Zenani, J Civil Legal Sci 2022, 11:6

Journal of Civil & Legal Sciences

Review Article Open Access

# The Oppressed Shareholder and His Remedy: A Brief Analysis of Section 163 of the South African Companies Act

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## Introduction

The Companies Act (the Act) provided a statutory framework for a modern regulation of South African company law, in the process revising the provisions of the old Companies Act (the 1973 Act) [1,2]. One such revision was section 252 of the 1973 Act by section 163 of the 2008 Act which outlines the scope and application of the oppression remedy, in which a party may obtain relief from conduct that is unfairly prejudicial or oppressive [3]. According to section 163(1) of the Act, only shareholders and directors have locus standi to exercise the remedy. In order for such a party to bring a successful application for the remedy, the applicant must prove that there was an act or omission of the company or a related person which had a result that is oppressive or unfairly prejudicial to, or unfairly disregards the interests of the applicant. In the alternative, the applicant could establish that the business of the company or a related person has been, or is being conducted in a manner that is oppressive, unfairly prejudicial or unfairly disregards the applicant's interests; or that the powers of a director, prescribed officer or person related to the company have been or are being exercised in such manner [4].

Section 163(1)(a) of the Act is explicit that the act or omission must have a consequence which is oppressive, unfairly prejudicial or unfairly disregards the applicant's interests. It is thus the result that must be unfairly prejudicial or oppressive [5].The same cannot be said, however, for section 163(1)(b) and (c), as this only requires that either the manner in which the company's business was conducted or the exercise of a director or other related person's powers, respectively, be oppressive or unfairly prejudicial [6].The conduct in question must not be prospective, but must be one which has already occurred or is still occurring [7]. Furthermore, section 76(3) of the Act saddles directors with a duty of utmost good faith to always advance the company's best interests. Any subjective belief, if any, on the part of a director that he or she is in fact acting in the company's best interests must have a rational basis [8].

The above begets the question: what constitutes "an act or omission of the company" or related person? Such an act or omission includes the resolutions passed in the company's general meeting or other meetings of shareholders, as well as those passed in a meeting of the board of directors [9,10]. Secondly, Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd (Visser Sitrus) tells us that a director's very exercise of a corporate power constitutes an act or omission of a company. As such, section 163(1)(c) offers little that section 163(1)(a) and (b) do not [11]. Visser Sitrus echoed Civils 2000 Holdings (Pty) Ltd v Black Empowerment Partner Civils 2000 (Pty) Ltd (Civils 2000 Holdings), where the court held that it is an established legal principle that directors' acts or omissions in the course of their dealing constitute the company's acts or omissions, even where the director might be in breach of fiduciary duty [12,13].

## Discussion

The Act does not define the terms "oppressive," "unfairly prejudicial" and "unfairly disregards" and they remain largely open-ended [14]. However, several judgments indicate how the courts have resolved to interpret them. The Supreme Court of Appeal (SCA) held in Grancy Property Ltd v Manala (Grancy Property) that the oppression remedy was naturally extensive, that any application of section 163 must be one which extends rather than limits the remedy and that where a conduct is alleged to fall under section 163(1), only the conduct and the effects thereof on the applicant or other members of the company must be assessed, not necessarily the motive thereof [15].

In Visser Sitrus, the court held that an applicant could not merely aver that there was a prejudicial act or omission but must show that such an act was, in the final analysis, unfair. It held that though not thus limited, section 163 was in one respect a remedy against unlawful corporate conduct. If the action complained of was unlawful, and the result thereof prejudicial or disregarded the applicant's interests, then the prejudice or disregard was likely to be unfair[16]. According to Donaldson Investments (Pty) Ltd v Anglo-Transvaal Collieries Co Ltd (Donaldson), unfairness is the essential test for the oppression remedy [17]. Importing several English law tests, Donaldson held that oppressive conduct involves "a lack of probity of fair dealing, a visible departure from accepted standards of fairness or a violation of the conditions of fair play on which every shareholder who entrusts his money to a company is entitled to rely." Meanwhile, Count Gotthard SA Pilati v Witfontein Game Farm (Pty) Ltd held that unfair prejudice of the applicant's interests "must result in commercial unfairness affecting the applicant " [18].

What are the shareholder's interests in a company? In Grancy Property it was held that part of the reason why applications of section 163 must extend rather than limit the oppression remedy is that the conduct complained of can be one which simply unfairly disregards the applicant's interests [19]. "Interests" is wider and more flexible than "rights" [20]. In Utopia Vakansie-Oorde Bpk v Du Plessis, the Appellate Division, as it then was, held that "a shareholder's interests flow" from the patrimonial rights attached to the share held by that shareholder [21]. The shareholder's interests thus include patrimonial rights such as dividends, along with secondary interests that flow from those rights, such as the value and profitability of the shares.

A secondary question arises regarding the relief that the court may order under section 163. Section 163(2) provides that once the

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**Received:** 23-May-2022, Manuscript No.JCLS-22-65522; **Editor assigned:** 25-May-2022, PreQC No. JCLS-22-65522(PQ); **Reviewed:** 8-Jun-2022, QC No.JCLS-22-65522; **Revised:** 13-Jun-2022, Manuscript No. JCLS-22-65522(R); **Published:** 20-Jun-2022, DOI: 10.4172/2169-0170.1000332

**Citation:** Zenani L (2022) The Oppressed Shareholder and His Remedy: A Brief Analysis of Section 163 of the South African Companies Act. J Civil Legal Sci 11: 332.

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provisions of section 163(1) are present, the court may make any final or interim order it deems appropriate in the circumstances, such as an order: appointing a liquidator if the company is insolvent, directing the issue or exchange of shares, directing the company to pay back to a shareholder the value or equivalent thereof that the shareholder had paid for the shares, or to compensate an aggrieved person. If the company is not insolvent, the order which the court makes must be one which enables the company's continued existence and the court may, where appropriate, order the company to buy back the shares of the oppressed shareholder at fair value [22]. Generally, shareholders cannot bring an action against a third party whose actions resulted in the drop in share value of a company in which they own shares, due to the company being a separate legal entity [23].However, this is not the case where it is the company's actions that are unfairly prejudicial or oppressive to the shareholder.

In Louw v Nel (Louw), the SCA held that the jurisdiction of the court under section 252 of the 1973 Act arose only once the statutory criteria had been fulfilled [24]. Section 163 of the Act gives a less restricted framework, but the court still only obtains jurisdiction to make an order under section 163(2) once at least one of the grounds in section 163(1) has been satisfied. The court has a flexible discretion to make an order that is equitable and fair in the circumstances, such as ordering the company to buy back the shares of an aggrieved shareholder [25]. In Off-Beat Holiday Club v Sanbonani Holiday Spa Shareblock Ltd (Off-Beat Holiday Club), the Constitutional Court maintained that s 252 of the 1973 Act gave the courts unfettered discretion to do what they considered fair and equitable to cure unfair prejudice suffered at the hands of the company, such as in instances of corporate bullying [26]. On such occasions, a court must apply an objective test for fairness, where it will weigh up the interests of both parties and make an order that is just and equitable.

It bears repeating that a court may order a company to purchase the shares of a prejudiced shareholder at fair value [27]. In Omar v Inhouse Venue Technical Management (Pty) Ltd the court issued such an order, and outlined a guideline of how a fair price could be determined [28]. The court held that an expert referee, such as a chartered accountant, must be appointed to independently determine what a fair share price could be. Because the company's directors had breached their fiduciary duty, which led to a drop in the share value, the court ruled that the referee was to "make appropriate adjustments to factor in the breach" of fiduciary duty and consider the price the shares would have been without the oppressive or prejudicial conduct in determining a fair price.[29]

## Analysis

Whenever a shareholder wishes to make use of the oppression remedy, the first question to be answered is of course whether the action that led to the undesired effect was in fact "an act or omission of the company or related person" in terms of section 163(1) of the Act. The jurisprudential framework of the Visser Sitrus and Civils 2000 Holdings cases is that an exercise of a corporate power by a director constitutes an act of the company. This is the case where, for instance, a director enters into a contract with a third party on behalf of the company, as a director's ability to bind the company into a contract is a fundamental corporate power, the exercise of which constitutes "an act of the company" itself. In accordance with Civils 2000 Holdings, such an exercise is regarded as an act of the company even if the director in fact undertakes it in breach of his or her fiduciary duty. Thus goes the first element of section 163(1)(a).

For purposes of section 163(1)(a), the second question is whether the director's actions have a consequence that is unfairly prejudicial, oppressive or unfairly disregards the shareholder's interests. Where a director acted dishonestly, such as through fraud or bribery, and the resulting backlash negatively affected the value of the company's shares, it is argued that the principal act will have been oppressive. Grancy Property cautions that section 163 should always be applied in a way that extends rather than limits the remedy, and that the final analysis does not lie in determining the motive, but the result of the conduct complained of and its effect on the affected applicant. This is to say that the conduct will remain oppressive even if its underlying motive had been to maximize the company's profits. As per Donaldson, the fundamental test for the oppression remedy is unfairness. And as Visser Sitrus also pointed out, if the conduct in question is unlawful, and the result thereof prejudicial, then the prejudice is likely to be unfair and the result thereof unfairly prejudicial and oppressive. This would constitute a visible departure from the accepted standards of fairness and a violation of the conditions of fair play to which shareholders are entitled; more so where the shareholder experienced commercial unfairness as the result, such as in a dramatic depreciation of his shares. Since a shareholder's interests in a company flow from the rights attached to his shares, and therefore includes the value thereof, the shareholder's interests would be negatively affected.

The alternative is section 163(1)(b), which states that an applicant may bring an application for the oppression remedy if he or she can prove that the company's business was run in a way that is oppressive, unfairly prejudicial or unfairly disregarded the applicant's interests. The difference between this paragraph and paragraph (a) is that it is not the result of the conduct that must be oppressive or unfairly prejudicial, but the way in which the company's business is administered. Under the framework above, any unlawful, dishonest action on the part of a director must be regarded as unfairly prejudicial, oppressive or unfairly disregarding the interests of the shareholder. Any breach of fiduciary duty that negatively affects the value of the company's shares, followed by a failure by the rest of the board to act against such a director, may also fall within the ambit of section 163(1)(b).

The last alternative is section 163(1)(c) of the Act. This subsection covers a potential abuse of power or breach of fiduciary duty by directors or prescribed officers. Where a director acts unlawfully or otherwise breaches his or her fiduciary duty in the course of his or her duties on behalf of the company, and the shareholders are disadvantaged as the result, this may constitute an abuse of power. As indicated in Visser Sitrus, section 163 exists partly to provide a remedy to parties oppressed by unlawful corporate conduct. A failure to act in the company's best interests, which at any rate could never be served by unlawful action, regardless of any potential gains, constitutes a breach of fiduciary duty, fulfilling the provisions of section 163(1)(c).

The last major question concerns remedy.

As set out in section 163(1), a shareholder has locus standi to bring an action according to section 163. What remains, however, is whether he is able to use this remedy to recover any losses that he had suffered as the result of a drop in share value.

First, markets are volatile, and a shareholder cannot always be assured optimum profitability of the shares he holds in a company. This means that the very practice of shareholding is a corporate risk, and shares may gain or lose value due to a myriad of factors. Second, as stated in London v Department of Transport, Roads and Public Works, Northern Cape (London), a company enjoys separate legal personality to its shareholders, which means that the shareholders cannot be sued in their personal capacity by the company's creditors. This also means

that where a company incurs a loss as the result of the actions of a third party, and this leads to a decline in the value of the company's shares, neither can the shareholders sue that third party for the share depreciation in their individual capacity. This is the position in which shareholders find themselves where a company's shares depreciate due to a third party's actions.

However, where the conduct that led to the shareholder's loss was an act of the company itself or constituted a manner in which the business of the company was conducted or a director's powers exercised, the case becomes one of oppression by the company's conduct. It thus falls outside the ambit of London, and the shareholder is entitled to relief.

The requirement set out in Louw is that the jurisdiction of the court arises in terms of section 163(2) once at least one of the three factors in section 163(1) is present. Where section 163(1) has been satisfied, the court has an unfettered discretion to make any equitable order to cure unfair prejudice suffered by a shareholder in the circumstances. If the company is not insolvent, any order that the court makes must be one which allows the company to continue its existence. But it must, nevertheless, be one which brings an end to the conduct complained of.

One such order the court can make is to order the company to buy back the shareholder's shares at fair value, as per De Sousa v Technology Corporate Management (Pty) Ltd. This buy-out remedy is crucial. Firstly, it is part of section 163(2)(g) because the shareholder has been aggrieved and thus oppressed. Secondly, it is within the court's ambit to make an order which is equitable and fair in the circumstances. A similar approach was followed in Omar. The fair value was to be determined by an independent and professional referee; since there had been oppressive conduct which affected the value of the shares, the price was to be adjusted to factor in said conduct in order to be considered fair. The court may thus appoint or order the appointment of an independent chartered accountant to, in their expert capacity, determine the fair price of the shares. In his assessment, the chartered accountant will have to factor in the oppressive conduct and determine what the fair value of the shares would have been had the oppressive or unfairly prejudicial conduct not arisen.

## Conclusion

What emerges most forcefully from the case law above is that the courts increasingly favour a wider application of the oppression remedy than a narrow one. This is based primarily on the premise that the remedy is geared towards the protection of shareholders' interests in the company, not merely their rights. Because interests reach further than rights, the oppression remedy also needs to stretch as far. Equally forceful is the assertion of the wide discretionary powers that the courts have in crafting remedies where a shareholder has thus suffered oppression. Despite the general risks connected with investments, a shareholder has some protection where he suffers loss as the result of oppressive conduct by the company itself.

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