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PROTECTION OF MINORITY SHAREHOLDERS AGAINST UNFAIRLY PREJUDICIAL CONDUCT BY THE MAJORITY SHAREHOLDERS

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Minority shareholders in both Companies and Close Corporations (members) enjoy a measure of protection against unfairly prejudicial, unjust or inequitable acts that arise from the conduct of majority shareholders or the Company. This protection is contained in Section 163 of the new Companies Act and Section 49 of the Close Corporations Act.

In brief summation of these sections it bestows upon minority shareholders or directors the right, when it is believed that the company, a director or a related person has acted in a manner that is oppressive, prejudicial or that unfairly disregards the interest of the minority, to amongst other steps, apply to a court for a final order restraining such conduct, directing the forced sale or exchange of shares or requiring the company to produce its financial statements in any reasonably prescribed form.

The interpretation of these sections and the extent of the protection that is offered to shareholders were the main legal questions in the recently decided judgment of *Geffen and Others v Victoriano Dominquez-Martin and Others* (2017). The alleged unfair conduct complained of by the Applicants, being the minority shareholders of various companies of which the First Respondent was the majority shareholder, amounted to:

1. The replacement of a key director.
2. The lack of audited and updated financial statements.
3. The lack of access to the bank accounts of the Companies.

4. Treating the First Applicant as “a mere silent investor”.
5. The secrecy surrounding the status of certain key employees of the Companies.
6. The refusal to adhere to the First Applicant’s right of first option to buy shares.
7. Abruptly cancelling and negotiating certain new contracts without ostensible authority.

The specific relief sought by the Applicants to alleviate these alleged injustices was the appointment of a chartered accountant to compile a report, including drafting financials statements and producing a reconciliation of the Companies’ actual obligations to the Respondents. The Court had to make a determination firstly on whether the Companies’ historic actions had amounted to unfair conduct toward the minority shareholders and secondly what order the Court is entitled to make in terms of the relevant sections of the Acts.

In making its finding on whether the Respondents’ conduct was unfair and oppressive, the Court took cognisance of the history of the relevant legislation and found that an objective test must be used to determine whether the conduct is not only prejudicial to the minority shareholders, but also at the very least unreasonable or unethical. The Court further determined that the present case was unique and warranted a further step as on offer was made by the First Respondent to buy the shares of the First Applicant. In light of this offer being made, the Court had to decide whether the relief sought by the Applicants was indeed necessary and justifiable in the factual circumstances in order to provide the Applicants with the protection that it is entitled to under the legislation.

The Court ultimately decided that the Applicants had not made out a proper case that any of the Respondents’ conduct had led directly to the prejudicial consequences suffered by them. This finding centred on the fact that the Respondents had been open and transparent in its approach and decisions, even if it had not involved the Applicants in its decision-making processes to the extent demanded by them. This also includes the offer that was made to purchase the shares of the First Applicant, which was based on a fair and substantiated valuation method. The Court came to the conclusion that in light of these factors, the conduct of the Respondents could not be seen as unethical

and unreasonable, essential elements to the conduct being assessed as unfairly prejudicial.

The above decision could certainly lead minority shareholders to believe that their interests are at risk from the actions of majority shareholders. However, the Court in *Geffen* did raise a number of important points regarding the factors and processes of determining whether there has been unfairly prejudicial conduct. Firstly, if the Applicants can show objectively that the alleged conduct has adversely affected or was detrimental to their financial interests, they will be able to succeed in remitting the burden of proof they carry. This is a factual question and may be proved by presenting various objective factors such as changes in stock market prices and financial statements of the Company. The second important point raised by the Court focuses on the relief available to the minority shareholders. In this particular instance the relief that was sought was to be actively involved in managerial decisions and not too simply be informed of them. This is a far-reaching remedy, but one that may be granted in the correct circumstances. The Court states that such relief may be granted if the Applicants can prove that they had either a right or a legitimate expectation to be actively involved in the decisions of the majority.

The crux of the Respondent's case in *Geffen* on why the applicants did not hold the right to be actively involved in management, was based on the non-existence of an agreement or the Memorandum of Incorporation granting them a right to that effect. The Respondents' attorneys even go so far as to admit that had such an agreement existed, they would have been obliged to adhere thereto. The Court in assessing the history of the case law and coming into existence of the relevant legislation, agreed that the remedy of active involvement of minority Shareholders would have been readily available had it been explicitly provided and agreed to in written format.

In the absence of minority shareholders specifically providing for a right of active involvement by way of a written shareholders' agreement or in the Memorandum of Incorporation of the Company, it will likely be almost impossible to prove that such a

right does in fact exist. A legitimate expectation may none the less be proved by either relying on past conduct whereby the minority were allowed to be involved in the decision-making processes of the business, or by relying on a verbal promise to that effect. The Applicants in *Geffen* was unable to prove that such a legitimate expectation existed, but the Court managed to open the door wide enough to make the remedy of managerial involvement a viable option even in the absence of a written agreement or inclusion thereof in the Company's MOI. It must however be carefully noted that such a legitimate might be very difficult to prove unless very detailed logs of events and conversations are kept on record.

In conclusion the Court in *Geffen* managed to strike a fair balance between the need to protect the minority shareholders on the one hand and the well-established principle in Company law that the minority bind themselves to the decisions of the majority. It is essential that all minority shareholders, current or potential, take careful note of the protection that they enjoy to hold the Company and the majority shareholders accountable for their actions. Without a doubt the most effective way of doing so, is to negotiate vigorously for the inclusion of the right to be actively involved at crucial junctures of the business's decision-making processes and the inclusion of such a right in either the Company's MOI or a written Shareholders' Agreement. A well-thought out agreement will ensure that, without necessitating unnecessary involvement in the day-to-day running of the business, silent partners will have a voice when it matters.

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