the objectors to establish that the resolution altered their rights in a way which is materially adverse to their rights and interests.<sup>262</sup> Section 164<sup>263</sup> does not apply where the board is authorised to change class rights. This is in line with section 163,<sup>264</sup> whose

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<sup>255</sup>D Davis *et al Companies and other Business Structures in South Africa* (2009) 193.

<sup>256</sup>Companies Act No 71 of 2009.

<sup>257</sup>Approval as per section 152 of the Companies Act No 71 of 2009.

<sup>258</sup>S 164(2) Companies Act No 71 of 2008.

<sup>259</sup>S 164(3) Companies Act No 71 of 2008.

<sup>260</sup>S 164(2)(a) Companies Act No 71 of 2008.

<sup>261</sup>S 164(2)(b) Companies Act No 71 of 2008; Proposals to dispose of all or a greater part of assets or undertakings, for amalgamation or merger and for schemes of arrangement.

<sup>262</sup>D Davis *et al Companies and other Business Structures in South Africa* (2009) 193.

<sup>263</sup>Companies Act No 71 of 2009.

<sup>264</sup>Companies Act No 71 of 2009.

purpose is to protect the minority shareholders against certain actions of the majority shareholders rather than the actions of the directors.<sup>265</sup>

### **b. Procedure**

Within 10 business days after a company has adopted a resolution the company must send a notice that the resolution has been adopted to each shareholder<sup>266</sup> who gave the company a written notice of objection,<sup>267</sup> who has neither withdrawn it nor voted in support of the resolution.<sup>268</sup> A shareholder may demand that the company pay the shareholder the fair value for all of the shares of the company held by that person,<sup>269</sup> if the shareholder sent the company a notice of objection<sup>270</sup> and in the case of an amendment to the company's memorandum of incorporation, holds shares of a class that is materially and adversely affected by the amendment.<sup>271</sup>

Payment of fair value may also be demanded where the company has adopted the resolution<sup>272</sup> and the shareholder voted against that resolution<sup>273</sup> and has complied with all of the procedural requirements.<sup>274</sup> A shareholder who satisfies these requirements may make a demand by delivering a written notice to the company<sup>275</sup> within 20 business days after receiving a notice,<sup>276</sup> and if the shareholder does not receive the notice, within 20 business days after learning that the resolution has been

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<sup>265</sup>D Davis *et al Companies and other Business Structures in South Africa* (2009) 193.

<sup>266</sup>S 164(4) Companies Act No 71 of 2008.

<sup>267</sup>S 164(4)(a) Companies Act No 71 of 2008.

<sup>268</sup>S 164(4)(b) Companies Act No 71 of 2008.

<sup>269</sup>S 164(5) Companies Act No 71 of 2008.

<sup>270</sup>S 164(5)(a)(i) Companies Act No 71 of 2008; as per S 164(6) Companies Act No 71 of 2008, this requirement does not apply if the company failed to give notice of the meeting, or failed to include in that notice a statement of the shareholders rights.

<sup>271</sup>S 164(5)(a)(ii) Companies Act No 71 of 2008.

<sup>272</sup>S 164(5)(b) Companies Act No 71 of 2008.

<sup>273</sup>S 164(5)(c)(i) Companies Act No 71 of 2008.

<sup>274</sup>S 164(5)(c)(ii) Companies Act No 71 of 2008.

<sup>275</sup>S 164(7) Companies Act No 71 of 2008.

<sup>276</sup>S 164(7)(a) Companies Act No 71 of 2008.

adopted.<sup>277</sup> This delivered demand must state the shareholder's name and address,<sup>278</sup> the number and class of shares in respect of which the shareholder seeks payment,<sup>279</sup> and a demand for payment of the fair value of those shares.<sup>280</sup>

Once a shareholder has made a demand, he has no further rights in respect of those shares, other than to be paid their fair value<sup>281</sup> unless, he withdraws that demand before the company makes an offer or allows an offer made to lapse;<sup>282</sup> if the company fails to make an offer and the shareholder withdraws the demand<sup>283</sup> or if the company revokes the adopted resolution that gave rise to the shareholder's rights. If any of these happens, all of the shareholder's rights in respect of the shares are reinstated without interruption.<sup>284</sup>

Within five business days after the later of: the day on which the action approved by the resolution is effective;<sup>285</sup> the last day for the receipt of demands;<sup>286</sup> the day the company received a demand, it must send to each shareholder who has sent such a demand a written offer to pay an amount considered by the company's directors to be the fair value of the relevant shares accompanied by a statement showing how that value was determined.<sup>287</sup> Every offer made in respect of shares of the same class or series must be on the same terms<sup>288</sup> and lapses if it has not been accepted within 30 business days after it was made.<sup>289</sup>

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<sup>277</sup>S 164(7)(b) Companies Act No 71 of 2008.

<sup>278</sup>S 164(8)(a) Companies Act No 71 of 2008.

<sup>279</sup>S 164(8)(b) Companies Act No 71 of 2008.

<sup>280</sup>S 164(8)(c) Companies Act No 71 of 2008.

<sup>281</sup>S 164(9) Companies Act No 71 of 2008.

<sup>282</sup> S 164(9)(a) Companies Act No 71 of 2008; A lapse as contemplated in s 164(12)(b) of the Companies Act No 71 of 2008.

<sup>283</sup>S 164(9)(b) Companies Act No 71 of 2008.

<sup>284</sup>S 164(9)(c) Companies Act No 71 of 2008.

<sup>285</sup>S 164(11)(a) Companies Act No 71 of 2008.

<sup>286</sup>S 164(11)(b) Companies Act No 71 of 2008.

<sup>287</sup>S 164(11)(c) Companies Act No 71 of 2008.

<sup>288</sup>S 164(12)(a) Companies Act No 71 of 2008.

<sup>289</sup>S 164(12)(b) Companies Act No 71 of 2008.

If a shareholder accepts an offer made he must tender the relevant share certificates to the company or its transfer agent,<sup>290</sup> or take the steps to direct the transfer of those shares to the company or the transfer agent, in the event of uncertificated shares.<sup>291</sup> Within 10 business days of this compliance, the company must pay that shareholder the agreed amount.<sup>292</sup> Once a demand is made, a shareholder may apply to a court to determine a fair value in respect of the shares.<sup>293</sup> An order requiring the company to pay the fair value will be made if the company has failed to make an offer<sup>294</sup> or made an offer that the shareholder considers to be inadequate and that offer has not lapsed.<sup>295</sup>

On an application to the court for fair value of shares, dissenting shareholders who have not accepted an offer from the company as at the date of the application must be joined as parties and are bound by the decision of the court.<sup>296</sup> The company must notify each affected dissenting shareholder of the date, place, and consequences of the application and of their right to participate in the court proceedings.<sup>297</sup>

In this capacity the court may determine whether any other person is a dissenting shareholder who should be joined as a party<sup>298</sup> and must determine a fair value in respect of the shares of all dissenting shareholders.<sup>299</sup> In the exercise of its discretion the court may appoint one or more appraisers to assist it in determining the fair value of the shares<sup>300</sup> or

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<sup>290</sup>S 164(13)(a)(i) Companies Act No 71 of 2008.

<sup>291</sup>S 164(13)(a)(ii) Companies Act No 71 of 2008.

<sup>292</sup>S 164(13)(b) Companies Act No 71 of 2008.

<sup>293</sup>S 164(14) Companies Act No 71 of 2008.

<sup>294</sup>S 164(14)(a) Companies Act No 71 of 2008.

<sup>295</sup>S 164(14)(b) Companies Act No 71 of 2008.

<sup>296</sup>S 164(15)(a) Companies Act No 71 of 2008.

<sup>297</sup>S 164(15)(b) Companies Act No 71 of 2008.

<sup>298</sup>S 164(15)(c)(i) Companies Act No 71 of 2008.

<sup>299</sup>S 164(15)(c)(ii) Companies Act No 71 of 2008; This is subject to s 164(16) of the Companies Act No 71 of 2008 which states that the fair value in respect of any shares must be determined as at the date on which and time immediately before the company adopted the resolution that gave rise to a shareholder's rights.

<sup>300</sup>S 164(15)(c)(iii)(aa) Companies Act No 71 of 2008.

allow a reasonable rate of interest on the amount payable to each dissenting shareholder from the date the action approved by the resolution is effective until the date of payment.<sup>301</sup> It may make an appropriate order of costs, having regard to any offer made by the company and the final determination of the fair value by the court.<sup>302</sup> Finally the court must make an order requiring the dissenting shareholders to either withdraw their respective demands, in which case the shareholder is reinstated to their full rights as a shareholder, or to comply with the requirements of accepting the offer.<sup>303</sup> The company is then obliged to pay the fair value in respect of their shares to each dissenting shareholder who accepts the offer.<sup>304</sup>

If there are reasonable grounds to believe that payment by the company of the fair value would result in the company being unable to pay its debts as they fall due and payable for the ensuing 12 months, it may apply to a court for an order varying its obligations.<sup>305</sup> The court may then make an order that is just and equitable, having regard to the financial circumstances of the company<sup>306</sup> and ensuring that persons to whom money are paid at the earliest possible date compatible with the company satisfying its other financial obligations.<sup>307</sup> If the resolution resulted in the amalgamation or merger with one or more other companies, such that the shares which are the subject of the demand have ceased to exist, the obligations of that company are obligations of the successor to that company resulting from the amalgamation or merger.<sup>308</sup>

This section concludes by stating that for greater certainty, the making of a demand, tendering of shares and payment by a company to a

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<sup>301</sup>S 164(15)(c)(iii)(bb) Companies Act No 71 of 2008.

<sup>302</sup>S 164(15)(c)(iv) Companies Act No 71 of 2008.

<sup>303</sup>S 164(15)(c)(v)(aa) Companies Act No 71 of 2008.

<sup>304</sup>S 164(15)(c)(v)(bb) Companies Act No 71 of 2008; This is subject to any conditions the court considers necessary to ensure that the company fulfils its obligations.

<sup>305</sup>S 164(17)(a) Companies Act No 71 of 2008.

<sup>306</sup>S 164(17)(b)(i) Companies Act No 71 of 2008.

<sup>307</sup>S 164(17)(b)(ii) Companies Act No 71 of 2008.

<sup>308</sup>S 164(17) Companies Act No 71 of 2008.

shareholder does not constitute a distribution by the company nor an acquisition of its shares by the company within the meaning of section 48 Companies Act No 71 of 2008,<sup>309</sup> and therefore are not subject to its provisions<sup>310</sup> nor the application of the solvency and liquidity test as set out in section 4 Companies Act No 71 of 2008.<sup>311</sup>

### **c. Conclusion**

The Companies Act No 71 of 2009 introduces an independent remedy for dissenting shareholders unlike the Companies Act of 1973 which is referred to as the dissenting shareholders and appraisal rights remedy. This seems to be in line with section 163,<sup>312</sup> whose purpose is to protect the minority shareholders against the actions of the majority shareholders rather than the actions of the directors. The circumstances in which the remedy is available have also been clearly and broadly defined with detailed procedural requirements that seem to ensure that the dissenting shareholder's shares are adequately appraised.

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<sup>309</sup>S 164(19) Companies Act No 71 of 2008.

<sup>310</sup>S 164(19)(a) Companies Act No 71 of 2008.

<sup>311</sup>S 164(19)(b) Companies Act No 71 of 2008.

<sup>312</sup>Companies Act No 71 of 2009.



## C. APPLICATION TO DECLARE DIRECTOR DELINQUENT OR UNDER PROBATION

### 1. The Companies Act No 71 of 2008

#### 2. Introduction

The Companies Act No 71 of 2008 introduces provisions that provide remedies against directors who have blatantly abused their positions. The court is empowered to disqualify these directors from serving as directors or place them under probation.<sup>313</sup> Section 162(2) of the Companies Act No 71 of 2008 provides that a company, a shareholder, director, company secretary or prescribed officer of a company, a registered trade union that represents employees of the company or another representative of the employees of a company may apply to a court for an order declaring a person delinquent or under probation. This power is also extended to the commission or the panel and any organ of state responsible for the administration of legislation.<sup>314</sup> This section applies where the person is a director of that company or within the 24 months immediately preceding the application, was a director of that company.<sup>315</sup>

#### 3. Procedure

The court must make an order declaring a person to be a delinquent director if the person:<sup>316</sup>

- (a) consented to serve as a director or acted in the capacity of a director or prescribed officer, while ineligible or disqualified<sup>317</sup> unless, the person was

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<sup>313</sup>D Davis *et al Companies and other Business Structures in South Africa* (2009) 185.

<sup>314</sup>S 162(3) Companies Act No 71 of 2008; S 162(4) Companies Act No 71 of 2008.

<sup>315</sup>S 162(2)(a) Companies Act No 71 of 2008.

<sup>316</sup>S 162(5) Companies Act No 71 of 2008.

<sup>317</sup>S 162(5)(a) Companies Act No 71 of 2008; Ineligible or disqualified in terms of s 69 of the Companies Act No 71 of 2008.

acting under the protection of a court order<sup>318</sup> or as a director who owns all the shares or has the written consent of all the shareholders;<sup>319</sup>

(b) while under an order of probation in terms of this section or section 47 of the Close Corporations Act, 1984 (Act No. 69 of 1984), acted as a director in a manner that contravened that order;<sup>320</sup>

(c) while a director, grossly abused the position of director,<sup>321</sup> took personal advantage of information or an opportunity,<sup>322</sup> intentionally or by gross negligence inflicted harm upon the company or a subsidiary of the company,<sup>323</sup> acted in a manner that amounted to gross negligence, wilful misconduct or breach of trust in relation to the performance of the his functions;<sup>324</sup> or acted in a manner contemplated in section 77(3)(a), (b) or (c) of the Companies Act No 71 of 2008;<sup>325</sup>

(d) has repeatedly been personally subject to a compliance notice or similar enforcement mechanism, for substantially similar conduct, in terms of any legislation;<sup>326</sup>

(e) has at least twice been personally convicted of an offence, or subjected to an administrative fine or similar penalty, in terms of any legislation;<sup>327</sup> or

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<sup>318</sup>S 162(5)(a)(i)Companies Act No 71 of 2008; Protection of a court order as contemplated in S 69(11) Companies Act No 71 of 2008.

<sup>319</sup>S 162(5)(a)(ii)Companies Act No 71 of 2008; S 69(12) Companies Act No 71 of 2008.

<sup>320</sup>S 162(5)(b) Companies Act No 71 of 2008.

<sup>321</sup>S 162(5)(c)(i)Companies Act No 71 of 2008;

<sup>322</sup>S 162(5)(c)(ii)Companies Act No 71 of 2008; Took personal advantage of information or an opportunity contrary to s 76(2)(a) of the Companies Act No 71 of 2008.

<sup>323</sup>S 162(5)(c)(iii)Companies Act No 71 of 2008; contrary to section 76(2)(a) Companies Act No 71 of 2008.

<sup>324</sup>S 162(5)(c)(iv)(aa)Companies Act No 71 of 2008.

<sup>325</sup>S 162(5)(c)(iv)(bb)Companies Act No 71 of 2008; A director of a company is liable for any loss, damages or costs sustained by the company as a direct or indirect consequence of the director having: acted in the name of the company, signed anything on behalf of the company, or purported to bind the company or authorise the taking of any action by or on behalf of the company, despite knowing that he lacked the authority to do so; acquiesced in the carrying on of the company's business despite knowing that it was being conducted in a manner prohibited by s 22(1) of the Companies Act No 71 of 2008, or been a party to an act or omission by the company despite knowing that the act or omission was calculated to defraud a creditor, employee or shareholder of the company or had another fraudulent purpose.

<sup>326</sup>S 162(5)(d) Companies Act No 71 of 2008.

(f) within a period of five years, was a director of one or more companies or a managing member of one or more close corporations, or controlled or participated in the control of a juristic person, irrespective whether concurrently, sequentially or at unrelated times, that were convicted of an offence, or subjected to an administrative fine or similar penalty, in terms of any legislation.<sup>328</sup>

The person should also have been a director of each such company, or a managing member of each such close corporation or was responsible for the management of each such juristic person, at the time of the contravention that resulted in the conviction, administrative fine or other penalty<sup>329</sup> and the court should be satisfied that the declaration of delinquency is justified, having regard to the nature of the contraventions, and the person's conduct in relation to the management, business or property of any company, close corporation or juristic person at the time.<sup>330</sup>

Declarations of delinquency in terms of subsection (5)(a) or (b) are unconditional and subsists for a lifetime,<sup>331</sup> while those made in terms of the rest of the provisions may be made subject to any conditions the court considers appropriate,<sup>332</sup> and subsist for seven years from the date of the order, or such longer period as determined by the court.<sup>333</sup>

A court may make an order placing a person under probation if while serving as a director, the person was present at a meeting and failed to vote against a resolution despite the inability of the company to satisfy the solvency and liquidity test,<sup>334</sup> acted in a manner materially inconsistent with the duties of a director<sup>335</sup> or acted in, or supported a decision of the company

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<sup>327</sup>S 162(5)(e) Companies Act No 71 of 2008.

<sup>328</sup>S 162(5)(f) Companies Act No 71 of 2008.

<sup>329</sup>S 162(5)(f)(i) Companies Act No 71 of 2008.

<sup>330</sup>S 162(5)(f)(ii) Companies Act No 71 of 2008.

<sup>331</sup>S 162(6)(a) Companies Act No 71 of 2008.

<sup>332</sup>S 162(6)(b)(i) Companies Act No 71 of 2008.

<sup>333</sup>S 162(6)(b)(ii) Companies Act No 71 of 2008.

<sup>334</sup>S 162(7)(a)(i) Companies Act No 71 of 2008.

<sup>335</sup>S 162(7)(a)(ii) Companies Act No 71 of 2008.

to act in a manner that was oppressive or unfairly prejudicial.<sup>336</sup> The court may declare a person under probation in the case of oppressive or unfairly prejudicial conduct only if it is satisfied that it is justified having regard to the circumstances of the company's or close corporation's conduct, if applicable, and the person's conduct in relation to the management, business or property of the company or close corporation at the time.<sup>337</sup>

An order for probation may also be made if within any period of 10 years after the effective date the person has been a director of more than one company, or a managing member of more than one close corporation, irrespective whether concurrently, sequentially or at unrelated times<sup>338</sup> and during the time that the person was a director of each such company or managing member of each such close corporation, two or more of those companies or close corporations each failed to fully pay all of its creditors or meet all of its obligations,<sup>339</sup> except in the case of a business rescue plan<sup>340</sup> and a compromise with creditors.<sup>341</sup>

The court may declare a person under probation in the these circumstances if the manner in which the company or close corporation was managed was wholly or partly responsible for it failing to meet its obligations<sup>342</sup> and the declaration is justified, having regard to the circumstances of the company's or close corporation's failure, and the person's conduct in relation to the management, business or property of the company or close corporation at the time.<sup>343</sup> A declaration placing a person under probation may be made subject to any conditions the court considers appropriate, including conditions limiting the application of the declaration

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<sup>336</sup>S 162(7)(a)(iii) Companies Act No 71 of 2008.

<sup>337</sup>S 162(8)(a) Companies Act No 71 of 2008.

<sup>338</sup>S 162(7)(b)(i) Companies Act No 71 of 2008.

<sup>339</sup>S 162(7)(b)(ii) Companies Act No 71 of 2008.

<sup>340</sup>S 162(7)(b)(ii)(aa) Companies Act No 71 of 2008; Business rescue plan resulting from a resolution of the board in terms of s 129 of the Companies Act No 71 of 2008.

<sup>341</sup>S 162(7)(b)(ii)(bb) Companies Act No 71 of 2008; Creditors in terms of s 155 of the Companies Act No 71 of 2008.

<sup>342</sup>S 162(8)(b)(i) Companies Act No 71 of 2008.

<sup>343</sup>S 162(8)(b)(ii) Companies Act No 71 of 2008.

to one or more particular categories of companies<sup>344</sup> and subsists for a period not exceeding five years.<sup>345</sup>

The court may order, as conditions applicable or ancillary to a declaration of delinquency or probation, that the person concerned to undertake a designated programme of remedial education relevant to the nature of the person's conduct as director;<sup>346</sup> carry out a designated programme of community service<sup>347</sup> or pay compensation to any person adversely affected by the person's conduct as a director.<sup>348</sup> In the case of an order of probation, an order may be also be made that, he be supervised by a mentor in any future participation as a director while the order remains in force,<sup>349</sup> or be limited to serving as a director of a private company, or of a company of which he is the sole shareholder.<sup>350</sup>

A person who has been declared delinquent,<sup>351</sup> or is subject to an order of probation, may apply to a court to suspend the order of delinquency, and substitute an order of probation, with or without conditions, at any time more than three years after the order of delinquency was made.<sup>352</sup> He may also make an application to set aside an order of delinquency at any time more than two years after it was suspended<sup>353</sup> or of probation, at any time more than two years after it was made.<sup>354</sup>

On considering this application the court may not grant the order applied for unless the applicant has satisfied any conditions that were

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<sup>344</sup>S 162(9)(a) Companies Act No 71 of 2008.

<sup>345</sup>S 162(9)(b) Companies Act No 71 of 2008.

<sup>346</sup>S 162(10)(a) Companies Act No 71 of 2008.

<sup>347</sup>S 162(10)(b) Companies Act No 71 of 2008.

<sup>348</sup>S 162(10)(c) Companies Act No 71 of 2008.

<sup>349</sup>S 162(10)(d)(i) Companies Act No 71 of 2008.

<sup>350</sup>S 162(10)(d)(ii) Companies Act No 71 of 2008.

<sup>351</sup>Declaration of delinquency other than as contemplated in s (6)(a) of the Companies Act No 71 of 2008

<sup>352</sup>S 162(11)(a) Companies Act No 71 of 2008.

<sup>353</sup>S 162(11)(b)(i) Companies Act No 71 of 2008.

<sup>354</sup>S 162(11)(b)(ii) Companies Act No 71 of 2008.

attached to the original order.<sup>355</sup> An order may be granted if, having regard to the circumstances leading to the original order, and the conduct of the applicant in the ensuing period, the court is satisfied that the applicant has demonstrated satisfactory progress towards rehabilitation,<sup>356</sup> and there is a reasonable prospect that the applicant would be able to serve successfully as a director of a company in the future.<sup>357</sup> The commissioner must be served with a copy of the application.<sup>358</sup>

#### **4. Conclusion**

The Companies Act No 71 of 2008 introduces provisions that provide remedies against directors who have blatantly abused their positions empowering the minority shareholder to disqualify these directors from serving as directors through a declaration of delinquency or placing them under probation. This remedy is not only open to the minority shareholder but to a host of other people who have an interest in the affairs of the company. It has the effect of preventing historically bad directors from continuing to act in that capacity. The new act also enhances director competence by providing for mentorship's for those on probation and providing for remedial education for the directors who are either delinquent or on probation.

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<sup>355</sup>S 162(12)(a) Companies Act No 71 of 2008.

<sup>356</sup>S 162(12)(b)(i) Companies Act No 71 of 2008.

<sup>357</sup>S 162(12)(b)(ii) Companies Act No 71 of 2008.

<sup>358</sup>S 162(13) Companies Act No 71 of 2008.

## D. APPLICATION TO PROTECT RIGHTS OF SECURITIES HOLDERS

### 1. The Companies Act No 71 of 2008

The Companies Act No 71 of 2008 introduces the right of a shareholder to make an application to protect his rights.

A holder of issued securities of a company may apply to a court for an order determining any rights of that person in terms of the act, the company's memorandum of incorporation, the rules of the company and any applicable debt instrument.<sup>359</sup> An application may be made for appropriate orders, necessary to protect the rights contemplated.<sup>360</sup> It could also rectify any harm done to the securities holder by the company as a consequence of an act or omission that contravened, the act or the company's memorandum of incorporation, rules, applicable debt instrument, violated any right<sup>361</sup> and directors to the extent that they may be held liable.<sup>362</sup> This right is in addition to any other remedy available in terms of the Companies Act No 71 of 2008 and common law.<sup>363</sup>

This provision in effect increases the avenues available to the minority shareholder in the protection of his interests.

## E. JUST AND EQUITABLE WINDING UP

A company may be wound up by the court if the court is of the opinion that it is just and equitable that the company be wound up.<sup>364</sup> This is a remedy which comes from partnership law and is particularly useful to the minorities of small companies which can often be regarded as glorified

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<sup>359</sup>S 161(1)(a) Companies Act No 71 of 2008.

<sup>360</sup>S 161(1)(b)(i) Companies Act No 71 of 2008.

<sup>361</sup>S 161(1)(b)(ii)(aa) Companies Act No 71 of 2008.

<sup>362</sup>S 161(1)(b)(ii)(bb) Companies Act No 71 of 2008; The liability of directors in terms of s 77 of the Companies Act No 71 of 2008.

<sup>363</sup>S 161(2) Companies Act No 71 of 2008.

<sup>364</sup>S 344(h) Companies Act No 61 of 1973; S 81(1)(d)(iii) Companies Act No 71 of 2008.

partnerships.<sup>365</sup> Under the Companies Act No 71 of 2008 a shareholder may not apply to a court for just and equitable winding up unless he has been a shareholder continuously for at least six months immediately before the date of the application;<sup>366</sup> became a shareholder as a result of acquiring another shareholder;<sup>367</sup> or the distribution of the estate of a former shareholder.<sup>368</sup>

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<sup>365</sup>Hendrick Prins *The Protection of the Minority Shareholders in a Limited Company at English, South African and Dutch Law* (1943) 86.

<sup>366</sup>S 81(2)(a) Companies Act No 71 of 2008.

<sup>367</sup>S 81(2)(b)(i) Companies Act No 71 of 2008.

<sup>368</sup>S 81(2)(b)(ii) Companies Act No 71 of 2008.



## CHAPTER FOUR

### A. MINORITY SHAREHOLDER PROTECTION IN THE UNITED KINGDOM

#### 1. Protection from unfair prejudice in the United Kingdom

A member of a company in The United Kingdom may apply to the court by petition for an order on the ground that the company's affairs are being or have been conducted in a manner that is unfairly prejudicial to the interests of members generally or of some part of its members, including at least himself<sup>369</sup> or that an actual or proposed act or omission of the company is or would be prejudicial.<sup>370</sup>

A petition for an order on the ground that the company's affairs are being or have been conducted in a manner that is unfairly prejudicial to the interests of members may also be initiated by the Secretary of State. This may occur where:

- (a) the Secretary of State has received an investigator's report under section 437 of the Companies Act 1985;<sup>371</sup>
- (b) the Secretary of State has exercised his powers to require documents and information or to enter and search premises under section 447 or 448 of the Companies Act 1985;<sup>372</sup>
- (c) the Secretary of State or the Financial Services Authority has exercised his or its powers of information gathering and investigations under Part 11 of the Financial Services and Markets Act 2000;<sup>373</sup> or
- (d) the Secretary of State has received a report from an investigator appointed by him or the Financial Services Authority under Part 11 of the Financial Services and Markets Act 2000.<sup>374</sup>

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<sup>369</sup>S 994(1)(a) Companies Act 2006 Chapter 46.

<sup>370</sup>S 994(1)(b) Companies Act 2006 Chapter 46.

<sup>371</sup>Chapter 6; S 995(1)(a) Companies Act 2006 Chapter 46.

<sup>372</sup>Chapter 6; S 995(1)(b) Companies Act 2006 Chapter 46.

<sup>373</sup>Chapter 8; S 995(1)(c) Companies Act 2006 Chapter 46.

If it appears to the Secretary of State that the company's affairs are being or have been conducted in a manner that is unfairly prejudicial to the interests of members generally or of some part of its members,<sup>375</sup> or an actual or proposed act or omission of the company is or would be prejudicial,<sup>376</sup> he may apply to the court by petition for an order to prevent unfair prejudice.<sup>377</sup> This may be done in addition to, or instead of presenting a petition for the winding up of the company.<sup>378</sup>

If the court is satisfied that a petition is well founded, it may make such order as it thinks fit for giving relief in respect of the matters complained of.<sup>379</sup> The court's order may:-

- (a) regulate the conduct of the company's affairs in the future;<sup>380</sup>
- (b) require the company to refrain from doing or continuing an act complained of, or do an act that the petitioner has complained it has omitted to do;<sup>381</sup>
- (c) authorise civil proceedings to be brought in the name and on behalf of the company by such person or persons and on such terms as the court may direct;<sup>382</sup>
- (d) require the company not to make any, or any specified, alterations in its articles without the leave of the court;<sup>383</sup>

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<sup>374</sup>Chapter 8; S 995(1)(d) Companies Act 2006 Chapter 46.

<sup>375</sup>S 995(2)(a) Companies Act 2006 Chapter 46.

<sup>376</sup>S 995(2)(b) Companies Act 2006 Chapter 46.

<sup>377</sup>S 995(2) Companies Act 2006 Chapter 46.

<sup>378</sup>S 995(3) Companies Act 2006 Chapter 46.

<sup>379</sup>S 996(1) Companies Act 2006 Chapter 46.

<sup>380</sup>S 996(2)(a) Companies Act 2006 Chapter 46.

<sup>381</sup>S 996(2)(b) Companies Act 2006 Chapter 46.

<sup>382</sup>S 996(2)(c) Companies Act 2006 Chapter 46.

<sup>383</sup>S 996(2)(d) Companies Act 2006 Chapter 46.

(e) provide for the purchase of the shares of any members of the company by other members or by the company itself and, in the case of a purchase by the company itself, the reduction of the company's capital accordingly.<sup>384</sup>

#### **a. Conclusion**

The new South African companies act<sup>385</sup> is similar to the United Kingdom companies act<sup>386</sup> in the circumstances where one may be protected from unfair prejudice or oppressive treatment. Under Section 163 of the Companies Act No 71 of 2009, a shareholder or a director of a company may apply to a court for relief if any act or omission of the company, or a related person, has had a result that is oppressive or unfairly prejudicial to, or that unfairly disregards the interests of the applicant.<sup>387</sup>

The Acts however have their differences; firstly, the Companies Act No 71 of 2008 extends this relief to both members and directors<sup>388</sup> while the United Kingdom Companies Act of 2006<sup>389</sup> only provides this remedy for members. Secondly, in the United Kingdom Companies Act of 2006,<sup>390</sup> this remedy may also be exercised by the Secretary of State, while in the Companies Act No 71 of 2008 this is not the case. Finally, the Companies Act no 71 of 2008 seems to have a more comprehensive description of the type of relief which the court may give in comparison to the United Kingdom Companies of 2006.<sup>391</sup>

The Companies Act no 71 of 2008 is mostly at par with the United Kingdom Companies Act of 2006<sup>392</sup> and in some instances perhaps even

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<sup>384</sup>S 996(2)(e) Companies Act 2006 Chapter 46.

<sup>385</sup>S 163(1) Companies Act No 71 of 2008.

<sup>386</sup>S 995(1) Companies Act 2006 Chapter 46.

<sup>387</sup>S 163(1)(a) Companies Act No 71 of 2008.

<sup>388</sup>S 163(1) Companies Act No 71 of 2008.

<sup>389</sup>Chapter 46.

<sup>390</sup>Chapter 46.

<sup>391</sup>Chapter 46.

<sup>392</sup>Chapter 46.

offers better protection to minority shareholders as far as protection from oppression and unfair prejudice is concerned. A possible recommendation would be to include a role to be played by the government similar to that played by the Secretary of State in the prevention of unfair prejudice.

## 2. Derivative Action in the United Kingdom

### a. Introduction

The Companies Act of 2006 eliminates the common law derivative action as elaborated in the rule in *Foss v Harbottle*,<sup>393</sup> for a statutory derivative action.<sup>394</sup> A derivative claim in the United Kingdom may be brought only in respect of a cause of action arising from an actual or proposed acts or omissions involving negligence, default, breach of duty or breach of trust by a director of the company.

The cause of action may be against the director, another person or both.<sup>395</sup> It is immaterial whether the cause of action arose before or after the person seeking to bring or continue the derivative claim became a member of the company.<sup>396</sup> A director includes a former director, a shadow director and references to a member of a company include a person who is not a member but to whom shares in the company have been transferred or transmitted by operation of law.<sup>397</sup> A shareholder or director responsible for the negligent act is not allowed to vote at a meeting of members called to ratify the act or omission.<sup>398</sup>

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<sup>393</sup>[1843] 2 Hare 461

<sup>394</sup>Paul Davies and Jonathan Rickford 'An Introduction to the New UK Companies Act' *European Company and Financial Law Review* 2008 (5) 48 at page 71.

<sup>395</sup>S 260(3) Companies Act 2006 Chapter 46.

<sup>396</sup>S 260(4) Companies Act 2006 Chapter 46.

<sup>397</sup>S 260(5) Companies Act 2006 Chapter 46.

<sup>398</sup>S 239 Companies Act 2006 Chapter 46.

## b. Procedure

A member of a company who brings a derivative claim must apply to the court for permission to continue it.<sup>399</sup> If it appears to the court that the application and the evidence filed by the applicant in support of it do not disclose a *prima facie* case for giving permission, the court must dismiss the application<sup>400</sup> and may make any consequential order it considers appropriate.<sup>401</sup> If the application is not dismissed the court may give directions as to the evidence to be provided by the company,<sup>402</sup> and may adjourn the proceedings to enable the evidence to be obtained.<sup>403</sup> On hearing the application, the court may give permission to continue the claim on such terms as it thinks fit,<sup>404</sup> refuse permission and dismiss the claim,<sup>405</sup> or adjourn the proceedings on the application and give such directions as it thinks fit.<sup>406</sup>

A derivative claim can also occur where a company has brought a claim, and the cause of action on which the claim is based could be pursued as a derivative claim.<sup>407</sup> A member of the company, may apply to the court for permission to continue the claim as a derivative claim on the ground that the manner in which the company commenced or continued the claim amounts to an abuse of the process of the court;<sup>408</sup> the company has failed to prosecute the claim diligently;<sup>409</sup> and it is appropriate for the member to continue the claim as a derivative claim.<sup>410</sup> If it appears to the court that the application and the evidence filed by the applicant in support of it do not disclose a *prima facie* case for giving permission, the court must dismiss the

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<sup>399</sup>S 261(1) Companies Act 2006 Chapter 46.

<sup>400</sup>S 261(2)(a) Companies Act 2006 Chapter 46.

<sup>401</sup>S 261(2)(b) Companies Act 2006 Chapter 46.

<sup>402</sup>S 261(3)(a) Companies Act 2006 Chapter 46.

<sup>403</sup>S 261(3)(b) Companies Act 2006 Chapter 46.

<sup>404</sup>S 261(4)(a) Companies Act 2006 Chapter 46.

<sup>405</sup>S 261(4)(b) Companies Act 2006 Chapter 46.

<sup>406</sup>S 261(4)(c) Companies Act 2006 Chapter 46.

<sup>407</sup>S 262(1) Companies Act 2006 Chapter 46.

<sup>408</sup>S 262(2)(a) Companies Act 2006 Chapter 46.

<sup>409</sup>S 262(2)(b) Companies Act 2006 Chapter 46.

<sup>410</sup>S 262(2)(c) Companies Act 2006 Chapter 46.

application,<sup>411</sup> and may make any consequential order it considers appropriate.<sup>412</sup> If the application is not dismissed the court may give directions as to the evidence to be provided by the company,<sup>413</sup> and may adjourn the proceedings to enable the evidence to be obtained.<sup>414</sup> On hearing the application, the court may give permission to continue the claim as a derivative claim on such terms as it thinks fit,<sup>415</sup> refuse permission and dismiss the application,<sup>416</sup> or adjourn the proceedings on the application and give such directions as it thinks fit.<sup>417</sup>

Permission must be refused if the court is satisfied that a person would not seek to continue the claim.<sup>418</sup> It will also be refused where the cause of action arises from an act or omission that is yet to occur; that act or omission has been authorised by the company;<sup>419</sup> and where the cause of action arises from an act or omission that has already occurred, which act or omission was authorised by the company before it occurred,<sup>420</sup> or has been ratified by the company since it occurred.<sup>421</sup>

In considering whether to give permission the court must take into account:

- (a) whether the member is acting in good faith in seeking to continue the claim;<sup>422</sup>
- (b) the importance that a person, acting with a duty to promote the success of the company, would attach to continuing it;<sup>423</sup>

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<sup>411</sup>S 262(3)(a) Companies Act 2006 Chapter 46.

<sup>412</sup>S 262(3)(b) Companies Act 2006 Chapter 46.

<sup>413</sup>S 262(4)(a) Companies Act 2006 Chapter 46.

<sup>414</sup>S 262(4)(b) Companies Act 2006 Chapter 46.

<sup>415</sup>S 262(5)(a) Companies Act 2006 Chapter 46.

<sup>416</sup>S 262(5)(b) Companies Act 2006 Chapter 46.

<sup>417</sup>S 262(5)(c) Companies Act 2006 Chapter 46.

<sup>418</sup>S 263(2)(a) Companies Act 2006 Chapter 46.

<sup>419</sup>S 263(2)(b) Companies Act 2006 Chapter 46.

<sup>420</sup>S 263(2)(c)(i) Companies Act 2006 Chapter 46.

<sup>421</sup>S 263(2)(c)(ii) Companies Act 2006 Chapter 46.

<sup>422</sup>S 263(3)(a) Companies Act 2006 Chapter 46.

<sup>423</sup>S 263(3)(b) Companies Act 2006 Chapter 46.

(c) where the cause of action results from an act or omission that is yet to occur, whether the act or omission could be, and in the circumstances would be likely to be authorised by the company before it occurs, or ratified by the company after it occurs;<sup>424</sup>

(d) where the cause of action arises from an act or omission that has already occurred, whether the act or omission could be, and in the circumstances would be likely to be ratified by the company;<sup>425</sup>

(e) whether the company has decided not to pursue the claim;<sup>426</sup> and

(f) whether the act or omission in respect of which the claim is brought gives rise to a cause of action that the member could pursue in his own right rather than on behalf of the company.<sup>427</sup>

In considering whether to give permission the court shall have particular regard to any evidence before it as to the views of members of the company who have no personal interest, direct or indirect in the matter.<sup>428</sup> The Secretary of State may make amendments so as to alter or add to the circumstances in which permission may be refused or matters that the court is required to take into account in considering whether to give permission.<sup>429</sup>

Another member of the company may also apply to the court for permission to continue the claim.<sup>430</sup> It may be done on the grounds that: the manner in which the proceedings have been commenced or continued amounts to an abuse of the court process;<sup>431</sup> the claimant has failed to prosecute the claim diligently;<sup>432</sup> or it is appropriate for the applicant to

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<sup>424</sup>S 263(3)(c) Companies Act 2006 Chapter 46.

<sup>425</sup>S 263(3)(d) Companies Act 2006 Chapter 46.

<sup>426</sup>S 263(3)(e) Companies Act 2006 Chapter 46.

<sup>427</sup>S 263(3)(f) Companies Act 2006 Chapter 46.

<sup>428</sup>S 263(4) Companies Act 2006 Chapter 46.

<sup>429</sup>S 263(5) Companies Act 2006 Chapter 46.

<sup>430</sup>S 264(2) Companies Act 2006 Chapter 46.

<sup>431</sup>S 262(2)(a) Companies Act 2006 Chapter 46.

<sup>432</sup>S 264(2)(b) Companies Act 2006 Chapter 46.

continue the claim as a derivative claim.<sup>433</sup> If it appears to the court that the application and the evidence filed by the applicant in support of it do not disclose a *prima facie* case, the court must dismiss the application,<sup>434</sup> and may make any consequential order it considers appropriate.<sup>435</sup> If the application is not dismissed, the court may give directions as to the evidence to be provided by the company,<sup>436</sup> and may adjourn the proceedings to enable the evidence to be obtained.<sup>437</sup> On hearing the application, the court may give permission to continue the claim on such terms as it thinks fit,<sup>438</sup> refuse permission and dismiss the application,<sup>439</sup> or adjourn the proceedings on the application and give such directions as it thinks fit.<sup>440</sup>

### c. Conclusion

This is a statutory derivative action which is wider than the common law derivative action. The novelty of the general statutory derivative claim, contained in Part 11 of the Act,<sup>441</sup> is that it places the decision about whether it is in the interests of the company for litigation to be commenced in any particular case in the hands of the court.<sup>442</sup> The advantages of this new procedure is that on one hand, the individual shareholder can easily obtain a decision on the central question on whether it is in the interests of the company for the litigation to be brought, whilst, on the other hand, the individual shareholder's enthusiasm for derivative litigation is subject to the filter of a judge having to be convinced that the litigation on behalf of the

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<sup>433</sup>S 264(2)(c) Companies Act 2006 Chapter 46.

<sup>434</sup>S 264(3)(a) Companies Act 2006 Chapter 46.

<sup>435</sup>S 264(3)(b) Companies Act 2006 Chapter 46.

<sup>436</sup>S 264(4)(a) Companies Act 2006 Chapter 46.

<sup>437</sup>S 264(4)(b) Companies Act 2006 Chapter 46.

<sup>438</sup>S 264(5)(a) Companies Act 2006 Chapter 46.

<sup>439</sup>S 264(5)(b) Companies Act 2006 Chapter 46.

<sup>440</sup>S 264(5)(c) Companies Act 2006 Chapter 46.

<sup>441</sup>Companies Act 2006 Chapter 46.

<sup>442</sup>Paul Davies and Jonathan Rickford 'An Introduction to the New UK Companies Act' *European Company and Financial Law Review* 2008 (5) 48 at page 71; S 261 (1) Companies Act 2006 Chapter 46.



company is desirable.<sup>443</sup> This act is similar to the South African Companies Act No 71 of 2008 in that they both do away with the common law derivative action in favour of a statutory one.

Section 165 of Companies Act No 71 of 2008 provides that the derivative action may be used to protect the legal interests of the company, while a derivative claim in the United Kingdom may be brought only in respect of a cause of action arising from an actual or proposed acts or omissions involving negligence, default, breach of duty or breach of trust by a director of the company. The definition in the South African act is therefore not restricted and is open to a wider interpretation than the United Kingdom Act. The reason for the wider application it could be argued was to make provision for the type of cases that would have fallen outside the ambit of section 266 of the Companies Act 61 of 1973 but still within the ambit of the common law derivative action.<sup>444</sup>

The derivative action in the United Kingdom is only available to the members of the company<sup>445</sup> while the derivative action under section 165 of Companies Act No 71 of 2008 is available to shareholders, directors and officers of the company, trade unions representing employees and any other person granted leave by the court.<sup>446</sup> In this respect, the derivative action in South Africa provides for wider range of people to take related steps, to protect the interests of the company.

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<sup>443</sup>Paul Davies and Jonathan Rickford 'An Introduction to the New UK Companies Act' *European Company and Financial Law Review* 2008 (5) 48 at page 71.

<sup>444</sup>Lindi Coetzee 'Comparative analysis of the derivative litigation proceedings under the 1973 Act and the new Companies Act' [2009] Nelson Mandela Metropolitan University Unpublished Journal Article 13.

<sup>445</sup>S 112 of the Companies Act 2006 Chapter 46, states that, the subscribers of a company's memorandum are deemed to have agreed to become members of the company and on its registration become members. It further states that every other person who agrees to become a member of a company, and whose name is entered in its register of members, is a member of the company.

<sup>446</sup>S 165(2) Companies Act No 71 of 2008.

The procedure for a derivative action in the United Kingdom and South Africa are similar to the extent that in the United Kingdom the permission of the court is necessary before the action is commenced while in South Africa, a company that has been served with a demand for a derivative action under the Companies Act 71 of 2008, may apply within 15 business days to a court to set aside the demand, only on the grounds that it is frivolous, vexatious or without merit.<sup>447</sup> In the United Kingdom permission must be refused if the court is satisfied that a person would not seek to continue the claim;<sup>448</sup> where the cause of action arises from an act or omission that is yet to occur; that act or omission has been authorised by the company;<sup>449</sup> and where the cause of action arises from an act or omission that has already occurred, which act or omission was authorised by the company before it occurred,<sup>450</sup> or has been ratified by the company since it occurred.<sup>451</sup> The effect is that the South African derivative action is more accessible since it can only be denied on the three grounds of being frivolous, vexatious or without merit.

The South African Companies Act 71 of 2008 provides for remuneration and expenses of the independent and impartial person or committee who investigate and report to the board<sup>452</sup> any facts or circumstances that may give rise to a cause of action.<sup>453</sup> The court may also at any time, make an order it considers appropriate about the costs <sup>454</sup>of the person who applied for or was granted leave,<sup>455</sup> the company,<sup>456</sup> or any other party to the proceedings or application.<sup>457</sup> In South Africa, if the

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<sup>447</sup>S 165(3) Companies Act No 71 of 2008.

<sup>448</sup>S 263(2)(a) Companies Act 2006 Chapter 46.

<sup>449</sup>S 263(2)(b) Companies Act 2006 Chapter 46.

<sup>450</sup>S 263(2)(c)(i) Companies Act 2006 Chapter 46.

<sup>451</sup>S 263(2)(c)(ii) Companies Act 2006 Chapter 46.

<sup>452</sup>S 165(4)(a) Companies Act No 71 of 2008.

<sup>453</sup>S 165(9)(a) Companies Act No 71 of 2008.

<sup>454</sup>S 165(10) Companies Act No 71 of 2008.

<sup>455</sup>S 165(10)(a) Companies Act No 71 of 2008.

<sup>456</sup>S 165(10)(b) Companies Act No 71 of 2008.

<sup>457</sup>S 165(10)(c) Companies Act No 71 of 2008.

shareholders of a company have ratified or approved any particular conduct of the company it does not prevent a person from making a demand, applying for leave, or bringing or intervening in proceedings with leave of the court unlike the United Kingdom.<sup>458</sup>

The derivative action in South Africa under the Companies Act 71 of 2008 seems to be an improvement to that of the United Kingdom, in that above and beyond offering the power of the court to dismiss frivolous suits is also provides for costs and does not prevent a derivative action in cases where the act has been ratified.

### **3. Just and Equitable Winding-Up**

S122(1)(g) of the Insolvency Act 1986 grants power to the Court to wind up the company on just and equitable grounds. This is similar to the Companies Act 71 of 2008 which also provides for just and equitable winding up.<sup>459</sup>

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<sup>458</sup>S 263(3) Companies Act 2006 Chapter 46.

<sup>459</sup>S 81(1)(d)(iii) Companies Act No 71 of 2008.

## B. OECD PRINCIPLES OF CORPORATE GOVERNANCE 2004

### 1. Introduction

The OECD principles of corporate governance were endorsed by the convention on the organisation for economic co-operation and development (OECD) ministers in 1999 and have since then become an international benchmark for policy makers, investors, corporations and other stakeholders worldwide. They have advanced the corporate governance agenda and provided specific guidance for legislative and regulatory initiatives in both OECD and non OECD countries.<sup>460</sup>

Twenty countries originally signed the convention on the organisation for economic co-operation and development (OECD) on the 14<sup>th</sup> of December 1960; and since then a further ten countries have become members of the organisation. South Africa has not yet signed the convention.<sup>461</sup> The financial stability forum has designated the principles as one of the twelve key standards for sound financial systems. The principles also provide the basis for an extensive programme of cooperation between OECD and non-OECD countries and underpin the corporate governance component of World Bank and International Monetary Fund (IMF) reports on the observance of standards and codes (ROSC).<sup>462</sup> The principles are a living instrument offering non-binding standards and good practices as well as guidance on implementation, which can be adapted to the specific circumstances of individual countries and regions.<sup>463</sup>

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<sup>460</sup>Organisation for economic co-operation and development 'OECD principles of corporate governance 2004' 4 Available at <http://www.oecd.org/dataoecd/32/18/31557724.pdf> [Accessed on 7th September 2009].

<sup>461</sup>[http://www.oecd.org/document/58/0,3343,en\\_2649\\_201185\\_1889402\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/58/0,3343,en_2649_201185_1889402_1_1_1_1,00.html) [Accessed on 9<sup>th</sup> September 2009]

<sup>462</sup>Organisation for economic co-operation and development 'OECD principles of corporate governance 2004' 3 Available at <http://www.oecd.org/dataoecd/32/18/31557724.pdf> [Accessed on 7th September 2009].

<sup>463</sup>Organisation for economic co-operation and development 'OECD principles of corporate governance 2004' 4 Available at <http://www.oecd.org/dataoecd/32/18/31557724.pdf> [Accessed on 7th September 2009].

## 2. Minority shareholder protection under the OECD Principles of Corporate Governance 2004.

### The Equitable Treatment of Shareholders

It states that the corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.<sup>464</sup> One of the ways in which shareholders can enforce their rights is to be able to initiate legal and administrative proceedings against management and board members.<sup>465</sup> The confidence of minority investors is enhanced when the legal system provides mechanisms for minority shareholders to bring lawsuits when they have reasonable grounds to believe that their rights have been violated.<sup>466</sup>

The provision of such enforcement mechanisms is a key responsibility of legislators and regulators.<sup>467</sup> There is some risk that a legal system, which enables any investor to challenge corporate activity in the courts, can become prone to excessive litigation. Thus, many legal systems have introduced provisions to protect management and board members against litigation abuse.<sup>468</sup> In the end, a balance must be struck between allowing investors to seek remedies for infringement of ownership rights and

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<sup>464</sup>Organisation for economic co-operation and development 'OECD principles of corporate governance 2004' 4 Part one III Available at

<http://www.oecd.org/dataoecd/32/18/31557724.pdf> [Accessed on 7th September 2009].

<sup>465</sup>Organisation for economic co-operation and development 'OECD principles of corporate governance 2004' 40 Part two III Available at

<http://www.oecd.org/dataoecd/32/18/31557724.pdf> [Accessed on 7th September 2009].

<sup>466</sup>Organisation for economic co-operation and development 'OECD principles of corporate governance 2004' 40 Part two III Available at

<http://www.oecd.org/dataoecd/32/18/31557724.pdf> [Accessed on 7th September 2009].

<sup>467</sup>Organisation for economic co-operation and development 'OECD principles of corporate governance 2004' 40 Part two III Available at

<http://www.oecd.org/dataoecd/32/18/31557724.pdf> [Accessed on 7th September 2009].

<sup>468</sup>Organisation for economic co-operation and development 'OECD principles of corporate governance 2004' 40 Part two III Available at

<http://www.oecd.org/dataoecd/32/18/31557724.pdf> [Accessed on 7th September 2009].

avoiding excessive litigation.<sup>469</sup> Many countries have found that alternative adjudication procedures are an efficient method for dispute settlement.<sup>470</sup>

In this regard all shareholders of the same series of a class should be treated equally<sup>471</sup> and within any series of a class, all shares should carry the same rights. All investors should be able to obtain information about the rights attached to all series and classes of shares before they purchase. Any changes in voting rights should be subject to approval by those classes of shares which are negatively affected.<sup>472</sup>

Minority shareholders should also be protected from abusive actions by, or in the interest of, controlling shareholders acting either directly or indirectly, and should have effective means of redress.<sup>473</sup> The potential for abuse is marked where the legal system allows, and the market accepts, controlling shareholders to exercise a level of control which does not correspond to the level of risk that they assume as owners through exploiting legal devices to separate ownership from control, such as pyramid structures or multiple voting rights.<sup>474</sup> In addition to disclosure, a key to protecting minority shareholders is a clearly articulated duty of loyalty by

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<sup>469</sup>Organisation for economic co-operation and development 'OECD principles of corporate governance 2004' 41 Part two III Available at <http://www.oecd.org/dataoecd/32/18/31557724.pdf> [Accessed on 7th September 2009].

<sup>470</sup>Organisation for economic co-operation and development 'OECD principles of corporate governance 2004' 41 Part two III Available at <http://www.oecd.org/dataoecd/32/18/31557724.pdf> [Accessed on 7th September 2009].

<sup>471</sup>Organisation for economic co-operation and development 'OECD principles of corporate governance 2004' 4 Part one III (A) Available at <http://www.oecd.org/dataoecd/32/18/31557724.pdf> [Accessed on 7th September 2009].

<sup>472</sup>Organisation for economic co-operation and development 'OECD principles of corporate governance 2004' 4 Part one III (A)(1) Available at <http://www.oecd.org/dataoecd/32/18/31557724.pdf> [Accessed on 7th September 2009].

<sup>473</sup>Organisation for economic co-operation and development 'OECD principles of corporate governance 2004' 4 Part one III (A)(2) Available at <http://www.oecd.org/dataoecd/32/18/31557724.pdf> [Accessed on 7th September 2009].

<sup>474</sup>Organisation for economic co-operation and development 'OECD principles of corporate governance 2004' 42 Part two III (A)(2) Available at <http://www.oecd.org/dataoecd/32/18/31557724.pdf> [Accessed on 7th September 2009].

board members to the company and to all shareholders.<sup>475</sup> Other common provisions to protect minority shareholders, which have proven effective, include pre-emptive rights in relation to share issues, qualified majorities for certain shareholder decisions and the possibility to use cumulative voting in electing members of the board.<sup>476</sup> Under certain circumstances, some jurisdictions require or permit controlling shareholders to buy-out the remaining shareholders at a share-price that is established through an independent appraisal.<sup>477</sup> Other means of improving minority shareholder rights include derivative and class action law suits.<sup>478</sup>

Other ways shareholders from the same class should be treated equally are that: votes should be cast by custodians or nominees in a manner agreed upon with the beneficial owner of the shares;<sup>479</sup> impediments to cross border voting should be eliminated;<sup>480</sup> processes and procedures for general shareholder meetings should allow for equitable treatment of all shareholders; and company procedures should not make it unduly difficult or expensive to cast votes.<sup>481</sup>

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<sup>475</sup>Organisation for economic co-operation and development 'OECD principles of corporate governance 2004' 42 Part two III (A)(2) Available at <http://www.oecd.org/dataoecd/32/18/31557724.pdf> [Accessed on 7th September 2009].

<sup>476</sup>Organisation for economic co-operation and development 'OECD principles of corporate governance 2004' 42 Part two III (A)(2) Available at <http://www.oecd.org/dataoecd/32/18/31557724.pdf> [Accessed on 7th September 2009].

<sup>477</sup>Organisation for economic co-operation and development 'OECD principles of corporate governance 2004' 42 Part two III (A)(2) Available at <http://www.oecd.org/dataoecd/32/18/31557724.pdf> [Accessed on 7th September 2009].

<sup>478</sup>Organisation for economic co-operation and development 'OECD principles of corporate governance 2004' 42 Part two III (A)(2) Available at <http://www.oecd.org/dataoecd/32/18/31557724.pdf> [Accessed on 7th September 2009].

<sup>479</sup>Organisation for economic co-operation and development 'OECD principles of corporate governance 2004' 4 Part one III (A)(3) Available at <http://www.oecd.org/dataoecd/32/18/31557724.pdf> [Accessed on 7th September 2009].

<sup>480</sup>Organisation for economic co-operation and development 'OECD principles of corporate governance 2004' 4 Part one III (A)(4) Available at <http://www.oecd.org/dataoecd/32/18/31557724.pdf> [Accessed on 7th September 2009].

<sup>481</sup>Organisation for economic co-operation and development 'OECD principles of corporate governance 2004' 4 Part one III (A)(5) Available at <http://www.oecd.org/dataoecd/32/18/31557724.pdf> [Accessed on 7th September 2009].

### 3. Conclusion

The Companies Act No 71 of 2008 as is seems to comply with most of the recommendations as proposed by the OECD principles of corporate governance.

Firstly section 166(1)<sup>482</sup> provides for alternative dispute resolution. It provides that as an alternative to applying for relief to a court, or filing a complaint with the commission a person who would be entitled to apply for relief, or file a complaint may refer a matter to the companies' tribunal or an accredited entity, for resolution by mediation, conciliation or arbitration. The new act therefore provides a suitable avenue for alternative dispute resolution as envisioned in the OECD principles of corporate governance.

The OECD principles of corporate governance state that one of the ways in which shareholders can enforce their rights is to be able to initiate legal and administrative proceedings against management and board members.<sup>483</sup> It emphasises that the confidence of minority investors is enhanced when the legal system provides mechanisms for minority shareholders to bring lawsuits when they have reasonable grounds to believe that their rights have been violated. The Companies Act No 71 of 2008 provides various ways in which shareholders can enforce their rights. It provides for: resolution of disputes concerning reservation or registration of company names;<sup>484</sup> an application process to protect the rights of securities holders;<sup>485</sup> an application process to declare a director delinquent or under probation;<sup>486</sup> an application process for relief from oppressive or prejudicial conduct or from abuse of separate juristic personality of company;<sup>487</sup> a

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<sup>482</sup>Act No 71 of 2008

<sup>483</sup>Organisation for economic co-operation and development 'OECD principles of corporate governance 2004' 40 Part two III Available at <http://www.oecd.org/dataoecd/32/18/31557724.pdf> [Accessed on 7th September 2009].

<sup>484</sup>S 160 Companies Act No 71 of 2008.

<sup>485</sup>S 161 Companies Act No 71 of 2008.

<sup>486</sup>S 162 Companies Act No 71 of 2008.

<sup>487</sup>S 163 Companies Act No 71 of 2008.



procedure for dissenting shareholders' appraisal rights<sup>488</sup> and the derivative action, where the shareholder will allowed to bring an action that belongs to the company, where the company cannot or will not institute the action because the wrong doers control the company.<sup>489</sup>

The OECD highlights that, there is risk that a legal system, which enables any investor to challenge corporate activity in the courts, can become prone to excessive litigation. In this regard, the Companies Act No 71 of 2008 provides for a way to prevent excessive litigation. Under the derivative action remedy, a person served under the section may apply to the court to set aside the demand on the grounds that it is frivolous, vexatious or without merit.<sup>490</sup> It therefore appears that the Companies Act No 71 of 2008 provides some balance in that, it enables the minority shareholder to institute suits against the management and directors, while providing protection from excessive litigation.

The OECD recommends that company procedures should not make it unduly difficult or expensive to cast votes. The Companies Act No 71 of 2008 allows conduct of meetings by proxy, person or electronically so long as it does not infringe the memorandum of incorporation.<sup>491</sup> It however seems unclear whether one can exercise their right to vote electronically as section 63(4)<sup>492</sup> states that any person present and entitled to exercise voting rights must on a show of hands have only one vote, irrespective of the number of shares he or she holds or represents. It further states in section 63(5)<sup>493</sup> that on a poll at any meeting of a company, any member including his or her proxy, must be entitled to exercise all the voting rights attached to the shares held or represented by that person. It is not clear whether presence includes electronic presence.

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<sup>488</sup>S 164 Companies Act No 71 of 2008.

<sup>489</sup>S 165 Companies Act No 71 of 2008.

<sup>490</sup>S 165(3) Companies Act No 71 of 2008.

<sup>491</sup>S 63(2) Companies Act No 71 of 2008.

<sup>492</sup>Companies Act No 71 of 2008.

<sup>493</sup>Companies Act No 71 of 2008.

The Companies Act No 71 of 2008 should be amended to include other provisions proposed by the OECD principles of corporate governance to protect minority shareholders which have proven effective such as, preemptive rights in relation to share issues, qualified majorities for certain shareholder decisions and the possibility to use cumulative voting in electing members of the board. Investors should also be able to obtain information about the rights attached to all series and classes of shares before they purchase and changes in voting rights should be subject to approval by those classes of shares which are negatively affected.

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## C. KING REPORT ON CORPORATE GOVERNANCE FOR SOUTH AFRICA 2002

### 1. Introduction

The King committee on corporate governance was formed in 1992, under the auspices of the institute of directors, to consider corporate governance in the context of South Africa. The purpose of the report was to promote the highest standard of corporate governance in South Africa.<sup>494</sup> The report highlighted the apparent lack of enforcement of existing remedies for breach of statutory and common law principles by delinquent directors and officers and recommended greater participation by the state in criminal remedies.<sup>495</sup>

### 2. Civil remedies under the King report

Civil remedies are available to shareholders in that, contraventions of the provisions of the act often give rise to a delictual action or even personal liability. The exposure of directors and managers to such civil liability is an important regulatory and enforcement tool, which liability is seldom enforced. The main reason as per the report is that there appears to be a lack of access to the law on the part of the victim who are often holders of small parcels of shares in the relevant company.<sup>496</sup> There is therefore no incentive for these small shareholders to resort to expensive litigation.<sup>497</sup> The report argues that this deficiency should be cured in the following ways.

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<sup>494</sup>King committee on corporate governance *'King Report on Corporate Governance for South Africa'* (2002) 5.

<sup>495</sup> King committee on corporate governance *'King Report on Corporate Governance for South Africa'* (2002) 5.

<sup>496</sup> King committee on corporate governance *'King Report on Corporate Governance for South Africa'* (2002) 157.

<sup>497</sup> King committee on corporate governance *'King Report on Corporate Governance for South Africa'* (2002) 157.

### a. Class Actions

The report proposes the establishment in practice of more liberal use of class actions, but with appropriate provisions to prevent abuse.<sup>498</sup> A class action enables a large number of claimants, whose claims are based on a well defined common question of fact or law, to have their matters heard in one proceeding. It avoids duplicity, thus ensuring economic and effective litigation.<sup>499</sup> The court should be satisfied that there are a sufficient number of claimants to render the joinder of individual actions both impractical and unfair on the basis that they may lead to inconsistent results.<sup>500</sup> This is referred to as certifying a class and once done, the named class plaintiffs and the attorneys assume fiduciary responsibility to protect the interest of the absent class members, who although not named, are bound by the outcome of the action.<sup>501</sup> It is a common form of litigation in the United States of America and represents an exception to the general rule that one cannot be bound by a judgement rendered in a proceeding wherein one was not joined as a party.<sup>502</sup> The liberal use of the class action can itself be a useful tool for providing better access to the law, particularly in the context of shareholders who are victims of management delinquency. The report concludes that, although the constitution provides for class actions, the rules of the court still need to be amended.<sup>503</sup>

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<sup>498</sup>King committee on corporate governance 'King Report on Corporate Governance for South Africa' (2002) 157.

<sup>499</sup>King committee on corporate governance 'King Report on Corporate Governance for South Africa' (2002) 157.

<sup>500</sup>King committee on corporate governance 'King Report on Corporate Governance for South Africa' (2002) 157.

<sup>501</sup>King committee on corporate governance 'King Report on Corporate Governance for South Africa' (2002) 157.

<sup>502</sup>King committee on corporate governance 'King Report on Corporate Governance for South Africa' (2002) 158.

<sup>503</sup>King committee on corporate governance 'King Report on Corporate Governance for South Africa' (2002) 158.

## **b. Contingency Fees**

The use of contingency fees in the context of delinquency in the management of the company is another mechanism for promoting easier access to the law.<sup>504</sup> A contingency fee is an agreement between a legal practitioner and a client to the effect that no fees will be charged if the case is conducted unsuccessfully.<sup>505</sup> In March 1996, the South Africa Law Commission (SALC) published a working paper on speculative and contingency fees which led to the Contingency Fees Act<sup>506</sup> which allows for contingency fee agreements with the exception of family and criminal matters.<sup>507</sup> It proposed that contingency fee agreements be allowed with limitations on the fee relating to the prospects of success. SALC is of the opinion that the introduction of this will require an amendment to the existing law.<sup>508</sup>

## **c. Register of Delinquent Directors**

The report finally recommended amendment to the Companies Act<sup>509</sup> to allow the disqualification of those persons who have been delinquent in the management of a company from being appointed as directors.<sup>510</sup> Consideration should be given to the formation of a register of directors to be maintained by the registrar of companies who are disqualified in any way

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<sup>504</sup>King committee on corporate governance 'King Report on Corporate Governance for South Africa' (2002) 158.

<sup>505</sup>King committee on corporate governance 'King Report on Corporate Governance for South Africa' (2002) 158.

<sup>506</sup>Act No 66 of 1997.

<sup>507</sup>King committee on corporate governance 'King Report on Corporate Governance for South Africa' (2002) 158.

<sup>508</sup>King committee on corporate governance 'King Report on Corporate Governance for South Africa' (2002) 158.

<sup>509</sup>Act No. 61 of 1973.

<sup>510</sup>King committee on corporate governance 'King Report on Corporate Governance for South Africa' (2002) 159.

from acting in that capacity.<sup>511</sup> It is further recommended that organised business plays a more active role in ensuring that persons who have proved themselves unsuitable to manage companies are disqualified under the act.<sup>512</sup>

### 3. Shareholder activism under the King report.

The inertia of shareholders and, more particularly, institutional shareholders is largely responsible for the non enforcement of the breach of duties by directors and managers.<sup>513</sup> Shareholder activists in both the United Kingdom and the United States of America have had an impact on the behaviour of companies and other bodies.<sup>514</sup> The report argues that similar bodies should be established and funded in South Africa.<sup>515</sup>

Shareholder activism will be encouraged through education and mechanisms which the rights of minority shareholders can be protected.<sup>516</sup> An example is given of The United States of America where, the Securities and Exchange Commission (SEC) Rule 14a-8 makes recommendations for facilitating the submission of shareholder proposals at annual general meetings so long as the proponent has a minimum investment in the company and the proposal is relevant to the business of the company.<sup>517</sup> It is argued that although representative bodies should try and educate the shareholder, the bulk of these shareholders are institutional investors and

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<sup>511</sup>King committee on corporate governance 'King Report on Corporate Governance for South Africa' (2002) 159.

<sup>512</sup>King committee on corporate governance 'King Report on Corporate Governance for South Africa' (2002) 159.

<sup>513</sup>King committee on corporate governance 'King Report on Corporate Governance for South Africa' (2002) 163.

<sup>514</sup>King committee on corporate governance 'King Report on Corporate Governance for South Africa' (2002) 163.

<sup>515</sup>King committee on corporate governance 'King Report on Corporate Governance for South Africa' (2002) 163.

<sup>516</sup>King committee on corporate governance 'King Report on Corporate Governance for South Africa' (2002) 163.

<sup>517</sup>King committee on corporate governance 'King Report on Corporate Governance for South Africa' (2002) 164.

focus should be shifted to their actions to protect the minority shareholder.<sup>518</sup> In this regard corporate rating analysts should be encouraged to report on the qualitative aspects of companies. Factors such as business risk and corporate governance should be quantified.<sup>519</sup>

The report recommends that sanctions should also be visited upon directors and the management of the company, notably institutional shareholders who fail to attend shareholders' meetings of companies of which they have invested.<sup>520</sup> The King report refers to the Myners Report on Institutional Investment in the United Kingdom<sup>521</sup> issued on 6<sup>th</sup> March 2001, which recommends that directors and managers of financial institutions such as insurance companies and trustees and managers of financial retirement funds who do not attend shareholders meetings of companies of which they have a prescribed level of investment should be censured.<sup>522</sup> In the United States of America, the department of labour rules under the Employee Retirement and Income Security Act of 1974 (ERISA) states that a vote is a trust 'asset' and must be treated with the same level of care as the cash and other assets under management and by law or rule the fiduciaries should be required to vote and disclose how they voted.<sup>523</sup>

Finally the report argues that reputational agents play a critical role in ensuring good governance and thus better minority shareholder

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<sup>518</sup>King committee on corporate governance 'King Report on Corporate Governance for South Africa' (2002) 163.

<sup>519</sup>King committee on corporate governance 'King Report on Corporate Governance for South Africa' (2002) 163.

<sup>520</sup>King committee on corporate governance 'King Report on Corporate Governance for South Africa' (2002) 164.

<sup>521</sup>Institutional Investment in the United Kingdom: A Review (*the Myners Report*) Available at <http://webarchive.nationalarchives.gov.uk/+http://www.hm-treasury.gov.uk/media/1/6/31.pdf> [Accessed on 9th September 2009].

<sup>522</sup>King committee on corporate governance 'King Report on Corporate Governance for South Africa' (2002) 164.

<sup>523</sup>King committee on corporate governance 'King Report on Corporate Governance for South Africa' (2002) 164.

protection.<sup>524</sup> These would typically include accountants, auditors, lawyers, corporate rating agencies, investment bankers, financial media, investment advisors, corporate governance analysts amongst others. These agents would play a part by not allowing their names or logos to be used in any transactions that do not deserve the sanctions of a respected reputational agent.<sup>525</sup>

#### 4. Conclusion

According to the King Report, the absence of shareholder activism in South Africa seriously undermines good levels of managerial compliance.<sup>526</sup> Institutional investors and pension funds remain passive for the most part despite some very obvious instances of poor and undesirable corporate governance practices by South African companies. A moderate level of activism has however emerged.<sup>527</sup>

Class actions, contingency fees and a register of delinquent directors have definite advantages as they are important tools in giving minority shareholders access to the courts.<sup>528</sup> The Companies Act No 71 of 2008 complies with the recommendations of the King Report to certain extents. Under section 162 of the Companies Act no 71 of 2008, there is a provision for an application to declare a director delinquent or under probation. The court is empowered to disqualify these directors from serving as directors or place them under probation. On the recommendations of the King report,

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<sup>524</sup>King committee on corporate governance 'King Report on Corporate Governance for South Africa' (2002) 165.

<sup>525</sup>King committee on corporate governance 'King Report on Corporate Governance for South Africa' (2002) 165.

<sup>526</sup>King committee on corporate governance 'King Report on Corporate Governance for South Africa' (2002) 164.

<sup>527</sup>King committee on corporate governance 'King Report on Corporate Governance for South Africa' (2002) 164.

<sup>528</sup>King committee on corporate governance 'King Report on Corporate Governance for South Africa' (2002) 159.



the new act should be amended to provide specifically for class action suits and contingency fees to enhance minority shareholder protection.

The act should be amended to establish bodies that encourage shareholder activism in order to prevent breaches of duty by directors and management that go unenforced. Shareholder education should also be specifically provided for in the new act introducing a report on qualitative aspects of companies such as corporate governance.

As for mechanisms which the rights of minority shareholders can be protected, S61(3)(b) of the Companies Act no 71 of 2008, allows for shareholders with at least 10 percent of the voting rights to exercise them in relation a matter proposed to be considered at the meeting.

The new act should also incorporate the part of the report that recommends sanctions be visited upon directors and the management of the company, notably institutional shareholders, who fail to attend shareholders' meetings of companies of which they have invested. the vote should be considered a trust 'asset' and treated with the same level of care as the cash and other assets under management and by law or rule the fiduciaries should be required to vote and disclose how they voted. Finally reputational agents should play their role in ensuring good governance and thus better minority shareholder protection by only endorsing companies with solid corporate governance practices.

## CHAPTER FIVE

### CONCLUSION AND RECOMMENDATIONS

#### A. NEW COMPANIES ACT NO 71 OF 2008 VIZ A VIZ THE OLD COMPANIES ACT NO 61 OF 1973.

##### 1. Derivative action

The Companies Act 71 of 2008 revokes the common law derivative action. It further extends access of the derivative action to a broader category of person's effectively increasing access to justice to other people that may be adversely affected by the actions of the wrongdoers in control.<sup>529</sup>

Other differences are that, under Companies Act 61 of 1973, this action could only be instituted against a director or past director to recover damage suffered by the company as a result of wrongful acts, breach of faith and trust.<sup>530</sup> The Companies Act 71 of 2008 entitles a person to initiate proceedings to protect the legal rights of the company.<sup>531</sup> This section does not specify the causes of action for which the derivative action is available and may be criticized as being too wide.<sup>532</sup> It may well be that the member needs to get access to the company's records in order to determine whether or not an action should be instituted, but this is inaccessible to him.<sup>533</sup> Rights of discovery prior to the initiation of litigation are therefore very important. Any amendments to the Act should introduce measures to remedy this disadvantage.<sup>534</sup>

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<sup>529</sup>S 165 Companies Act No 71 of 2008.

<sup>530</sup>S 266 Companies Act 61 of 1973

<sup>531</sup>S 165 Companies Act No 71 of 2008.

<sup>532</sup>Lindi Coetzee 'Comparative analysis of the derivative litigation proceedings under the 1973 Act and the new Companies Act' [2009] Nelson Mandela Metropolitan University Unpublished Journal Article 23.

<sup>533</sup>Darryl D. McDonough 'Proposed new statutory derivative action -does it go far enough? (1996)8(1) *Bond Law Review* Article 3 45 at 51.

<sup>534</sup>Arad Reisburg 'Promoting the Use of Derivative Actions' (2003) 24 (250) *Company Lawyer* Available at SSRN <http://ssrn.com/abstract=502864> [Accessed on 13 August 2009].

## **2. Unfairly prejudicial and oppressive conduct**

Under the Companies Act No 61 of 1973, this remedy was only available to members of the company while the Companies Act No 71 of 2008 extends this remedy to apply to both members and directors. The circumstances in which the remedy is available have been clearly and broadly defined. There is a more comprehensive description of the type of relief which the court may give compared to the old act.

With a view to providing effective relief, section 163(1) of the Companies Act No 71 of 2009, provides for the shareholder or director to approach the court by way of application. Where the application is opposed and there is conflicting evidence on affidavit which the court can only resolve with oral evidence, section 163(2) (k) of the Companies Act No 71 of 2009, expressly empowers the court to make an order for the trial of any issue as determined by the court, where it cannot be decided by way of application proceedings.<sup>535</sup>

## **3. Dissenting Shareholders and Appraisal Rights**

The Companies Act No 71 of 2009 introduces an independent remedy for dissenting shareholders and provides an appraisal rights remedy. This seems to be in line with section 163,<sup>536</sup> whose purpose is to protect the minority shareholders against the actions of the majority shareholders rather than the actions of the directors. The circumstances in which the remedy is available have also been clearly and broadly defined with detailed procedural requirements that seem to ensure that the dissenting shareholder's shares are fairly appraised.

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<sup>535</sup>D Davis *et al Companies and other Business Structures in South Africa* (2009) 192.

<sup>536</sup>Companies Act No 71 of 2009.

#### **4. Delinquency and Probation of directors**

The Companies Act No 71 of 2008 introduces provisions that provide remedies against directors who have blatantly abused their positions, empowering the minority shareholder to disqualify these directors from serving as directors through a declaration of delinquency or placing them under probation. This remedy is not only open to the minority shareholder but to other people who have an interest in the company. It prevents historically bad directors from continuing to act in that capacity. The new act further provides for mentorship's and remedial education programmes for delinquent directors.

#### **5. Application to protect rights of securities holders**

The Companies Act No 71 of 2008 introduces the right of a shareholder to make an application to protect his rights. A holder of issued securities of a company may apply to a court for an order determining any rights of that person in terms of the act, the company's memorandum of incorporation, the rules of the company and any applicable debt instrument.<sup>537</sup> This right is in addition to any other remedy available in terms of the Companies Act No 71 of 2008 and common law.<sup>538</sup> This provision effectively increases the avenues available to the minority shareholder in the protection of his interests.

#### **6. Just and equitable winding up**

A company may be wound up by the court if the court is of the opinion that it is just and equitable that the company be wound up.<sup>539</sup>

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<sup>537</sup>S 161(1)(a) Companies Act No 71 of 2008.

<sup>538</sup>S 161(2) Companies Act No 71 of 2008.

<sup>539</sup>S 344(h) Companies Act No 61 of 1973; S 81(1)(d)(iii) Companies Act No 71 of 2008.

## B. THE NEW COMPANIES ACT NO 71 OF 2008 VIZ A VIZ MINORITY SHAREHOLDER PROTECTION IN THE UNITED KINGDOM

### 1. Protection from unfair prejudice

The new South African companies act<sup>540</sup> is similar to the United Kingdom companies act<sup>541</sup> in the circumstances where one may be protected from unfair prejudice or oppressive treatment. Under Section 163 of the Companies Act No 71 of 2009, a shareholder or a director of a company may apply to a court for relief if any act or omission of the company, or a related person, has had a result that is oppressive or unfairly prejudicial to, or that unfairly disregards the interests of the applicant.<sup>542</sup>

The Acts however have their differences; firstly, the Companies Act No 71 of 2008 extends this relief to both members and directors,<sup>543</sup> while the United Kingdom Companies Act of 2006<sup>544</sup> only provides this remedy for members. Secondly, in the United Kingdom Companies Act of 2006,<sup>545</sup> this remedy may also be exercised by the Secretary of State, while in the Companies Act No 71 of 2008 this is not the case. Finally, the Companies Act no 71 of 2008 seems to have a more comprehensive description of the type of relief which the court may give in comparison to the United Kingdom Companies of 2006.<sup>546</sup>

The Companies Act no 71 of 2008 is mostly at par with the United Kingdom Companies Act of 2006<sup>547</sup> and in some instances perhaps even offers better protection to minority shareholders as far as protection from oppression and unfair prejudice is concerned. A possible recommendation

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<sup>540</sup>S 163(1) Companies Act No 71 of 2008.

<sup>541</sup>S 995(1) Companies Act 2006 Chapter 46.

<sup>542</sup>S 163(1)(a) Companies Act No 71 of 2008.

<sup>543</sup>S 163(1) Companies Act No 71 of 2008.

<sup>544</sup>Chapter 46.

<sup>545</sup>Chapter 46.

<sup>546</sup>Chapter 46.

<sup>547</sup>Chapter 46.

would be to include a role to be played by the government similar to that played by the Secretary of State in the prevention of unfair prejudice.

## 2. Derivative Action

In the UK there is a statutory derivative action which is wider than the common law derivative action. The derivative claim, contained in Part 11 of the Act,<sup>548</sup> places the decision about whether it is in the interests of the company for litigation to be commenced in any particular case in the hands of the court.<sup>549</sup>

The advantage is that the individual shareholder can easily obtain a decision on the central question on whether it is in the interests of the company for the litigation to be brought. The action is subject to the filter of a judge having to be convinced that the litigation on behalf of the company is desirable.<sup>550</sup> This act is similar to the South African Companies Act No 71 of 2008 in that, they both do away with the common law derivative action in favour of a statutory one.

Section 165 of Companies Act No 71 of 2008 provides that the derivative action may be used to protect the legal interests of the company, while a derivative claim in the United Kingdom may be brought only in respect of a cause of action arising from an actual or proposed acts or omissions involving negligence, default, breach of duty or breach of trust by a director of the company. The definition in the South African act is therefore not restricted and is open to a wider interpretation than the United Kingdom Act. It is argued that the wider application would make a provision for the type of cases that would have fallen outside the ambit of section 266 of the

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<sup>548</sup>Companies Act 2006 Chapter 46.

<sup>549</sup>Paul Davies and Jonathan Rickford 'An Introduction to the New UK Companies Act' *European Company and Financial Law Review* 2008 (5) 48 at page 71; S 261 (1) Companies Act 2006 Chapter 46.

<sup>550</sup>Paul Davies and Jonathan Rickford 'An Introduction to the New UK Companies Act' *European Company and Financial Law Review* 2008 (5) 48 at page 71.

Companies Act 61 of 1973 but still within the ambit of the common law derivative action.<sup>551</sup>

The derivative action in the United Kingdom is only available to the members of the company<sup>552</sup> while the derivative action under section 165 of Companies Act No 71 of 2008 is available to shareholders, directors and officers of the company, trade unions representing employees and any other person granted leave by the court.<sup>553</sup> The derivative action in South Africa provides for wider range of people to take related steps, to protect the interests of the company.

The procedure for a derivative action in the United Kingdom and South Africa are similar to the extent that in the United Kingdom the permission of the court is necessary before the action is commenced while in South Africa, a company that has been served with a demand for a derivative action under the Companies Act 71 of 2008, may apply within 15 business days to a court to set aside the demand, only on the grounds that it is frivolous, vexatious or without merit.<sup>554</sup>

In the United Kingdom, permission must be refused if the court is satisfied that a person would not seek to continue the claim;<sup>555</sup> where the cause of action arises from an act or omission that is yet to occur; that act or omission has been authorised by the company;<sup>556</sup> and where the cause of action arises from an act or omission that has already occurred, which act or

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<sup>551</sup>Lindi Coetzee 'Comparative analysis of the derivative litigation proceedings under the 1973 Act and the new Companies Act' [2009] Nelson Mandela Metropolitan University Unpublished Journal Article 13.

<sup>552</sup>S 112 of the Companies Act 2006 Chapter 46, states that, the subscribers of a company's memorandum are deemed to have agreed to become members of the company and on its registration become members. It further states that every other person who agrees to become a member of a company, and whose name is entered in its register of members, is a member of the company.

<sup>553</sup>S 165(2) Companies Act No 71 of 2008.

<sup>554</sup>S 165(3) Companies Act No 71 of 2008.

<sup>555</sup>S 263(2)(a) Companies Act 2006 Chapter 46.

<sup>556</sup>S 263(2)(b) Companies Act 2006 Chapter 46.

omission was authorised by the company before it occurred,<sup>557</sup> or has been ratified by the company since it occurred.<sup>558</sup> The South African derivative action is more accessible since it can only be denied on the three grounds of being frivolous, vexatious or without merit.

The South African Companies Act 71 of 2008 provides for remuneration and expenses of the independent and impartial person or committee who investigate and report to the board<sup>559</sup> any facts or circumstances that may give rise to a cause of action.<sup>560</sup> The court may also make an order it considers appropriate about the costs<sup>561</sup> of any person who applied for or was granted leave.<sup>562</sup>

In South Africa, if the shareholders of a company have ratified or approved any particular conduct of the company it does not prevent a person from making a demand, applying for leave, or bringing or intervening in proceedings with leave of the court unlike the United Kingdom.<sup>563</sup>

The derivative action in South Africa under the Companies Act 71 of 2008 seems to be an improvement to that of the United Kingdom, in that above and beyond offering the power of the court to dismiss frivolous suits it also provides for costs and does not prevent a derivative action in cases where the act has been ratified.

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<sup>557</sup>S 263(2)(c)(i) Companies Act 2006 Chapter 46.

<sup>558</sup>S 263(2)(c)(ii) Companies Act 2006 Chapter 46.

<sup>559</sup>S 165(4)(a) Companies Act No 71 of 2008.

<sup>560</sup>S 165(9)(a) Companies Act No 71 of 2008.

<sup>561</sup>S 165(10) Companies Act No 71 of 2008.

<sup>562</sup>S 165(10)(a) Companies Act No 71 of 2008.

<sup>563</sup>S 263(3) Companies Act 2006 Chapter 46.



### 3. Just and Equitable Winding-Up

S122(1)(g) of the Insolvency Act 1986 grants power to the Court to wind up the company on just and equitable grounds which is similar to the Companies Act 71 of 2008.<sup>564</sup>

#### C. OECD PRINCIPLES OF CORPORATE GOVERNANCE

The Companies Act No 71 of 2008 seems to comply with most of the recommendations as proposed by the OECD principles of corporate governance. Firstly, it provides a suitable avenue for alternative dispute resolution as envisioned in the OECD principles of corporate governance.<sup>565</sup>

The OECD principles of corporate governance state that one of the ways in which shareholders can enforce their rights is to be able to initiate legal and administrative proceedings against management and board members.<sup>566</sup> The Companies Act No 71 of 2008 provides various ways in which shareholders can enforce their rights. It provides for: resolution of disputes concerning reservation or registration of company names;<sup>567</sup> an application process to protect the rights of securities holders;<sup>568</sup> an application process to declare a director delinquent or under probation;<sup>569</sup> an application process for relief from oppressive or prejudicial conduct or from abuse of separate juristic personality of company;<sup>570</sup> a procedure for dissenting shareholders' appraisal rights<sup>571</sup> and the derivative action, where the shareholder will allowed to bring an action that belongs to the company,

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<sup>564</sup>S 81(1)(d)(iii) Companies Act No 71 of 2008.

<sup>565</sup>S 166(1) Companies Act No 71 of 2008

<sup>566</sup>Organisation for economic co-operation and development 'OECD principles of corporate governance 2004' 40 Part two III Available at <http://www.oecd.org/dataoecd/32/18/31557724.pdf> [Accessed on 7th September 2009].

<sup>567</sup>S 160 Companies Act No 71 of 2008.

<sup>568</sup>S 161 Companies Act No 71 of 2008.

<sup>569</sup>S 162 Companies Act No 71 of 2008.

<sup>570</sup>S 163 Companies Act No 71 of 2008.

<sup>571</sup>S 164 Companies Act No 71 of 2008.

where the company cannot or will not institute the action because the wrong doers control the company.<sup>572</sup>

The OECD highlights that, in some instances there could be a risk of excessive litigation to the detriment of the company. The Companies Act No 71 of 2008 prevents excessive litigation by providing that a person served under the section may apply to the court to set aside the demand on the grounds that it is frivolous, vexatious or without merit.<sup>573</sup>

On the recommendations proposed by the OECD principles of corporate governance, the Companies Act No 71 of 2008 should be amended to include other provisions to protect minority shareholders which have proven effective such as, pre-emptive rights in relation to share issues, qualified majorities for certain shareholder decisions and the possibility to use cumulative voting in electing members of the board. Investors should also be able to obtain information about the rights attached to all series and classes of shares before they purchase and changes in voting rights should be subject to approval by those classes of shares which are negatively affected.

#### **D. KING REPORT**

According to the King Report, the absence of shareholder activism in South Africa seriously undermines good levels of managerial compliance.<sup>574</sup> The report suggest that class actions, contingency fees and a register of delinquent directors have definite advantages as they are important tools in giving minority shareholders access to the courts.<sup>575</sup>

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<sup>572</sup>S 165 Companies Act No 71 of 2008.

<sup>573</sup>S 165(3) Companies Act No 71 of 2008.

<sup>574</sup>King committee on corporate governance 'King Report on Corporate Governance for South Africa' (2002) 164.

<sup>575</sup>King committee on corporate governance 'King Report on Corporate Governance for South Africa' (2002) 159.

The Companies Act No 71 of 2008 complies with the recommendations of the King Report to certain extents. Under section 162 of the Companies Act no 71 of 2008, there is a provision for an application to declare a director delinquent or under probation. The court is empowered to disqualify these directors from serving as directors or place them under probation. On the recommendations of the King report, the new act should be amended to provide specifically for class action suits and contingency fees to enhance minority shareholder protection.

The act should be amended to establish bodies that encourage shareholder activism in order to prevent breaches of duty by directors and management. Shareholder education should also be specifically provided for in the new act introducing a report on qualitative aspects of companies such as corporate governance. As for mechanisms which the rights of minority shareholders can be protected, S61(3)(b) of the Companies Act no 71 of 2008, allows for shareholders with at least 10 percent of the voting rights to exercise them in relation a matter proposed to be considered at the meeting.

The new act should also be amended to incorporate the part of the report that recommends sanctions be visited upon directors and the management of the company, notably institutional shareholders, who fail to attend shareholders' meetings of companies of which they have invested. The vote should be considered a trust 'asset' and treated with the same level of care as cash and other assets and by law or rule the fiduciaries should be required to vote and disclose how they voted.

Finally reputational agents should play their role in ensuring good governance and thus better minority shareholder protection by only endorsing companies with solid corporate governance practices.