Shareholder rights and minority protection in South Africa – Have we tipped the scale in favour of minority shareholders?

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Company Law based on ‘Majority rule’

- Foss vs. Harbottle
  - When a wrong is committed against a company, the company itself must institute action
  - An irregularity can be cured by a vote in favour at the general meeting

**Fundamental Principle**

- The company & not its shareholders can bring an action against the wrongs done to the company
- Affirms the ‘majority rule’ principle
Legal Position

- The Company is a legal entity distinct from its shareholders.
- A group cannot function efficiently (in important matters of commerce) unless the will of the majority prevails.

Objective

- To protect the company from unwanted & harmful litigation.
Why protect minority shareholders?

- Strict application of the Rule in *Foss v Harbottle* would be harsh and unjust
- Directors by virtue of their position may trade on inside information and therefore act outside of the best interests of the company
- Minimise the risk of asset expropriation

Examples of abuse by the majority

- Permitting conflicts of interest
- Imposing decisions / making policy changes without reference to minority shareholders
- Blocking access to the company
- Withholding information on the company
Exceptions to the *Foss v Harbottle* Rule

- Where the act complained of was *ultra vires* or illegal
- Where the act complained of was in breach of the company’s constitutional documents
- Where the act complained of violated claimant’s personal and individual rights in the claimant’s capacity as a member
- Where ‘fraud on the minority’ has been committed by the majority

Problems with the Common Law derivative action

- *Locus standi* – when will a shareholder be entitled to enforce the company’s rights?
- Court discretion – lack of certainty
- Personal risks – possible non recovery of costs
Statutory Derivative Action

• Companies Act, 1973
  – Damages or loss suffered by the company as a result of actions of a Director or Officer of that company – s266

Remedies

• Companies Act, 1973
  – Unfairly prejudicial, unjust or inequitable conduct leading to oppression of the minority shareholders – s252
Companies Act 2008

(s164)
- Introduces the concept of ‘appraisal rights’ entitling minority shareholders to dispose of their shares to the company where:
  - the company has amended its memorandum of incorporation in a materially adverse manner affecting rights attaching to shares
  - the company enters into a ‘fundamental transaction’

(s115)
- Fundamental ‘transactions’ include the disposal of the company’s business or the majority of its assets, a merger or a scheme of arrangement:
  - must be approved at the general meeting by special resolution
  - require court sanction where at least 15% of the voting rights voted against the resolution
Appraisal rights unlocked

- Court approval required where 85% majority or less is obtained
- Notwithstanding 85% majority, a dissenting shareholder may petition the court, demanding that the company pay “fair value” for all the shares such dissenting shareholder owns

Objective
- To provide disaffected minority shareholders with an exit mechanism
- To arrest tyranny subjected upon minority shareholders
Some challenges with ‘Appraisal Rights’

- Dilute the principle of ‘majority rule’
- Could delay significant transactions resulting in huge costs and increasing complexity of transactions
- Likely dispute as to what constitutes ‘fair value’
- An extra-ordinary remedy that tilts the balance carefully developed over many years in favour of minority shareholders — can this be justified?
- Exposes the company to the possibility of disgruntled shareholders ‘acting in concert’ or ‘ganging up’ to frustrate transactions
Additional rights – Companies Act 2008

(s61)
- Shareholders meetings – reduced level of shareholding to requisition meetings (10% of the voting rights)

(s156)
- Alternative dispute resolution (ADR) – provides additional avenues to minority shareholders, including Companies Tribunal, the High Court and the Takeover Regulation Panel

(s159)
- Protection of whistle blowers – affords minority shareholders protection for making certain disclosures

(s162)
- Application to declare a Director to be delinquent
Corporate Governance

• King III
  – Enhances risk management processes and audit requirements
  – Disclosure of directors’ and senior executives remuneration
  – Ethical leadership and corporate citizenship
  – Stakeholder engagement broadens the scope for consultation and constructive engagement
  – Integrated reporting with focus on non-financial issues will drive transparency and accountability
Legislative Trends – South Africa

- Landmark ruling in 2003 that boosted rights for shareholders in private companies *Davis v Clutcho (1289/03) ZAWCHC 23*:
  - Private company compelled to grant a shareholder access to its financial records in terms of the Promotion of Access to Information Act (PAIA)

- Ruling overturned by Supreme Court *Clutcho v Davis 2005 (3) SA 486 (SCA)*:
  - Failed to make out successful case for accounting books to be open for inspection by minority shareholder
  - In principle and upon appropriate facts, such a request could be granted (test – ‘substantial advantage or element of need’).
BEE – South Africa

*Newspaper reports 2012*

- Quoted company, Kelly Group accused of ‘tender fronting’ by its black economic empowerment (BEE) partners
- Two joint venture companies (JVs) formed, BEE partners holding a majority of the shares
- BEE partners allege that although they were a majority shareholder the minority shareholder “acted as a majority shareholder” by solely:
  - controlling the bank accounts of the JVs
  - deciding how profits from major business contract will be split
  - denying the BEE partners access to bank account statements & financial records
BEE – South Africa contd.

Newspaper reports 2012

- Quoted company, Arcelor Mittal (AM) ordered by High Court to pay R241.3m to BEE partner and minority shareholder, Kalahari for failing to comply with court judgment compelling AM to carry out funding commitment in terms of shareholder agreement.
- Three parties in manganese mining JV – AM with 50%, Kalahari with 40% & the IDC with 10%.
- AM withholding funding apparently due to ‘corporate governance concerns’
- BEE partner alleges AM withholding funding in violation of shareholder commitment ‘in order to control the mining project’
International Developments

• UK
  – Shareholders have sued Barclays for failing to protect their shareholder pre-emption rights when raising emergency funding in the Middle East in 2008
  – Shareholders have sued the Royal Bank of Scotland (RBS) for misleading them regarding RBS’s true financial position ahead of the rights issue in 2008
International Developments – contd.

• Russia
  - Minority shareholders of TNK-BP (Anglo-Russian oil JV company) successfully sued BP for $3bn over BP’s failed bid to form a strategic partnership with Rosneft (Russian state owned oil company)
  - Minority shareholders (from Russia) claimed that plan to partner with Rosneft was in breach of shareholders agreement entitling them to damages
  - It was claimed that shareholders agreement with BP required investment opportunities in Russia to be pursued through the JV
How to minimise disputes

• Due diligence of co-partners/shareholders extending to ethical behaviour
• Enter into a comprehensive shareholders’ agreement
• Key issues to be covered include:
  - financing of the company
  - dividend policy, directors’ fees and salaries
  - responsibilities for different areas of the business
  - pre-emptive rights and exit strategy
• Insert in the memorandum of incorporation (MOI) matters fundamental to the company/JV
• Certain provisions may fall foul of competition law
• Select appropriate governing law
Lessons learnt.....

• Frustrated minority shareholders will exercise their rights to the fullest possible extent, often to the detriment of a trusting partner/shareholder – e.g. outcome of *TNK-BP claim in Siberian court*

• Increased transparency among shareholders, allowing for reasonable participation grants opportunity to deal with conflict early

• Directors and officers (including those no longer in office) are being sued for decisions taken by companies – *business judgment rule*

• International trends suggest that shareholder activism is on the increase

• We can expect to see closer scrutiny from stakeholders

• Companies must hold directors and prescribed officers to account
Questions?