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ARTICLE

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BOARDROOM DOMINATION – TREATING MINORITY SHAREHOLDERS FAIRLY

Article by CGF Research and reviewed by Goldman Judin Inc.

There are quite a number of corporate governance codes that document the manner in which organisations should govern their business; notably the King Report on Governance for South Africa 2009 ('King III') is one of the more recognised codes throughout the world. King III -- being an amended version of its former King I and King II versions -- goes to great lengths and provides recommendations to ensure the independence, structure and balance of a Board, amongst other important governance matters. King III, and the new Companies Act 2008 ("the Act"), provides further detail to ensure that the Board, including its committee members, remain free from any form of conflict, be this at an individual or at a corporate level. When any situation places a Board or the organisation's executives in a conflictive situation, they need to know how to deal with it, effectively, efficiently, and transparently.

Whilst King III does not provide specific guidelines on how to deal with, for example, a shareholder who is dominating or attempting to dominate strategic decisions being taken by the Board, companies may find relief in the Act that should protect not only the remaining shareholders, but indeed the Board itself as well as the other stakeholders of the company. The Act has significantly improved many of its provisions as contained in its predecessor Companies Act of 1973; and one of the purposes of the Act is the promotion of its compliance with the Bill of Rights. To this extent, the Bill of Rights and the Act, both seek to protect minority groups and this is enshrined in our Constitution and democracy. Section 163 is known as the 'oppression' clause, and although the clause is quite broad and not yet fully interpreted by our courts, it does however provide relief for any aggrieved company shareholder wanting to take action against any individual acting oppressively toward any other shareholder, particularly where this behaviour may cause damage to the company. Regrettably -- but also ironically -- considering the massive personal liability directors in South Africa are exposed to, many directors may find themselves acting as 'shadow directors' and submit to either dominating directors, or directors who serve the interests of a particular controlling (dominating) shareholder and not those of the company. Obviously such behaviour is completely wrong and is not aligned with the recommendations of King III vis-à-vis the Board's collective purpose, including issues which include its balance, and its member's requirements to act in the best interests of the company amongst their other fiduciary duties.

There are many well documented cases where directors have not fulfilled their fiduciary, neither statutory duties to protect their companies, and they have been exposed when these duties were selfishly bestowed to themselves or a dominating shareholder. Such examples include those directors linked to the corporate collapses of the Enron Corporation (US), Maxwell (UK) and even a number of South African cases such as Leisurenet, Macmed and Regal Treasury Private Bank.

As the world economy continues to battle a path toward economic recovery, no doubt there will be more directors who will attempt to 'sugar-coat' certain matters and or transactions, which may initially appear good for the company, but are actually intended for an ulterior or selfish motive. It is imperative that the directors

who serve on a Board where such activity may occur, are diligent and 'interrogate' each and every facet of reasoning when one of their fellow colleagues appears dead-set to bulldoze such matters for approval. Two of a Board's most vulnerable areas it could face is when the Board has to make certain key strategic decisions and finds itself complacent or ignorant upon the matter at hand, or worse, when a particular individual dominates the Board and effectively 'neutralises' the proper functioning and power of the Board.

Clearly therefore, as espoused in King III, it is critical that the Board be allowed to fulfill its purpose -- to remain effective and functional -- and not in any way be dominated by external agendas, be these from directors themselves or any shareholder or their representatives.

The need to dominate seems to be a trait for many human beings, and whilst it has been around for centuries, Boards must be acutely aware and prevent it from occurring at its first signs. It's easy to spot the symptoms of boardroom dominance and in most cases it will be a strong-willed person who brandishes excessive power, is intolerant of views contrary to their own and is usually followed by a group of submissive followers.

"There is abundant evidence of directors becoming involved in 'groupthink', where unspoken assumptions are taken for granted and sensible commonsense options are ignored. It is often when the group consensus is strongest that there is the greatest need for a devil's advocate who will ask unpopular questions and force his or her colleagues to square up to reality."

Extracted from the book: What you should know about Corporate Governance

Authors: Tom Wixley & Geoff Everingham

There are a number of ways to deal with dominance in the boardroom, but failing counteractive measures to deal with this burden, especially where the company and or its minority shareholders suffer at their expense, decisive action should be followed through the courts. Fortunately the principles enshrined in the Bill of Rights are a 'protection' safety net for the minority shareholders of a company -- and similarly would be the case for the government when its citizens are unfairly treated by the majority. Such protection must be enacted (as necessary) when unfairness prevails against the minority shareholders, or the weak.

Finally, one must be mindful that domination in the boardroom may in fact not necessarily and always be done by a controlling or dominating shareholder. It is quite possible that a minor shareholder, or a representative director of a shareholder, may have the power to act oppressively toward the majority. It therefore is imperative that in the case of a private company a proper, clearly written and understandable, binding Shareholders' Agreement and policy is in place to govern the company's relations with its shareholders, more specifically so when there is a dominating shareholder who requires 'managing'. In both private and public company care should be taken in the crafting of the Memorandum on Incorporation to effectively deal with this potential problem. Dominating shareholders can be a blessing or a curse - to some extent the choice is yours.

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CGF is a Proudly South African company that specialises in conducting desktop research on Governance, Risk and Compliance (GRC) related topics. The company has developed numerous products that cover GRC

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