13

DISSERTATION

ON

SHAREHOLDERS' AGREEMENTS IN PRIVATE COMPANIES

The regulation of the relationship between the shareholders of the company inter se

by

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CONTENTS

PREFACE

A company and all its members for the time being can, within the limitations imposed by its memorandum, by agreement depart from its articles and such agreement would bind the company and those members [1].

Such agreements are frequently entered into between proposed shareholders of a company to be formed or shareholders of an existing company. When these agreements relate to companies to be formed they are known as formation agreements but commercially the agreements are generally known as shareholders' agreements. They usually govern the rights and obligations of the respective shareholders as well as other matters relating to the affairs of the company.

Members of private companies, particular small domestic companies usually enter into shareholders' agreements for various reasons, e.g. where they wish to secure special safeguards for their prospective interests in the company. Thus, a majority shareholder may want to ensure that control of the company will remain with his family, or a minority shareholder may seek special protection.

Whilst such special safeguards could be contained in the memorandum or articles of association, which will bind the company and its members, the memorandum and articles by themselves will not always afford the protection because they are capable of being amended by special resolution.

Legislation may override the articles, e.g. section 220 of the Companies Act provides that, notwithstanding anything in the articles, a director may be removed from his office by ordinary resolution.

A shareholder, unless he commands at least twenty-six per centum of the voting rights in general meeting, may be unable to prevent an alteration of the articles of which he does not approve. An agreement could prevent the variation of the rights attaching to any class of share in terms of section 102 where a company has more than one class of shares.

In view of the common law principle that where a wrong is done to it, only the company may take proceedings against the wrongdoers [2], a minority shareholder could find difficulty in bringing proceedings based on a breach of the articles, e.g. where the irregularity does not amount to an ultra vires act, fraud or oppression[3].

Even where the memorandum or articles could provide effective protection, the members may prefer to insert certain safeguards in an agreement for the sake of simplifying the articles or keeping their arrangements confidential.

This dissertation is concerned with the various matters that affect members of private companies either in terms of the Companies Act or as a matter of law and to discuss how these can be dealt with in a shareholders' agreement, particularly with the object of safeguarding individual interest.

This work includes a review of the statutory provisions and authorities relating to various aspects as well as the manner in which these aspects are dealt with in commercial shareholders' agreements based on the views and experience of the writer as a commercial lawyer arising from litigation involving disputes between shareholders and the drafting of shareholders' agreements and articles of private companies.

FOOTNOTES

[1] Gohlke & Schneider v Westies Minerale (Edms) Bpk 1970 (2) SA 685 (AD) at P692).

[2] Foss v Harbottle 1843 2 Hare 461; 67 ER 189;

[3] Foss v Harbottle *supra*; Heyting v Dupont [1964] 2 All ER 273; [1964] 1 W.L.R. 843, C.A.).

ABBREVIATIONS

In the text, the following abbreviations shall have the following meanings unless otherwise indicated:

"Act" means the Companies Act, 61 of 1973 as amended;

"section" means a section of the Act;

"Table B" means Table B to the Act;

TABLE OF CASES

Cullinan v Noord Kaaplandse Aartappelkernmoerkwekers Ko-Op Bpk 1972 (1) SA 761 (A)

Daniel & Company v Siebert and Van Eeden 9 SC 31

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CHAPTER I

PRELIMINARY AND INTERPRETATION

Parties

The parties to the shareholders' agreement must be the company and all its members at the time of entering into the agreement.

The registration number of the company and of any other companies who are members should be inserted in order to clearly identify them, particularly where their names are similar.

The full names of the members and their physical addresses should also be inserted in the agreement and not postal addresses since it is often not practicable to deliver notices to members at their postal address.

Definitions

It is important that the definitions contained in the agreement are clear and unambiguous. Except where the context otherwise requires, reference to "the members" should be defined as the members for the time being and from time to time of the company.

Since the auditor of the company generally has significant functions in terms of the agreement, particularly in regard to the determination of certain disputes and the valuation of shares, any reference to the auditor should not be limited to the existing auditor.

The "auditor" should therefore be defined as being the auditors for the time being and from time to time of the company and the definition should stipulate that should such auditors be unwilling or refuse or be unable to act as provided for in the agreement, then the person who is to act shall be such other suitably qualified person (e.g. a chartered accountant acceptable to all the members but failing agreement, an independent person nominated by an independent party, such as the president for the time being of the Cape Society of Chartered Accountants).

Interpretation

It should be stipulated in the agreement that if any conflict exist between the provisions of the agreement and articles, then the provisions of the agreement shall take precedence and shall be appropriately implemented between the parties. However, the agreement does not result in an alteration of the articles, for the articles can only be altered by special resolution in terms of section 62.[1]

The interpretation clause should contain a provision to the effect that the agreement shall be binding on and enforceable by the estates, heirs, executors, administrators, trustees, assigns, liquidators, curators or other legal representatives of the parties as fully and effectually as if they had signed the agreement in the first instance and that reference to any party shall be deemed to include all such persons or other legal representatives of the parties, as the case may be.

FOOTNOTES: CHAPTER I

[1] Quadrangle Investments (Pty) Ltd v Witind Holdings Ltd Ltd. 1975 (1) SA 572 (AD) at 581).

CHAPTER II

SHARE CAPITAL

Alterations of share capital

Subject to the provisions of section 56 and 102, a company having a share capital, if so authorised by its articles, may by special resolution alter its share capital and shares, e.g. by increasing its share capital or by increasing the number of its shares [1].

The increase of the share capital or the issue of additional shares will compel the members to take up the additional shares if they want to maintain their percentage of the shareholding in the company. Consequently, the shareholding of a member who cannot afford to take up the additional shares will be diluted.

Shareholders' agreement thus often contain a provision to the effect that the issued share capital of the company shall not be increased (whether by way of a rights issue or otherwise) nor shall any further shares be issued, without the written consent of all the members from time to time.

Division of shares

Where the members of the company constitute separate factions or groups of members each having some common interest different from those of the other groups, the issued shares of each group are grouped and identified separately (e.g. A shares and B shares) but on the basis that each group of shares ranks pari passu with the other subject to the articles. For the purposes of this dissertation, these shares are referred to as "grouped shares".

As will be seen from Chapter III, the advantage of grouped shares is that the holders of a particular group of shares can reserve the right to appoint a specific number of directors.

They can also enjoy pre-emptive rights of each other's shares without first having to offer their shares to the other members.

FOOTNOTES: CHAPTER II

[1] Section 75(1)

CHAPTER III

DIRECTORS

Appointment of directors

Every public company shall have at least two directors and every private company shall have at least one director. Until directors are appointed, every subscriber to the memorandum of a company shall be deemed for all purposes to be a director of the company.[1]

Subject to the provisions of the articles of any company, the number of directors of the company may be determined and the first directors may be appointed in writing by a majority of the subscribers to its memorandum [2].

At a general meeting of a company, a motion for the appointment of two or more persons as directors of the company by a single resolution shall not be moved, unless a resolution that it has been so moved has first been agreed to by the meeting without any vote being given against it. Subject to the provisions of section 214, a resolution moved in contravention of the aforegoing shall be void, whether or not its being so moved was objected to at the time, but if the resolution so moved is passed, no provision for the automatic reappointment of a retiring director in default of another shall apply [3].

The number of directors of the company and the appointment of the directors are usually contained in the articles [4].

Since the appointment of the directors is ordinarily decided by the majority, the members can grant the minority the right to appoint a specified number of directors. For example, the agreement could provide that the registered holder or holders for the time being of a specified percentage of all the issued shares in the capital of the company or a specified class of shares shall, in respect of such shareholding, be entitled to appoint one or a specified number of directors and one or more alternates to each such directors and to remove, replace or fill any vacancies in any one of those appointments.

Any appointment, removal or replacement in terms of such a provision usually required to be made by a written notice to the company, signed by the holder or holders exercising the right and shall be operative as soon as the notice is received at the registered office of the company or such other address as may be stipulated.

In the case of grouped shares, the registered holders of each class of shares usually have the right to appoint a specified number of the directors of the company. For example, where there are "A" and "B" shares, the agreement would provide that:

- the registered holders of the "A" shares shall be entitled to appoint one-half of the directors of the company (who would be known as the "A" directors) and one or more alternates to each of them and to remove, replace and fill any vacancies in any of those directors and alternate directors;

- the registered holders of the "B" shares shall be entitled to appoint the other half of the directors of the company (who would be known as the "B" directors) and one or more alternates to each of them and to remove, replace and fill any vacancies in any of those directors and alternate directors;

- any appointment or removal in terms of these provisions shall be made by written notice to the company signed by the registered holders for the time being of the issued "A" or "B" shares, as the case may be, or the registered holders of a majority thereof respectively, and shall similarly be operative as soon as any such written notice is received at the registered office of the company.

Removal of Directors

A company may, notwithstanding anything in its memorandum or articles or any agreement between it and any director, by resolution remove a director before the expiration of his period of office [5].

If the articles contain a power to remove a director, he may with impunity be removed before the expiration of his period of office unless there is an independant contract, express or implied, between himself and the company that he is to hold office for a specified period; and, in the absence of such an independent contract, if the articles do not contain such power, he may with impunity be removed in terms of such power obtained by alteration of

the articles [6]. Such a power contained in the articles is not derogated from by section 220[7]. Indeed, if the articles contain no such power, and are also silent as to the directors period of office, the company, in the absence of such independent contract, may remove him at any time [8].

In the fairly recent case of Del Fante v Delta Electrical [9], the Court was faced with a conflict between the articles of association and a shareholders' agreement regarding the removal/disqualification of a director: the articles provided for the disqualification of a director by a simple majority, while the agreement provided that for so long as persons in one of three identified groups of minority shareholders were the holders of no less than a specified percentage of all the issued shares in the capital of the company, such holders were entitled to appoint one director to the board, and remove, replace and fill in any vacancy in any such appointment. The agreement further provided that in the event of a conflict between its terms and those of the Articles, then the terms of the agreement would be binding.

The Court found the agreement to represent an endeavour to strike a balance of power between groups of shareholders and expressly qualified the operation of the principle of majoritarianism underlying the joint stock company and that to allow the articles to prevail in the circumstances would be to offend the intention of the parties evident in the agreement (especially in the light of the conflict provision mentioned above). The court also found section 220 to be inapplicable in the circumstances as it related to the removal of directors by the company, while the relevant provision in the articles related to their disqualification. Although the court's distinction between removal and disqualification may, with respect, be critisized as being somewhat semantic [10], the decision remains and section 220 should be applied with it in mind.

The company is not able to remove a director in terms of section 220 where in terms of an agreement binding the members and the director inter se, the members are precluded from voting for the resolution; such an agreement is valid and enforceable [11]. It makes no difference if the company is a party to such agreement so long as the part of it binding the members and the director inter se is severable from the part of it binding the company.

Where the rights of the holder or holders of a specific percentage of shares including the right to appoint a director is contained in a shareholders' agreement, it is usually provided that each such holders shall furthermore be entitled to appoint one alternate to each such director and to remove, replace and fill any vacancy in any such appointment as a director

or alternate director, by means of written notice to the Company. However, on the strength of the authorities cited above, it seems doubtful whether the company may remove a director under section 220 if such director is appointed in terms of a entrenched right to do so under the shareholders' agreement.

It is often stipulated in the agreement or the articles that notwithstanding any provision thereof or of any contract between the company and any director, a general meeting, by an ordinary resolution of which notice has been given in accordance with the provisions of the Act, may remove a director from office before the expiration of his period of office without prejudice to any claim which he may have against the company for damages for breach of any contract between himself and the company.

In the event of such a provision being inserted in the agreement or the articles, it should be stipulated that if the company in general meeting removes in terms of such provision any director appointed by a shareholder in terms of a clause entitling such shareholder to appoint a director or directors, then the vacancy so created shall be filled only in terms of that clause.

Disqualification of directors

Section 218 sets out the statutory grounds for the disqualifications of directors and section 219 deals with the disqualification of directors, officers and other persons by the court.

Any provision of a shareholders' agreement which attempts to detract from or limit the scope of section 218 or 219 cannot be valid or enforceable.

On the other hand, members can validly extend the grounds for the disqualification of any person from being appointed or acting as a director of the company but provided that such grounds are not contra bones mores. For example: the shareholders' agreement could stipulate that no person who, directly or indirectly, carries on or assists financially or otherwise is engaged or concerned or interested in any business, company or other entity which carries on any business which is similar to or in competition with the business of the company, shall be appointed as a director; or it could stipulate that a director who becomes secretly concerned in a contract with the company shall be disqualified.[12]

Powers of the directors

Subject to the Act, the powers of the directors are those conferred by the articles. Under article 60 of Table B, they have all the powers of the company except those which in terms of the Act or the other articles must be exercised by the company in general meeting.

The articles of a private company usually provide that the management of the business and the control of the company shall be vested in the directors who, in addition to and without limitation of the powers expressly conferred upon them by the Act or the articles, may exercise or delegate to any one or more persons and committees all such powers as may be exercised by the company and are not in terms of the Act required to be exercised by a general meeting.[13]

The articles of a private company often grant to the directors the right to raise or borrow such sums of money without limitation for the purposes of the company as they think fit and to secure the repayment of any sums of money so borrowed in such manner and upon such terms and conditions as they think fit. However, the minority may wish to limit all or certain of the specific powers of the directors, particularly their borrowing powers.

The powers of the directors can be controlled by stipulating that all matters at a meeting of the directors of the company shall be decided by a majority of votes except that a resolution of the directors in respect of certain specified matters shall not be passed or acted upon unless all the directors or one of the directors appointed by certain shareholders (e.g. the shareholders holding a specified percentage of the share capital, say 51%) vote in favour of such resolution. The matters in question can comprise the following:

- the entering into or the acquisition of any business otherwise than in the ordinary course of the company's business;

- the issue of any new shares (including any capitalisation or bonus shares);

- the borrowing of any monies from the company's shareholders or from any one else so as to result in the aggregate borrowings of the company (excluding amounts owing to the company's shareholders) exceeding a specified amount at any one time, e.g. Article 61 Table B: the amount is half the share capital (including share premium account if any).

- the giving of any security for any borrowings referred to above;

- the terms, conditions and making of a loan to any one, except the giving of credit facilities or making of loans to customers in the ordinary course of business or the making of loans (not exceeding a specific amount) to employees;

- the creation of or transfer to or from reserves;

- the purchase or sale of any assets, business (or part thereof) or shares otherwise than in the ordinary course of the company's business or the purchase or sale of any immovable property;

- the formation of a subsidiary otherwise than in the ordinary course of business;

- the giving of pensions, gratuities or allowances to any one otherwise than in terms of a fund which the company has established or joined;

- the remuneration or payment of travelling or other expenses of the directors and alternate directors in excess of a specified amount;

- share option schemes of any nature whatever;

- profit sharing arrangements with employees otherwise than in the ordinary course of business;

- any transaction of any nature whatever between the company and its shareholders or any one else associated directly or indirectly with the company or its shareholders, otherwise than a bona fide transaction in the ordinary course of the company's business;

- the incurring of any capital expenditure in excess of a specified amount in respect of any one transaction.

It is sometimes stipulated that if there is a dispute between the members and the directors as to whether or not the proposed resolution falls outside the ambit of any one or more of the matters referred to in the relevant clause, then that dispute shall be referred to and

decided by the auditors (acting as experts) whose determination shall be final and binding on all the members and directors.

Disposal of assets

Section 228 provides that notwithstanding anything to the contrary contained in its memorandum or articles, the directors of a company shall not have the power, save with the approval of a general meeting of the company, to dispose of -

- the whole or substantially the whole of the undertaking of the company; or

- the whole or the greater part of the assets of the company.

No resolution of the company approving of such disposition shall have the effect unless it authorises or ratifies the specific transaction.[14]

A company has no power to dispose of its undertaking or any of its assets otherwise than in furtherance of its objects.[15] A disposal which is not in furtherance of the company's objects is *ultra vires* the company. It is not intended by the words "Notwithstanding anything contained in its memorandum and articles" to alter this situation. The intention is merely to discount the operation of a provision in the memorandum or articles which purports to empower the directors to effect a disposal contemplated by this section without the approval of a general meeting or a provision which prohibits any such disposal by the directors. A disposal, therefore, which is not in furtherance of the company's objects remains *ultra vires* and void even if purportedly effected by the directors with the approval of a general meeting, subject, of course, to the operation of section 36.[16]

It is interesting to note that section 228 does not seem to include anything to the contrary contained in an agreement between the company and its members in regard to the disposal of the undertaking or greater part of the assets of the company. It is submitted that if the agreement authorises the directors to do so, they would be entitled to dispose of the whole of the assets of the company provided that it is in furtherance of the company's objects. However, it would be most unusual for the members to grant the directors such wide powers.

Meetings of directors

Sections 242 to 246 deal with the proceedings at meetings of directors, including the keeping of minutes of directors' meetings.

Meetings of directors and the quorum necessary for the transaction of the business of the directors is ordinarily contained in the articles.

The shareholders' agreement often contains a provision to the effect that there shall be no quorum at any meeting of directors of the company unless the representatives of the holder(s) are not less than a specified percentage of all the issued shares in the capital of the company are present at such meeting.

Where there are grouped shares, it will be usually specified that the quorum necessary for the transaction of the business of the directors will consist of directors from each group. For example, in the case of "A" and "B" shares, it will be stipulated that one-half of the quorum shall consist of "A" directors or their alternates and the other of the quorum shall consist of "B" directors or their alternates.

Where the agreement grants the holders of a specified percentage of the shareholding the right to appoint one or more directors, it is usually stipulated that each of the directors so appointed or any alternate to such director shall have a specified number of votes at any meeting of directors and that such votes shall be cast as such directors and who are at the meeting shall decide. The chairman of any meeting of directors usually does not have a casting or deciding vote in this instance as it would defeat the object of granting the right to appoint directors according to shareholding.

In the case of grouped shares, the provisions of the agreement will stipulate the number of votes of the directors appointed by each group. For example, in the case of "A" and "B" shares, it will be stipulated that:

- all the "A" directors present at any meeting of directors shall have one vote collectively between them and it shall be cast as the "A" directors who are at the meeting shall decide; and

- all the "B" directors present at any meeting of directors shall also have one vote collectively between them and it shall similarly be cast as the "B" directors who are at the meeting shall decide.

It is practice to record that a resolution in writing, signed by all the directors and entered into the minute book, shall be as valid and effective as if it were passed at a meeting of the directors duly convened and held, but usually such a provision is contained in the articles.

FOOTNOTES : CHAPTER III

[1] Section 208 (also Article 54 Table B)

[2] Section 209

[3] Section 210 and Schachat v Trans-Africa Credit & Savings Bank Limited 1963 (4) 523 (C)

[4] See Article 54 and 67 of Table B

[5] See Section 220 for the removal of directors and procedures in regard thereto

[6] Henochsberg 348; Southern Foundries (1926) Ltd v Shirlaw [1940] AC 701 (HL); [1940] 2 All ER 445; Read v Astoria Garage (Streatham) Ltd [1952] CH 627 (CA); [1952] 2 All ER 292; De Villiers v Jakobusdal Saltworks (Michaelis & De Villiers) (Pty) Ltd 1959 (3) SA 873 (O) at 874 - 875; 877- 879

[7] Sub-section (7)

[8] Appel v Sher 1950(2) SA 244 (W)

[9] 1992 (2) 221 (C)

[10] Commercial Law Digest Volume I Part I March 1992 at page 9

[11] Stewart v Schwab 1956 (4) SA 791 (T); Amoils v Fuel Transport (Pty) Ltd 1978 (4) SA 343 (W) at 347; Desai v Greyridge Investments (Pty) Limited 1974 (1) 509 (A) at 518; Henochsberg at 348

[12] In re The Bodega Company Limited [1904] 1 Ch 276

[13] Article 79 of Table B

[14] Section 228(2)

[15] Ridge Securities Ltd v IRC [1964] 1 All ER 275 (Ch)

[16] Henochsberg at 364

CHAPTER IV

POWERS OF THE MEMBERS

Powers of the members

By becoming a shareholder in a company a person undertakes by his contract to be bound by the decisions of the prescribed majority of shareholders, if those decisions on the affairs of the company are arrived at in accordance with the law, even where they adversely affect his own rights as a shareholder.[1]

Unless otherwise provided in the articles or any agreement between the company and its members, the members may use their powers as they think fit provided that the majority shareholders are obliged to use their powers bona fide for the benefit of the company as a whole.[2] Thus the loss of confidence in the manner in which they company's affairs are conducted or resentment at being outvoted or mere dissatisfaction with or disapproval of the conduct of the company's affairs, whether on grounds relating to policy or to efficiency, however well-founded, will not in themselves constitute prejudice, injustice or inequity within the meaning of section 252.[3]

The Act requires the following powers conferred thereunder to be approved by a special resolution of the members, viz:

- the change of the name of the company [4];
- the alteration of the memorandum of association of the company [5];
- the alteration of the articles of the company [6];
- the alteration of the share capital and the shares of the company [7];
- the variation of rights in respect of shares [8];

- voluntary winding-up of the company [9];
- investigation of company's affairs [10];
- share option plans where a director is interested [11];
- payments to directors for loss of office or in connection with arrangements and takeover schemes [12].

However, there are many transactions that the majority shareholders are entitled to approve with an ordinary resolution, including the disposal of the whole or substantially the whole of the undertaking of the company, subject, of course, to it being in the furtherance of the objects of the company [13].

In addition to these common law remedies, any member of any 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 conducted in a manner unfairly prejudicial, unjust or inequitable to him or to some part of the members of the company, may, subject to the provisions of section 52(2), make an application to the court for an order under section 252. However, the purpose of this dissertation is not to analysise or discuss the powers of the members or the members' remedies in the case of oppressive or unfairly prejudicial conduct.

Limitation of powers

The members may wish to limit the powers of the majority by providing that certain resolutions of the members shall not be valid or enforceable unless all the members or the holders of a specified percentage of all the issued shares in the company shall have voted in favour thereof.

The following are a number of typical instances were limitations can be imposed to protect the minority, viz.:

- the change in the principal business carried on by the company;
- the disposal of the whole or substantially the whole of the undertaking of the company;

- the disposal of the whole or the greater part of the assets of the company;

- the acquisition or disposal of any immovable property by the company;

- the suspension, cessation or abandonment by the company of its business or any substantial part thereof;

- the pledge, mortgage, hypothecation or encumbrance by the company of any of its assets;

- the issue by the company of any shares in its capital other than in accordance with the agreement;

- the incurring by the company of any liability or any obligation of any third party, whether contingently or otherwise;

- the appointment of any director other than the appointment of any director in terms of the agreement;

- the appointment of bankers, auditors or attorneys of the company;

- the borrowing of any money from any one other than the company's shareholders and the repayment terms of any borrowings of the company;

- the declaration and payment of any dividend to shareholders from time to time;

- the incurring of any capital expenditure in respect of any one transaction in excess of a specified amount or such greater amount as may from time to time be determined by the members;

- the repayment of loan accounts and the rate of interest payable in respect of loan accounts;

- the remuneration of the directors of the company for services rendered as directors from time to time.

It is submitted that these provisions will not preclude a member from exercising the remedies available under section 252 or 344 in the appropriate circumstances.

FOOTNOTES : CHAPTER IV

[1] Trollip JA in Sammel v The President Brand Gold Mining Co. Ltd 1969 (3) SA 629 (AD) at 678; Garden Province Investment the Aleph (Pty) Ltd 1979 (2) SA 525 (D) at 533- 535

[2] Gundelfinger v African Textile Manufacturers Ltd 1939 (AD) 314 at 324 - 325; Sammel case *supra* at 680 - 681; Garden Province case *supra* at 531 - 532

[3] Re Five Minute Car Wash Service Ltd (1966) 1 All ER 242 (CH) at 246 - 247; Garden Province case *supra* at 535

[4] Section 44(1)(a)

[5] Section 51(1)

[6] Section 62(1)

[7] Section 75(1)

[8] Section 102(1)

[9] Section 349

[10] Section 258

[11] Section 223

[12] Section 227

[13] Section 228

CHAPTER V

GENERAL MEETINGS

Calling of general meetings

The calling of general meetings of a company is generally governed by the articles, subject to the provisions of section 179 and 186 (1) relating to the annual general meeting. General meetings are ordinarily convened by the directors [1].

General meetings of a company may, subject to the provisions of its articles, be held from time to time. Any such meeting may, save insofar as is otherwise provided for in the articles of a company and without derogation from any other provisions of the Act, be called by two or more members holding not less than one-tenth of its issued share capital or, in the case of a company not having a share capital, by not less than five per cent in number of the members of the company [2].

The directors of a company shall, notwithstanding anything in its articles, on the requisition of one hundred members of the company or of members holding at the date of the lodging of the requisition not less than one-tenth of such of the capital of the company as at the date of the lodgement carries the right of voting at general meetings of the company, within 14 days of the lodging of the requisition, issue a notice to the members convening a general meeting of the company [3].

In private companies with a small number of members, the shareholders' agreement often grants the right to any member by notice to every other member and every other person entitled to attend a meeting of members, to call a general meeting for any purpose disclosed in the notice.

Quorum for general meetings

Unless the articles of a company provide for a greater number of members entitled to vote to constitute a quorum at meetings of a company, the quorum for such meeting shall, in the case of a private company, not being a private company having one member, be two members entitled to vote, present in person or by proxy or, if a member is a body corporate, represented. In the case of a wholly-owned subsidiary company, the representative of the holding company shall constitute a quorum [4].

The articles cannot effectively provide for a lesser number of members to constitute a quorum than the number stipulated under section 190. [5]

Shareholders' agreements often stipulate that the quorum for any meeting shall be a minimum percentage of the members (in number) present in person or represented by proxy with the condition that such member/s (present in person or proxy) hold/s in aggregate more than a specified percentage of the total voting rights of all the members. In this instance, the agreement stipulates that no resolution of the company shall be passed unless all the members present in person or by proxy holding an aggregate more than that percentage of the total voting rights of all the members of the company, shall have voted in favour thereof and that any resolution which is passed in breach thereof shall be of no force or effect.

In the case of grouped shares, it is usually stipulated that a quorum shall be a specified number of members present in person or duly represented at the meeting, one of whom shall be the holder of each group or class of share, e.g. one of whom shall be the holder of "A" shares and one of whom shall be the holder of "B" shares.

From a practical point of view, the agreement or the articles should provide that a resolution in writing, signed by all the members and entered in the minute book, shall be valid and effective as if it were passed at a meeting of the members duly convened and held [6].

Voting rights and voting

Section 193 provides that subject to the provisions of sections 194 and 195 and to the exceptions stated in section 196, every member of a company having a share capital shall have a right to vote at meetings of that company in respect of each share held by him. Every member of a company limited by guarantee shall, unless the articles otherwise provide, have the right to vote at meetings of that company and shall have one vote [7].

The effect of section 193(1) is that in relation to a company formed under the Act[8] and with regard to its members who hold ordinary shares[9] every member must have a right to vote at a general meeting in respect of each share held by him. This does not mean that he must have only one vote per share. It means that a right to vote must attach to each share, i.e. the valid issue of a non-voting share is impossible[10].

In terms of section 195 (2), the voting rights of a member of a private company shall, subject to the provisions of section 193(1), be determined by the articles of the company. This sub-section relates only to a private company and governs only to the determination of voting rights on a poll.

The articles of a company may provide for the chairman of any meeting to have a casting vote[11]. Article 44 of Table B accords the chairman a casting vote where there is an equality of votes on a poll or on a show of hands.

Where a private company has not adopted Table B, and its articles are silent as to whether or not the chairman has a casting vote but do not impliedly provide that it does not, he will have such a vote[12]. For this reason, the shareholders' agreement usually provide that in the event of an equality of votes, the chairman shall not have a second or casting vote.

In terms of section 195(4)(b), the articles may provide that the votes to which any member is entitled above a stated number are to increase, not in direct proportion to the number of shares held, but in some lower proportion, e.g. they may provide for one vote for every share held up to one hundred and, thereafter, one vote for every ten shares held. Where they do so, they may further provide that no member may have more votes than the said stated number or that any members' votes may not exceed a specified number. Table B does not contain such an article.

The provisions of section 193 (1) do not apply in respect of shares of a company which at the date of the commencement of the Act[13] had already been issued without voting rights, or in respect of issued shares (other than preference shares) in respect of which at that date there existed different voting rights or in respect of shares subsequently issued in respect of which there existed at that date a contractual right or obligation to issue any such shares. If any such company issues new shares, all the provisions of the Act as to voting rights shall, save as provided in section 196(1), apply in respect of such new shares, and, for the purposes of determining the voting rights attaching to such new shares as provided for in section 195, all its shares shall be deemed to have been issued with voting rights in accordance with the provisions of the Act [14].

Section 198 renders void any provision in a company's articles insofar as it would have the effect of excluding the right to demand a poll on any question other than: the election of the chairman of the meeting; or the adjournment of the meeting; or of making ineffective a demand for a poll by any five members having a right to vote at the meeting. Furthermore, articles cannot effectively deny a right to demand a poll to any member or members representing not less than one-tenth of the total voting rights of all members entitled to vote at the meeting (including e.g. preference shareholders entitled, by virtue of the provisions of section 194(1)(a) or (b) (or otherwise) to vote at the meeting) or to a member or members entitled to vote at the meeting who hold in aggregate at least one-tenth of the issued share capital[15].

It is submitted that any provision in a shareholders' agreement that purports to exclude the right to demand a poll in conflict with the provisions of section 198 would also be void.

Voting rights of preference shareholders

Section 194 (1) provides that notwithstanding the provisions of section 193(1), the articles of a company may provide that preference shares shall not confer the right to vote at meetings of the company except -

- during any period determined as provided in section 194 (2) during which any dividend or any part of any dividend on such shares or any redemption payment thereon remains in arrear and unpaid; or

- in regard to any resolution proposed which directly affects any of the rights attached to such shares or the interests of the holders thereof, including a resolution for the winding-up of the company or for the reduction of its capital.

The period referred to in section 194(1)(a) shall be a period commenced on a day specified in the articles of the company concerned, not being more than six months after the due date of the dividend or redemption payment in question, or, where no due date is specified, after the ending of the financial year of the company in respect of which such dividend accrued or such redemption payment became due.

Voting agreements

The manner of voting of the members depends on the articles of association. Unless a poll is demanded, voting at general meetings takes place on a show of hands. This means that each member present in person or by proxy is entitled to vote as only one vote irrespective of the number of shares held by him[16]. The representative of a body corporate is not regarded as a proxy and may therefore take part in a voting on a show of hands[17].

A person representing himself and one or more corporate bodies may nevertheless cast only one vote on a show of hands [18].

However, voting on a show of hands is merely a rough and inconclusive manner by which to gauge the opinion of the meeting. On a poll, each member or his proxy is entitled to exercise his full voting rights as determined by section 195. Usually the articles determine who may demand a poll but cannot exclude the right to demand a poll if it is made by at least five members entitled to vote at the meeting, by a member or members representing at least 10% of the total voting rights, or by a member or members entitled to vote at the meeting representing at least 10% of the issued share capital of the company[19]. Nevertheless the articles may for instance provide that the chairman or even a single member has the right to demand a poll. The instrument appointing a proxy is deemed to confer authority to demand a poll and a demand thus made must be treated as a demand by a member [20]. The articles may not exclude a members' right to demand a poll on any question other than the election of a chairman or the adjournment of the meeting [21].

A poll must be demanded immediately after the declaration by the chairman of the results of the voting on a show of hands. However, if the articles permit a poll may be demanded without taking a vote on a show of hands[22]. A poll must be taken in the manner[23] and as

such time [24] as the chairman directs. A poll demanded on the election of a chairman or on the question of adjournment of the meeting must be taken forthwith. The result of the poll is deemed to be the resolution of the meeting at which the poll was demanded. In the case of voting on a show of hands, the articles usually provide that the declaration of the chairman regarding the result of the voting and the entry of such declaration in the minute book are regarded as conclusive evidence of the fate of the relevant resolution [25].

Unlike company directors, members may enter into enforceable voting agreements [26]. It must, however, be borne in mind that shareholders' agreements are not binding on third parties.[27]

It is common in voting agreements to establish a "voting pool" in respect of shares owned by specific members or in respect of specific shares or groups of shares ("the pool shares").

Each pool member remains the beneficial and registered owner of his respective pool shares and is entitled to the dividends and other payments and benefits accruing thereon from time to time. However, a meeting of the pool members determines how the votes in respect of the pool shares shall be cast in respect of each resolution to be proposed at a general meeting of the company.

It is usually stipulated that at any meeting of the pool members each member shall have that number of votes that corresponds with the percentage of such members' interests in the pool shares. Each such member who is entitled to attend a meeting of pool members should be entitled to appoint a representative for such meeting and the appointment of a representative should be by way of a written notice handed in at the meeting of the pool members.

In certain instances, it is stipulated that unless a meeting of the pool members determines otherwise by resolution, the members appoint a named person (or such other person as may from time to time be nominated by one of the members) with power of substitution, as the lawful attorney and agent of the pool members, in their name, place and stead to vote in respect of the pool shares owned by them at any meeting of the company and to sign in their name and on behalf of them any general or special form of proxy required for the purposes of any such meeting.

The agreement should state the period for which the voting agreement shall remain in force and effect and whether it is binding on the specific members or includes their successors in title[28].

The voting agreement usually provides that if a holder of the pool shares is desirous of selling all or any of such shares, then the member shall be obliged to offer to the other pool members the number of shares which that member so wishes to sell by giving notice in writing thereof to them. The offer is required to state the number of shares which the member so wishes to sell and the purchase price of each share with the other pool members having an irrevocable option to purchase the shares within a prescribed period at the stipulated price and that if the other pool members fail to exercise the option within the prescribed period, the offeror shall be entitled for a specified period after the expiry of the prescribed option period to sell all or any of his pool shares to any third party provided that the offeror shall not sell the same at a price less than the price stated in the notice and/or on terms and conditions more favourable than stipulated in the notice.

It should, however, be stipulated that the provisions of the voting agreement do not preclude any member from purchasing pool shares from any other party or selling any shares which do not consist of pool shares. No pool member should however be permitted to sell and/or transfer all or any of his pool shares without the written consent of the other pool members, save as provided for in the agreement.

The parties to a voting agreement can compel a member to comply therewith. The agreement could provide that in the event of a failure to act in terms thereof, the defaulting member shall be obliged to offer all his shares to the other pool members at a specified value, e.g. at the auditor's valuation thereof.

However, there is a great difference in principle between the case of a shareholder binding himself by a voting agreement and a director of the company undertaking such obligations. The shareholder is dealing with his own property, and is entitled to consider merely his own interests, with regard to the interests of the other shareholders. But a director is in a fiduciary position and it is his duty to do what he considers will best serve the interests of the shareholders. If, therefore, he has bound himself by contract to do a certain thing, and thereafter have bona fide come tc the conclusion that it is not in the interests of the shareholders that he should carry out his undertakings, the court would not be justified in interfering with his discretion and compelling him to do what he honestly believes would be detrimental to the interests of the shareholders[29].

If a party to a voting agreement seeks to act contrary to the agreement, then the other parties will not be remediless and a decree of specific performance against the defaulting member would be the appropriate remedy[30].

FOOTNOTES : CHAPTER V

[1] Article 33 of Table B

[2] Section 180

[3] Section 181(1)

[4] Section 190

[5] Henochsberg at 297

[6] For more on the principle of unanimous consent, see Gohlke and Schneider *supra*).

[7] Section 193 (2)

[8] As to exceptions in the case of companies formed prior to the commencement of the Act, see section 196

[9] As to the voting rights of preference shares, see section 194

[10] Henochsberg at 301 - 302

[11] Section 195(4)(a)

[12] See section 59(2); Henochsberg at 306

[13] 19th June 1973

[14] Section 196(2)

[15] Henochsberg at 309

[16] In re Horbury Bridge Coal, Iron & Waggon Company (1879) 11 Ch D 109

[17] Hahlo's "S.A. Company Law Through the Cases" at 313

[18] Vrede Gold Exploration Company Limited v Lubner & Others 1973 (2) 331 (C)

[19] Section 198

[20] Section 198(2)

[21] See Section 198(1)(a)

[22] Article 42 Table B

[23] Article 43 Table B

[24] Article 45 Table B

[25] Article 42 Table B

[26] See generally Coronation Syndicate Ltd v Lilienfield and the New Fortuna Co. Ltd 1903 TS 489; Unity Investments v Johnson 1932 (CPD 275); Marting v Van Oordt, Russell & Co. (Pty) Ltd 1939 TPD 106; Northern Counties Securities Ltd v Jackson A Steeple Ltd (1947) 2 All ER 625; Stewart v Schwab case *supra*; Diner v Dublin 1962 (4) (36) (N); Flegg v McCarthy & Flegg 1942 (CPD 109); Adams v North 1933 CPD 100; Puddethate v Leith (1916 1 (CH 200); Swerdlow v Cohen 1977 (T) SA 1050 (T); Murray A Pickering 'Shareholders' Voting Rights and Company Control' (1965) 81 LQR 248; Peter G Xuereb 'Voting Rights: A Comparative Review' (1987) 8 *Company Law* 16; Peter G Xuereb *Rights of Shareholders* (1989); Stephen Kruger 'Corporate Voting Agreements and Restriction-of-Directors Agreements (1981) 10 *Anglo American LR* 73; Stephen Kruger 'Pooling Agreements' under English Company Law (1978) 94 LQR 557'; P Finn 'Shareholders Agreements' (1978) *Australian Business LR 97).*

[27] Scotmotors (Plant Hire) Ltd v Dundee Petrosea (1982) SLT 445; Greenhalgh v Mallard (1943) 2 All ER 234). See also Consolidated Crusher Holdings (Pty) Ltd v Plen 1968 (1) PH A2 (T) in regard to the obligation of a shareholder bound by a voting agreement to ensure that his successors comply therewith.

[28] Greenhalgh v Mallard *supra*

[29] Coronation Syndicate Ltd v Lilienfeld and The New Fortuna Co Ltd 1903 TS 489 at p 496 and 497 (Coronation Syndicate Limited *supra* at 496

[30] Unity Investment Company (Pty) Ltd v Johnson case *supra* at p286

CHAPTER VI

LOAN ACCOUNTS

Loans to the company

Unless otherwise provided in the articles or the conditions on which the shares are issued to a member, there is no obligation on a member to lend any monies to the company.

The Act contains no provisions restricting the right to transfer loan accounts. Unless the articles of any agreement between the members and the company provides to the contrary, a member is free to cede or pledge his loan account without the consent of the company or the other members subject always to the rule that no right can be ceded to more than one person without the consent of the debtor[1].

If there are no fixed terms for the repayment of a members' loan account, the member is entitled to require repayment of his loan account on demand. In the case of a private company (where the loan account is usually part of the member's equity in the company), a demand for repayment of a loan account could place a severe financial strain on the company and could bring about its liquidation.

Loan account provisions

Where the company is dependant upon finance from its members, the shareholders' agreement sometimes provides that each member shall lend and advance to the company on loan account a specific sum of money or a proportion of the capital requirements of the company from time to time as determined by the board of directors of the company, such proportion being the same proportion as exists between the number of shares in the capital of the company held by each such member and the total number of shares in the capital of the company held by all members.

In certain instances, where the intention is to obtain third party finance, the members agree that, if so required by the third party financier, they will bind themselves as sureties and

co-principal debtors for the obligations of the company in favour of such financier. In that instance, the members usually agree that should any of them be called upon to perform any financial obligation in terms of any such suretyship, each of them indemnifies the other so that each of the members shall not be liable to pay more than an amount proportionate to such member's shareholding in the company.

The difficulty that arises from these provisions is the remedy available to the members in the event of one of the members defaulting in their obligations to lend and advance the requisite funds or to indemnify the other members. The most effective solution is to provide that in the event of a member failing to perform its obligations within a specified period after receiving written notice to do so, the other members shall have an option to purchase the shares of the defaulting members at the fair market value of his shares as determined by the auditors[2].

For the reasons stated above, it is essential that the shareholders' agreement stipulates that subject only to the terms of any particular agreement relating to any loan to the company, no member shall as long as he is the registered or beneficial holder of any shares in the capital of the company be entitled to require repayment of any amount due to him by the company on loan account unless all the members shall agree thereto in writing.

In addition, the agreement should provide that any member entitled to transfer shares in the capital of the company in terms of the agreement may not sell or transfer a portion of, or his complete shareholding in the company, unless he simultaneously sells or transfers to the same person a pro rata proportion of his loan account, or his complete loan account against the company, as the case may be. The reason for this provision is to prevent a member from selling or transferring all his shares without his loan account to enable him to overcome a provision that no member shall as long as he is the holder of any shares be entitled to require repayment of his loan account.

It is often stipulated that should the company repay the loan account of the members in whole or in part that such repayments shall firstly be made towards the settlement of any amounts owing to the members in excess of the amounts proportionate to their shareholding in the company and only thereafter in payment of the amounts which are in proportion to their shareholding. In this instance, it is usually stipulated that if the company has surplus funds (as determined by the directors or the auditors), then such surplus funds shall be applied towards repayment of the excess loan account.

The excess loan account normally bears interest at a stipulated rate of interest (e.g. the prime rate) if so required by the members in order to give the member who lends the company funds in excess of an amount proportionate to his shareholding in the company, the right to interest thereon. The balance of the loan accounts of the members against the company, i.e. their entire loan accounts less the aforesaid excess loan accounts) normally bear interest at such rate as may be determined by the board of directors from time to time.

Subordination of loan accounts

The essence of a subordination agreement is that the enforceability of a debt, by agreement with a creditor to whom it is owed, is made dependant upon the solvency of the debtor and prior payment of its debts to other creditors.

Such agreements have traditionally been used in two main areas:

- where companies are technically insolvent in the sense that their liabilities exceed their assets, but are commercially solvent in the sense that they continue to pay their debts in the normal course as these fall due. To improve the company's balance sheet, the shareholders loan claims (the loan accounts) would be subordinated in favour of outside creditors;

- in the context of schemes of arrangement under Section 311 of the Companies Act where the persons proposing the scheme would acquire the claims of the creditors (the loan accounts) and thereafter subordinate these claims, preserving their existence for tax purposes and improving the company's balance sheet;

In the Witwatersrand Local Division of the Supreme Court[3], subordination agreements had been critisized and their validity disputed, resulting in a state of legal uncertainty in this area of the law. However, the Appellate Division has recently considered the matter[4] and clarified the issues as follows:

- Stegmann, J in the court *a quo* held that the liquidator of a company would not be entitled to have any regard to the terms of a subordination agreement because to do so would entail a rearrangement of the statutory ranking of claims. The Appellate Division, however, has pointed out that in the case of debt subordination, the creditor has no claim unless other creditors receive payment in full, and therefore there is no question of a rearrangement of the claims of the creditors who are to be paid out of

the unencumbered assets of the company. The liquidator of a company is thus obliged to have regard to the subordination agreement (if any) which was valid and enforceable as at the date of winding-up.

- Stegmann, J suggested a subordination agreement was inefficient as, if bilateral, it could at any time be cancelled by the parties thereto, i.e. the company and the creditor. The Appellate Division's attitude was that this would be a rare occurrence and in any event would only arise when such a cancellation had occurred.

Thus the Appellate Division has now clearly recognised that it is possible to utilise properly drafted subordination agreements in the conduct of honest business.

FOOTNOTES : CHAPTER VI

[1] Spies v Hansford & Hansford 1940 TPD 1; Lief NO v Dettmann 1964 (2) sa 252(A); Cullinan v Noordkaaplandse Aartappelkernmoerkwekers Ko-op Beperk 1972 (1) SA 761 (A)

[2] See Hahlo at 192 for commentary on such provisions and Chapter VIII in regard to the valuation of the shares by the auditors

[3] Ex parte De Villiers and Another NNO : in re: Carbon Developments (Pty) Limited (in liquidation) 1992 (2) SA 95 (W)

[4] Ex parte De Villiers and Another NNO : in re: Carbon Developments 1993 (1) SA 495(A)

CHAPTER VII

TRANSFER OF SHARES

Transfer of shares generally

A private company must restrict the right to transfer its shares[1].

In a private company, the provisions for restriction are ordinarily complemented by others empowering the directors to refuse to register a transfer without giving any reason for the refusal, according to existing members a right of pre-emption where any one of them intends to dispose of his shares and regulating the transfer or transmission of shares on death or insolvency [2].

The shareholders' agreement should provide that notwithstanding anything to the contrary contained in the articles, no member shall sell or transfer any shares or any interest therein other than in accordance with the agreement or with the consent of every other member of the company. This will prevent the directors from approving of the transfer of any shares other than in accordance with the agreement.

The agreement should stipulate that save as provided for in the agreement or the articles, no member shall be entitled to sell or transfer any shares or any interest in such shares or his loan account unless all the members agree thereto in writing.

It is essential that the agreement provides that no member shall be entitled to sell or transfer any shares in the capital of the company or any interest in such shares or his loan account against the company unless the purchaser or the transferee agrees in writing to become a party to the agreement and observe the terms and conditions thereof.

The agreement can confer on any particular person falling within a defined group or categories of persons or shareholders the right to freely transfer all or any of the shares in the company or his loan account to any other person falling within that group or category, but such provision must be subject to the requirement that the transferee agrees in writing to become a party to the agreement and observe the terms and conditions thereof.

The latter mentioned provisions are intended to permit a group or class of persons to transfer their shares to each other without the other members having a pre-emptive right thereto. For example, such a group often comprises:

- a particular member; and/or
- the spouse of that member; and/or
- any descendants of that member; and/or
- a trust provided that all the beneficiaries under such trust are persons falling within the categories provided for in the above categories of person above and/or any wife, husband, widow or widower of the descendants of that member;
- any company or close corporation provided that such company or close corporation is at all times controlled by persons falling within the categories provided for in the categories of persons.

Pre-emptive rights

Whilst the articles invariably regulate the transfer or transmission of shares, the pre-emptive rights of the members should be spelt out in the shareholders' agreement.

The pre-emptive clause usually provides that any member, including the estate of any member ("the selling member"), desiring to sell or transfer any shares shall be obliged to offer all his shares in, and all his loan account (if any) against the company (his equity) to the other members of the company by giving notice in writing thereof to each of the other members of the company[3].

The notice is usually required to state the purchase price and the terms as to payment thereof and the terms as to the provision of security (if any) for the payment thereof upon which the selling member is prepared to sell his equity. It is important to stipulate that the purchase price shall sound in money and be payable in South African currency otherwise the selling member could stipulate a consideration that excludes certain of the members from exercising their pre-emptive rights, e.g. a consideration payable in a foreign currency or by way of shares in a company in which its shares are not readily available to all the other shareholders.

In terms of the pre-emptive clause, the other members usually have an irrevocable option to purchase the selling member's equity for a specified period after receipt by them of the notice at the price and upon the terms and conditions set out in the notice and subject to the provisions thereof, and the option shall be exercisable by notice in writing given to the selling member at any time within the prescribed period [4].

Invariably, the clause provides that if a dispute arises at any time between the members as to the share of the selling members' equity to be acquired by them, then they shall each be entitled to acquire a proportion thereof; such proportion being the same proportion as exists between the number of shares in the capital of the company held by each such other member and the total number of shares in the capital of the company held by all such other members.

If only some of the other members desire to exercise the option in terms of the clause, then each of such member should be entitled and obliged to acquire a proportion of the selling members' equity; such proportion being the same as exists between the number of shares in the capital of the company held by each such member exercising the option and a total number of shares in the capital of the company held by all such members exercising the option[5].

If the other members fail to exercise the option within the prescribed period, then the selling member usually has the right to sell his equity to a third party[6]. However, this right should be limited to a specified period after the expiry of the option since the value of his equity could reduce as time passes or the interests of the other members could alter from time to time.

Furthermore, the selling member should not be entitled to sell his equity to any third party. For example, the selling member could ask an exorbitant price for his equity which the other members are not willing to pay for his equity but which a competitor of the company would be willing to pay in order to gain access to the company. On the other hand, the selling member must not be entitled to sell his equity at a price less than the price stated in the transfer notice and/or on terms and conditions more favourable than the terms and conditions stated in the transfer notice.

Consequently, the pre-emptive clause normally provides that if the other members fail to exercise the option within the prescribed period, then the selling member shall be entitled for a specified period after the expiration of the prescribed period to sell his equity to any third party provided that:

- the selling member shall not sell his equity at a price less than the price stated in the transfer notice and/or on terms or conditions more favourable than the terms and conditions stated in the transfer notice unless he first offers the same for sale to the other members in writing for a specified period at the price and/or on the terms and conditions which he is willing to accept therefor;

- the third party and the proposed transfer to that third party has been approved by the directors. It should be stipulated that the directors shall not be entitled to withhold their approval unless they have good and reasonable grounds for stating that the admission of that third party as a member of the company is not in the best interests of the company with the proviso that if the auditors certify that the purchase price stated in the transfer notice is not in their opinion an unreasonable purchase price for the selling members' equity, then the directors shall not be entitled to withhold their approval to the proposed transfer. The directors should be required to advise the selling members in writing of their decision within a stipulated period after receipt by the company of the transfer forms lodged or transfer to the third party and should be required, in the event of their approval being withheld, to state fully all their reasons therefor;

- if the selling member fails to sell his equity within the specified period, then if the selling member is still thereafter desirous to sell or transfer his equity, he shall be obliged to again comply with the provisions of the pre-emptive clause, i.e. he will be required to offer his equity again to the other members by giving notice in writing thereof stating the purchase price and the terms as to payment thereof.

The pre-emptive clause should provide that if the selling members' equity is sold pursuant to the provisions of that clause, the company shall be obliged to transfer any shares sold and if loan account is ceded to more than one person, the company agrees to a cession of parts of the loan account and to recognise the purchaser of its part of the loan account as the true creditor in respect thereof.

In the case of grouped shares or classes of shares, the provisions are similar except that if any holder of a group of shares desires to sell or transfer any shares, he shall first offer his shares and loan account to other members holding similar shares. For example, in the case of "A" and "B" shares, the position would be as follows:

- the "A" shareholder desiring to sell or transfer any shares shall likewise offer all his shares and all his loan account to the other members of the company by giving notice in writing thereof;

- the other "A" shareholders shall have the first option to purchase the selling member's equity for a specified period;

- if the other "A" shareholders do not exercise their right, the "B" shareholders shall for a specified period be entitled to purchase the selling member's equity upon the same terms and conditions as set out above;

- if the shareholders of the company fail to exercise their pre-emptive right, the selling member shall similarly be entitled to sell his equity to any third party provided that the selling member shall not sell his equity at a price less than the price stated in the transfer notice and/or on terms and conditions more favourable than the terms and conditions stated in the transfer notice unless he first offers the same for sale to the other "A" shareholders for a specified period and thereafter if the equity is not purchased by any or all of them, to the "B" shareholders for a further specified period, at the price and on the terms and conditions which he is willing to accept therefor;

- these provisions will apply mutatis mutandis if a "B" shareholder desires to sell or transfer any shares, on the basis that those shares shall first be offered to the other "B" shareholders and thereafter to the "A" shareholders in accordance with the abovementioned provisions.

Grandfather clause:

Where the beneficial members are natural persons who have a close relationship (e.g. a small domestic company), the members often do not want to admit a third party as a member of the company. However, the pre-emptive provisions described in the preceding paragraph will not afford the members of such a company a pre-emptive right if one of the beneficial members holding his shares through an entity, such as a company or close corporation, transfers or sells his shares in that entity thereby indirectly transferring the shares in the company.

The shareholders' agreement could stipulate that no person other than a natural person shall be entitled to hold shares in the company, but such a provision would not be practicable for various reasons. For example, some persons may wish to put their shares in a company for tax purposes or in a family trust for estate duty purposes.

The method of overcoming this difficulty is by means of inserting a provision commonly known as a "grandfather" clause. The intention of the provision is that should the natural person concerned or the natural persons falling within a defined group of persons cease to control the entity holding the shares, then that entity shall be deemed to have offered all its shares and all its loan accounts against the company to the other members, usually at a price equal to the fair market value of the equity as determined by the auditors[7].

The other members will have an irrevocable option to purchase the equity of the entity for a specified period after receipt of the auditors' valuation whereafter the option will lapse.

The difficulty lies in defining the term "control" in relation to the shareholding in the entity concerned.

The term "cease to control" could be defined as meaning that the natural person or group of natural persons concerned are not:

- the registered and/or beneficial owner of more than 50% of the equity share capital where the member is a company (and in this context "equity share capital" should have the meaning assigned to it under the Act);

- the registered and/or beneficial owner of more than 50% of the entire members' interests were the entity is a close corporation.

Where the member is a trust, the term "to cease to control" becomes far more difficult to define. The problem with identifying specific and natural persons as the persons who are required to maintain control is that if their shares in the entity concerned are transferred and other members do not exercise their pre-emptive rights under the grandfather clause, then the provisions will not be applicable to the subsequent shareholders.

Consequently, it might be possible to achieve the desired result by inserting instead a provision to the effect that save as otherwise provided for in the agreement, if at any time there is, directly or indirectly, a change in the control of any member which is a company or

a close corporation, or a material change in the beneficiaries of any member which is a trust, then such company, close corporation or trust, as the case may be shall be deemed to have offered all its shares and all its loan account against the company to the other members at a specified price (e.g. at the fair market value determined by the auditors) with the usual provisions relating to the exercise of pre-emptive rights.

For the purposes of such a general provision, the term:

- "change in control" in respect of any member which is a company, could be defined to include a change in shareholding in such a member as a result of which none of the shareholders of such company as at the date on which it became a member of the company is, either individually or together with any of such shareholders, the registered and/or beneficial owner of more than 50% of all the issued shares in the capital of the company or is able to control the composition of the board of directors of such company;

- "change in control" in respect of any member which is a close corporation, could be defined to include a change in membership of such close corporation as a result of which none of the members of such close corporation as at the date on which it became a member of the company is, either individually or together with any of such members, the registered and/or beneficial owners of more than 50% of the entire members' interests in such close corporation;

- "material change in beneficiaries" in respect of any member which is a trust, could be defined to include a change in the beneficiaries of such trust as a result of which none of the beneficiaries of such trust as at the date on which it became a member of the company is a bona fide beneficiary of such trust.

The grandfather clause should contain a general expression of intent to the effect that no shareholder should directly or indirectly do anything or refrain from doing anything which would defeat the pre-emptive right of the members which is intended to be safeguarded in terms of the clause.

FOOTNOTES: CHAPTER VII

[1] section 20

[2] Henochsberg at 33

[3] Article 21 Table B

[4] Article 22 Table B

[5] Article 22 Table B

[6] Article 24 Table B

[7] See Chapter VIII for the determination of the fair market value of the equity by the auditors

CHAPTER VIII

DEEMED OFFER OF SHARES

Circumstances for deemed offer:

There are situations where a member needs to be compelled to offer his shares to the other members.

For example, this situation would arise where a member who holds shares only by reason of his being an employee of the company, leaves the employ of the company. It may also arise where a key "partner" in a domestic company retires and it is necessary to take in another "partner" to replace the loss of the skill or expertise of the retiring member.

Procedure for deemed offer:

The deemed offer provision usually provides that upon the happening of the specified event (e.g. the member concerned ceasing to be an employee of the company for any reason whatsoever), then such member shall be deemed to have offered all his shares in and all his loan account against the company to the other members of the company.

As soon as possible after the happening of the event, the auditors should be required to prepare a valuation of the fair market value of the equity of the member as at such date and shall forward copies of the valuation to the other members.

The relevant clause should stipulate the guidelines for the auditors in determining the valuation. For example, the clause should stipulate whether the auditors shall:

- take into account any recent valuation by the members of the issued shares in the capital of the company;

- take into account the value of the goodwill of the company and the actual value of the assets of the company or merely their book value;

- take into account the fact that the shares of the selling member constitutes a majority or majority holding and/or the voting rights attaching to such shares by virtue of the agreement, and whether the auditors shall value the shares as constituting their pro rata share of all the issued shares in the capital of the company;

- take into account all such other facts relating to the business and affairs of the company as the auditors may consider necessary or desirable, including those which the auditors consider may be taken into account by a bona fide independent purchaser purchasing in an arms' length transaction.

It should be stipulated that the auditors shall, if so required by the selling member or the other members or their respective representatives, hear representations relevant to the determination of the valuation. The auditors should also be entitled to obtain such sworn or other valuation of the company's assets as may be necessary or desirable.

Since the sale of the selling member's shareholding is forced upon them, the selling member should not be bound by the auditors' valuation. The provisions therefore should provide that the auditors' valuation will only become binding if any member fails within a specified period after receipt of a valuation to exercise the right to refer the matter to arbitration pursuant to the arbitration provisions of the agreement [1].

FOOTNOTES: CHAPTER VIII

[1] See Chapter XII

CHAPTER IX

SALE OF ALL THE ISSUED SHARES

Statutory provisions:

Subject to the provisions of Chapter XII of the Act, there are no statutory provisions that entitle the members of the company to compel other members to sell their shareholding in the company.

There are often good reasons for a purchaser who is desirous of acquiring the business of the company to do so by purchasing all the issued shares in the capital of the company. Whilst the members holding the necessary voting rights have the power to pass a resolution to dispose of its business, such members do not have the power to compel the minority to sell their shares to the purchaser[1].

Come with, Go with provisions:

Accordingly, shareholders' agreements often contain what is commonly known as a "come with, go with" clause.

This clause stipulates that if at any time the members collectively holding not less than a specified percentage of all the issued shares in the capital of the company ("the willing members") receive an offer for all the issued shares in the capital of the company from a third party dealing bona fide and at arms' length which they wish to accept, then the following shall apply:

- the willing members shall forthwith and in writing furnish the other members of the company with full details of the offer;

- within a specified period after receipt of details of the offer, any other member shall be entitled to purchase from all the remaining members in the company their entire shareholding in the company at the same price and on the same terms and conditions mutatis mutandis contained in the offer. If more than one of the other members

desires to acquire all the shares in the company, then each of such other members shall be entitled to acquire a proportion thereof as agreed upon or failing agreement, such proportion as shall exist between the number of shares in the capital of the company held by each of such other members and the total number of shares in the capital of the company held by all such members.

- if none of the other members elect to purchase the shares, then all the other members shall be entitled and obliged to sell their entire shareholding in the company to the offeror at the same price and on the same terms and conditions contained in the offer mutatis mutandis and the willing members shall not accept the offer unless the offeror so purchases the shareholdings of the other members and at the same time procures that the company discharges all amounts owing on loan account to the other members;

- should any of the members acquire all the other shares of the members, pursuant to the provisions referred to in paragraph (b) above, then they shall procure that the company shall simultaneously discharge all amounts owing on loan account to the members so selling for which obligations they shall be liable jointly and severally.

In order to protect the minority shareholders from abuse of such provisions, particularly in the case of offers which entail a consideration not sounding in money (e.g. a restraint which only a specific member is able to offer) the "come with, go with" provisions should provide further that the above provision should only apply if:

- the third party is dealing bona fide and at arms' length;

- the purchase price sounds in money and is payable in South African currency;

- the offer only includes terms and conditions related to the purchase price, the payment thereof and the giving of security (if any) for such payment.

FOOTNOTES: CHAPTER IX

[1] Section 321 repealed by Act 78/89

CHAPTER X

DISTRIBUTION OF PROFITS

Distribution of profits generally

The Act itself makes no provision for the manner of declaration of a dividend or each payment or how profits distributable by way of dividend are to be determined.

The manner of declaration of a dividend is ordinarily regulated by the articles[1].

The language of the articles may be such that a right to payment of a dividend accrues merely upon the establishment of the fact that there are divisible profits[2] but ordinarily the accrual of such rights depends upon their being a declaration of a dividend[3].

Dividend policy

The members sometime adopt a dividend policy in an agreement in order to ensure that the distribution of profits are not entirely in the discretion of the majority.

This dividend policy usually takes the form of a provision to the effect that the members shall procure that the company declares and pays a dividend of not less than a specified percentage of the entire after tax profits of the company in respect of the fiscal period under review at a general meeting.

The dividend policy should be subject to the following stipulations:

- no distribution should be made to the extent that such distribution will prevent the company from paying its debts as the same become due in the ordinary course of business;

- the after tax profits for the fiscal period under review should, for the purposes of determining the dividend to be declared, be reduced by the accumulated loss (if any) brought forward from the preceding fiscal period compare [4];

- the amounts to be distributed from time to time shall be distributed to the members within a specified period after the end of the fiscal period under review.

The members may require a provision that the company shall not declare a dividend in respect of any fiscal period under review in excess of a specified percentage of the after tax profits of the company unless all the members or a specified percentage of the members agree thereto in writing.

To safeguard the minority shareholders, it is sometimes stipulated that the company shall exercise its borrowings in such manner that it does not thwart or prejudice the declaration of a dividend to the members in terms of the dividend policy.

The agreement usually provides that in the event of any dispute arising in regard to the dividend policy, such dispute shall be determined by the auditors whose determination shall be final and binding on the company and its members. This remedy enables disputes to be resolved in an expeditious and practical manner.

FOOTNOTES : CHAPTER X

[1] See Cilliers and Benade 408 - 410; Articles 84 - 90 of Table B;

[2] Pennington 306

[3] Boyd v CIR 1951 (3) SA 534; Cohen v Segal 1970 (3) SA 702 (W) at 705;

[4] Ammonia Soda Co. v Chamberlain (1918) 1 Ch 266

CHAPTER XI

DEADLOCK

Deadlock generally

The articles generally provide that the management of the business of the company shall vest in directors[1].

Where for any reason the company lacks an effective board of directors (i.e. where they have all resigned or are deadlocked or a quorum of directors cannot be obtained) the general meeting has inherent power to exercise the powers vested by the articles in the directors [2]. The inherent power of the general meeting also enables it to ratify an act intra vires with the company but ultra vires the directors[3].

However, difficulties will arise where the directors and the members are deadlocked or at meetings of either of them, quorum cannot be obtained. It is submitted that this situation cannot fall within the ambit of section 252 and therefore no member could seek relief from the court under that section in the event of a bona fide deadlock.

In the case of a domestic company (i.e. a company with a small membership) winding up would be just and equitable under section 344(h) where one or more of the members destroy the relationship that ought to exist between the members of such a company. The destruction of the relationship often results in a deadlock, e.g. where the factions hold equal voting power in general meeting, in which event winding-up must ordinarily inevitably ensue[4].

Resolution of deadlock

Shareholders' agreements sometimes contain a provision dealing with deadlocks between the directors or the members of the company.

Such a provision usually provides that should there be any deadlock at any meeting of directors or it is not possible to obtain a quorum for a meeting of directors or a quorum at any meetings of directors be broken, then any director or alternate director shall be entitled by written notice to the company within a specified period after the meeting of the date upon which it should have been held, to require that the matters which were under discussion and were to be discussed at that meeting shall be submitted to and decided by the company in general meeting.

Such a provision should provide that should there be any deadlock at any general meeting or it is not possible to obtain a quorum for a meeting of directors or a quorum at any meeting of directors be broken, then any member shall be entitled by written notice to the company in a specified period after the meeting or the date upon the meeting should have been held, to require that the matters which were under discussion and were to be discussed at that meeting shall be submitted to and decided by arbitration[5]. This provision should provide that copies of any written notice given in terms thereof should be sent forthwith by the company to all directors, alternate directors and members and, possibly, to the auditors, particularly where the deadlock relates to an accounting issue.

It is submitted that the deadlock provisions will not deprive a member of a "domestic" company of the right to apply for the winding-up of the company on the grounds that would be just and equitable to do so in the appropriate circumstances, e.g. where the destruction in the relationship of the members results in a literal deadlock.

Furthermore, it is submitted that the deadlock provisions are not always appropriate in certain instances. The decision of an arbitrator can sometimes lead to dissatisfaction amongst the members which may affect the relationship between them and the decision may be prejudicial to a section of members. However, the aggrieved members will be bound by the decision of the arbitrator unless there are grounds to set aside or review the decision [6].

For the same reason that the courts have not been willing to make business decisions for companies, an arbitrator cannot make decisions for the members particularly where there is a deadlock in regard to the question of a business principle in issue which is neither a question of fact or law, e.g. whether or not to make a particular investment.

Shareholders should therefore consider carefully whether they should incorporate deadlock provisions in their agreement or whether the extent of such deadlock provisions should be limited to specific circumstances.

Some members may, for perfectly sound reasons, not want their capital to be invested in a particular investment but this could be forced against their will as a result of the decision of the arbitrator.

The suitability and the nature of the arbitrator to be appointed is an important aspect which will be dealt with in Chapter XII relating to arbitration.

FOOTNOTES : CHAPTER XI

[1] Article 60 of Table B

[2] Barron v Potter [1914] 1 CH 895 at 903; Alexander Ward & Co. Ltd v The Samyang Navigation Co. Ltd [1975] 2 All ER 424 (HL) at 428/429, 433)

[3] Gundelfinger v African Textile Manufacturers Ltd (supra) at 316 and see rest of authorities Henochsberg foot of page 273

[4] Ammonia Soda Co. v Chamberlain (1918) 1 CH 266 In re Yenidje Tobacco Co. Ltd [1916] 2 Ch 426 (CA) at 435; Ammonia Soda Co. v Chamberlain (1918) 1 Ch 266 Moosa v Mavjee Bhawau (Pty) Ltd. 1967 (3) SA 131 (T) at 137 - 138

[5] See Chapter XII for arbitration provisions

[6] See also Chapter XII relating to revision of appeals against an arbitrator's decision

CHAPTER XII

RESOLUTION OF DISPUTES

Arbitration generally

Arbitration is the process by which parties to a dispute are, with the approval and encouragement of the law, enabled to take and abide by the judgment of a selected person or persons instead of carrying the dispute, in the ordinary course, to the established courts of justice[1].

According to Voet, the reasons for resorting to arbitration were to avoid the heavier expenses of litigation, the din and strife of the courts, the laws' delay and the anxiety caused by the uncertainty of the result [2].

The main motivating factors for members to resort to arbitration are that the proceedings are private and the mechanism should result in a speedy resolution of the dispute instead of having a lingering court case that sometimes results in a breakdown in the relationship between the members to the detriment of the company. As arbitration is sometimes not particularly suited to resolving all disputes relating to the affairs of a company, shareholders' agreements do not always contain arbitration clauses.

In my view, arbitration is not suitable to resolving disputes relating to business decisions of the directors for the same reasons that the courts have been reluctant to become involved in making business decisions[3].

It is submitted that if an arbitration clause is contained in the shareholders' agreement, it should expressly not be applicable to business decisions and should perhaps provide that if there is a deadlock between the directors in regard to a business or policy decision which cannot be resolved by the company in general meeting or there is a deadlock at a general meeting in regard to such issues, the issue in question must be dropped.

However, arbitration is particularly suited in technical matters where the arbitrator himself has technical knowledge of the issue in dispute, such as the valuation of shares. Where the auditor is best qualified to determine the dispute, it is customary for the agreement to provide that the auditor shall determine such disputes. In such instances, there should be the right to refer an objection to the auditors' decision to arbitration in order to avoid that the aggrieved party feels that the auditor is more partial towards the other parties, e.g. where the other parties are the controlling shareholders or where the aggrieved party is about to cease to be a member of the company by reason of the sale or deemed sale of the shares.

Insofar as expense is concerned, it must borne in mind that the arbitrator receives remuneration for his services, but particularly in technical matters where the arbitrator himself has technical knowledge, this expense may well be more than offset by the saving incurred by not having to explain technical details and to call expert evidence[4].

The Arbitration Act No 42 of 1965 (as amended) was promulgated "to provide for the settlement of disputes by arbitration tribunal in terms of written arbitration agreements and for the enforcement of the awards of such arbitration tribunals"[5].

Many provisions of the Arbitration Act may be excluded or varied by agreement and indeed arbitration proceedings may be still be governed by the common law[6] but in general arbitration proceedings fall under the provisions of the Arbitration Act, 1965.

Mediation

Mediation, in its widest sense, is a voluntary procedure whereby a mutually acceptable third party helps to bring the parties to a dispute to an agreed solution[7]. The mediator may or may not be expected to give a non-binding opinion if he fails to guide the parties to an agreed solution.

In more detail, mediation differs from arbitration in the following respects:

- the mediator may meet and confer with the parties separately, whereas the arbitrator must scrupulously avoid giving the impression that he may be discussing the dispute with the one party in the absence of the other.

- the mediator may attempt to guide the parties to solution based on their present and future interests, whereas the arbitrator has to make his award based on the parties substantive legal rights determined with reference to what occurred in the past.

- the mediator should give cogent reasoning for his opinion if it is to persuade a recalcitrant party to alter his position, while the arbitrator is not required to give reasons unless the arbitration agreement provides otherwise.

- in mediation, disputants have control over both the procedure and the outcome, in that the mediator's opinion is not binding. In arbitration, the parties may regulate the procedure in their agreement, but agree to accept the arbitrator's award as binding and final.

- no record is usually kept of the negotiations before a mediator, while an arbitrator is bound by the Arbitration Act either to record oral evidence, or, subject to the arbitration agreement and after consultation with the parties, to direct how oral evidence is to be recorded.

- in mediation, the costs thereof are usually apportioned equally between the parties, while the party who achieves substantial success in arbitration is usually entitled to be awarded costs.

Mediation deserves serious consideration as a means of settling a dispute, particularly because it is quicker and less expensive than arbitration or litigation. However, "no-one ever agreed to settle a dispute if they thought there was a more profitable alternative, whether that alternative was slogging it out in the hope of victory or dragging their feet in the hope that the disputes would go away"[8].

Arbitration provisions

The arbitration clause normally provides that save as otherwise provided for in the agreement (e.g. where the auditor determines the issue in dispute), any dispute, question or difference arising at any time between the parties to the agreement out of in regard to any matters arising out of, or the rights and duties of any of the parties thereto, or the interpretation of, or the termination of, or any matter arising out the termination of, or the rectification of the agreement, shall be submitted to and decided by arbitration on written notice given by either party to the other of them in terms of the clause.

The clause should state where the arbitration is to be held and whether the provisions of the Arbitration Act are applicable thereto. It should stipulate a venue where it is most practicable for the arbitration, such as a place near the principal place of business of the company where its books and records are kept.

It is customary for the arbitration provisions to state that the arbitration shall be informal and that the arbitrator shall have the absolute discretion to determine the procedure to be adopted, it being the intention that, if possible, the arbitration should be held and concluded within a specified period after it has been demanded.

The selection of the person to be appointed as the arbitrator is most important. It is customary to stipulate that the arbitrator shall be, if the question in dispute is:

- primarily an accounting matter, an independent and suitably qualified chartered accountant of not less than a specified number of year experience;

- primarily a legal matter, a senior counsel or attorney of not less than a specified number of years experience;

- any other matter or technical issue, an independent and suitably qualified person.

If the parties are unable to agree upon the arbitrator, the court will appoint the arbitrator[9]. In order to avoid the delay of having to apply to court for the appointment of an arbitrator, the arbitration clause should provide that if the parties are unable to agree in regard thereto, the arbitrator should be appointed by a named person (e.g. the company's auditor) or by an independent person, such as the President for the time being of the Law Society of the Cape of Good Hope or the Chairman for the time being of the Cape Bar Council.

Unless a contrary intention is expressed in an arbitration clause, the reference shall be to a single arbitrator [10]. The award of the arbitrator is final and binding and not subject to appeal[11] and may, on application to court by any party to the arbitration, be made an order of court[12].

However, the award may only be set aside under limited circumstances provided for under section 33(1) of the Arbitration Act.

As the award of the arbitrator is final and binding and not subject to appeal[13] except under specified circumstances[14], the parties sometimes provide that the dispute shall be referred

to an arbitration tribunal consisting of three persons, one to be appointed by each of the parties and a third who shall be the President of the arbitration tribunal who shall be appointed by the two arbitrators appointed by the parties. The majority position will be the decision of the tribunal.

It must borne in mind, however, that the reference of a dispute to an arbitration tribunal consisting of three persons will be extremely costly and should be limited to extremely material issues that warrant the expenditure. An alternative to such an arbitration tribunal would be to appoint a single arbitrator with a right of appeal to a named appeal tribunal, such as a senior counsel or retired judge appointed by the President for the time being of the Bar Council. Such an appeal would be fairly inexpensive in that it would not involve the rehearing of the arbitration but will merely involve the argument of the appeal before the appeal tribunal based on the record of the arbitration as in the case of appeals to court.

The arbitration clause normally provides that it constitutes the irrevocable consent of each party to the arbitration proceedings and that no party shall be entitled to withdraw therefrom or to claim at such arbitration proceedings that it is not bound by the clause. It also stipulates that each of the parties irrevocably agrees that the decision of the arbitrator or the arbitration tribunal in the arbitration proceedings shall, in the absence of the right to appeal, be final and binding on each of them and will be carried into effect and shall be capable of being made an order of the court to whose jurisdiction the parties are subject.

As a precaution, it should be stipulated that the clause is separate and severable from the rest of the agreement and shall remain in force notwithstanding the expiration or termination of the agreement for any reason whatsoever[15].

Since the arbitration clause should not bar any party from seeking urgent or interim relief from the court, the provisions should stipulate that nothing in the clause shall preclude any court whose jurisdiction the parties are subject from granting any interim interdict or interim relief pending the determination of any dispute in terms thereof.

In terms of Section 6 of the Arbitration Act, if any party to an arbitration agreement commences any legal proceedings in any court, any party to the proceedings may at any time after entering appearance but before delivering any pleadings or taking any steps in the proceedings, apply to the court for a stay of such proceedings. However, the court has a discretion whether or not to stay proceedings, but it would generally do so once it is satisfied that the dispute falls within the ambit of the arbitration agreement. [16].

It is submitted that the existence of an arbitration agreement will not deprive a member of his remedy to make an application to the court for an order under section 252 of the Companies Act in the case of oppressive or unfairly prejudicial conduct. It is my view too that it would not exclude an application by a member to court for the winding-up of the company in terms of section 344 of the Companies Act, as read with section 346 (1)(c).

FOOTNOTES: CHAPTER XII

[1] Wille and Millin at 521 ; See also Halsbury Vol. II at 255; Russell at 1

[2] Voet 4.8.1 as translated by Percival Gane

[3] See Pennington at Ch. 16 (648 ff); Foss v Harbottle *supra*

[4] See Chaffer and Tassi v Richards (1905) 26 N.L.R. 207; Mediterranean and Eastern Export Co. Ltd. v Fortress Fabrics (Manchester) Ltd. [1948] 2 All ER 186 at 188

[55] Preamble to the Act

[6] See Nkuke v Kindi 1912 CPD 529

[7] See DW Butler "Legal Aspects of Mediation in the South African Construction Industry" (unpublished lecture for Western Cape Branch of the Association of Arbitrators at Cape Town on 22nd September 1992) and compare Anstey "Negotiating Conflict" Juta 1991 at 249

[8] Donaldson "Alternative Dispute Resolution" (1992) 58 JCI A RB 102 at 104.

[9] Section 12(1)(a) of the Arbitration Act

[10] Section 9 Arbitration Act; cf Dipenta Africa Construction (Pty) Limited v Cape Provincial Administration 1973 (1) 666 (C) 667

[11] Section 28 of the Arbitration Act

[12] Section 31(1) of the Arbitration Act

[13] Section 28

[14] Section 33(1) of the Arbitration Act

[15] See Mackenzie at 118 note 36; Scriven Bros. v Rhodesian Hides & Produce Co. Limited & Others 1943 AD 393

[16] MacKenzie at 118 note 36; Netherlands South African Railway Co. v The New Primrose Gold Mining Company 4 or 111; Daniel & Co. v Siebert & Van Eeden 9 SC 31; Mossop v Frater 1917 CPD 403; Smith Brothers v Henen 1929 EDL 371; Bloomberg v S A Sporting Publications (Pty) Limited 1942 WLD 77; Stanhope v Combined Holdings & Industries Ltd. 1950 (3) 52 (E); Elebelle (Pty) Limited v Szynkaski 1966 (1) 592 (W).

CHAPTER XIII

CONFIDENTIALITY AND RESTRAINT

Duties of directors and members generally

It is not within the scope of this dissertation to deal with the directors' fiduciary duties or the duties of the members of the company. It is intended only to deal with those aspects that are normally covered under shareholders' agreements.

Unless the articles provide otherwise, and subject to any contract between them *dehors* the articles, a director of a company is not precluded from becoming a director, officer or employee of a rival company or from carrying on business in competition with the company[1] except whereby doing so he would place himself in a situation of conflict of interest and duty[2].

Where a director is also an employee of the company, he may, depending on the circumstances, also act in breach of the duty not to use for his own purposes or disclose confidential information, a duty which subsists even after his employment has ceased [3]. In many instances, it is often difficult to detect or prove a breach by a director of his fiduciary duties. For example, a director could improperly compete with the company without the knowledge of each other members by competing through a rival company of which he is not a director and which his shares are held by a nominee. Furthermore, where a director resigns or ceases to be an employee of the company, it is often difficult to prove that he misappropriated corporate opportunities whilst being a director.

However, the members do not have fiduciary duties to the company but the majority shareholders are obliged to use their powers bona fide for the benefit of the company as a whole[4]. The members of course have remedies for relief from oppression under section 252 or for a winding-up under section 344 where it is just and equitable to do so.

The members per se are not under any duty to acquire economic opportunities for the company nor do they have a duty not to compete with the company. A member is also entitled to have a personal interest which conflicts with the interests of the company.

Members are nevertheless subject to the principles of unlawful trading and unfair competition. [5].

It must be borne in mind that in private companies (particularly small domestic companies), the members become exposed to far more confidential information relating to the affairs of the company than in the case of a public company where such information is limited to the directors. Members of private company therefore legislate for the difficulties set above by inserting provisions in their shareholders' agreement relating to confidentiality and placing restraints on certain or all of their members in order to avoid any anomaly or uncertainties particular after a member has left the company.

Confidentiality and Restraint provisions

The shareholders' agreement will often provide that each member shall undertake to the company that:

- he shall not during his employment by the company or at any time thereafter, either himself utilise and/or directly or indirectly divulge and/or disclose to any third party (except as required by the terms and nature of such member's employment with the company) any of the company's trade secrets (which for the purpose hereof means the company's goodwill, technical and business knowhow, trade secrets, confidential information and the company's intangible assets in general);

- he shall treat as confidential all trade secrets which a third party has in terms of any contract made available to the company and which has become known to such member in the course of his duties as director and/or employee of the company, and not to divulge to other third parties any information regarding such trade secrets contrary to the terms of the aforesaid contract;

- any documents or records relating to the trade secrets of the company which are made by the member or which come into the member's possession during the period of his employment with the company, shall be deemed to be the property of the company and shall be surrendered to the company on demand, and in any event, on the termination of the member's employment with the company and the member will not retain any copies thereof or extracts therefrom;

- he shall not, within a period of specified years of the termination date (the date upon which such member ceases to be an employee or director of the company for

whatsoever reason, whichever is the last to occur) and within the specified territory, directly or indirectly offer employment or cause to be employed any person who was employed by the company as at the termination date or at any time within a specified period of years immediately preceding the termination date;

- he shall not directly or indirectly be employed by, carry on or assist financially or otherwise be engaged or concerned or interested in, or act as consultant or advisor to, or act as agent or representative for, any person or firm or body corporate or incorporate which within the specified territory carries on any business which is similar to or in competition with such business as the company may be carrying on at the termination date, whether or not such business is being carried on by the company as at the date of execution hereof.

The agreement may further provide that the restraints imposed upon each such member in terms of the above clauses shall be deemed in respect of each part thereof to be severable and separately enforceable in the widest sense from the other parts thereof and invalidity or unenforceability of any clause or part thereof shall not in any way affect the validity or enforceability of any other part of the clause or the agreement.

The agreement may also expressly provide that the restraint imposed on each such member shall not preclude that member from holding by way of bona fide investments any shares, stocks, debentures, debenture stock or other securities of any companies which are quoted and dealt with on any registered stock exchange; provided, however, that such holding (which shall include any interest in any such holding), when added to any holdings of any relative of each such member, does not exceed a specified percentage of the total shares, stock, debentures, debenture stock or other securities in issue of the class in question; and provided always that nothing in this clause should permit any such member from directly or indirectly being actively engaged or concerned or interested in any way in the affairs or management of any such public company;

Some shareholders' agreements provide in addition that each such member acknowledges that he has carefully considered the restraint provisions and agrees that the provisions are, after taking all relevant circumstances into account, reasonable and that if he should at any time dispute the reasonableness of the provisions, then the onus of proving such unreasonableness shall be upon him;

The law relating to the enforceability of restraint of trade agreements has been settled by the Appellate Division, in the sense that where a party seeks to avoid being bound by a

restrictive condition to which he has agreed, he bears the onus of proving that enforcement thereof would be contrary to public policy[6].

In determining the enforceability of a restraint, a court will have regard to two considerations: firstly, that public interest requires, in general, that parties should comply with contractual obligations even if these are unreasonable or unfair; and secondly, that all persons should, in the interests of society, be permitted as far as possible to engage in commerce or the professions or, put differently, that it is detrimental to society if an unreasonable fetter is placed on a person's freedom of trade or to pursue their profession. In applying these considerations, the court will obviously have regard to the circumstances of the case before it. In general, however, it will be contrary to the public interest to enforce an unreasonable restriction on a person's freedom to trade [7].

Moreover, reasonableness is not established by the mere inclusion of a provision whereby a member expressly acknowledges the restraint as reasonable[8].

FOOTNOTES : CHAPTER VIII

[1] Bell v Lever Brothers Ltd. [1932] AC 161 HL at 195; Robinson v Randfontein Estates Gold Mining Co. Ltd. 1921 AD 168 at 216

[2] Atlas Organic Fertilizers (Pty) Ltd. v Pikkewyn Ghwano (Pty) Ltd. 1982 (2) SA 173 (T) at 198

[3] See Atlas Organic Fertilizers (Pty) Ltd. v Pikkewyn Ghwano (Pty) Ltd. case *supra* at 198; Multi Assistants (Pty) Ltd. v Ponting 1984 (3) SA 102 (D); Faccendie Chicken Ltd. v Fowler [1986] 1 All ER 617 (CA); Dowson & Mason Ltd. v Potter [1986] 2 All ER 418 (CA).

[4] Gundelfinger v African Textile Manufacturers Ltd. case *supra* at 324-325; Sammel Case *supra* at 680 - 681; Gardens Province case *supra* at 521 - 522

[5] See Atlas Organic Fertilizers (Pty) Limited v Pikkewyn Ghwano (Pty) Limited case *supra*; S.J. Naude "Competition in Law S.A." Vol. II 484 - 515

[6] Magna Alloys and Research (S.A.) (Pty) Limited v Ellis 1984 (4) 874 (A)

[7] See Sunshine Records (Pty) Limited v Frohling and Others 1990 (4) 782 (A) at 794

[8] See dictum In David Wehl (Pty) Limited and Others v Badler and Another 1984 (3) 427 (W). Relying on that dictum, the court in Bonnet v Schofield 1989 (2) 156 (D), "attached very little significance" to the contents of such a clause (at 160).

CHAPTER XIV

GENERAL PROVISIONS

General provisions

The shareholders' agreement usually contains general or ancillary provisions relating thereto, including those ancillary provisions that are included in most commercial contracts today. I shall deal with hereunder those provisions that are generally contained in shareholders' agreements.

The auditors

As stated earlier on in this work, the auditors of the company can play a vital role as between the members and the company, particularly in regard to issues within their personal knowledge and expertise, such as the valuation of shares, etc.

If the auditor has the confidence of the members and acts in an impartial manner, he has a valuable role to play in the affairs of the company and can often resolve disagreements between the members that could cause a breakdown in the relationship and could be potentially harmful to the company.

Shareholders' agreements often contain the following provisions for the benefit and protection of the auditors, viz.:

- whenever the auditors act in terms of the agreement, they shall act as experts and not as arbitrators and their decision, determinations and certificates shall be final and binding on the parties thereby subject only to the arbitration provisions, if any;

- the parties waive and abandon all and claims which all or any of them may have against the auditors arising out of any decision, determination made or certificate given in good faith by the auditors pursuant to the provisions of the agreement;

- the provisions constitute a stipulatio alteri in favour of the auditors.

Co-operation

The agreement often contains a general co-operation clause in terms of which each of the parties undertake to do all such things and to pass or procure the passing of all such resolutions to the extent that these may lie within the power of such party and may be required to give effect to the import or intent of the agreement or any contract concluded pursuant to the provisions thereof.

It is common for a clause to be inserted to the effect that in the implementation of the agreement, the parties undertake to observe the utmost good faith and warrant in their dealings with each that they shall neither do anything nor refrain from doing anything which might prejudice or detract from the right, assets or interests of any of them.

Notices and domicilia

The clause dealing with the service of notices and the domicilia citandi et executandi of the parties are particularly important because of the various provisions relating to the giving of notices and time limits for the exercise of certain rights, e.g. the exercise of pre-emptive rights.

The agreement should therefore contain a provision in terms of which the parties choose domicilia citandi et executandi for all purposes under the agreement at specified addresses. In the case of the company, this address should be its registered office for the time being or a specified address such as its principal place of business.

In the case of the members, the address appointed by them should be a specified address or their registered address for the time being as reflected in the share register of the company. This address should be a physical address which is within the Republic of South Africa in order to facilitate the giving of notice and the delivery thereof.

It is often stipulated that any notice to any party shall be addressed to him at his domicilium as set out in the agreement and either be sent by prepaid registered post or be delivered by hand. It is sometimes stipulated that in the case of any notice:

- sent by prepaid registered post, it shall be deemed to have been received, unless the contrary is proved, within a specified period after posting; or

- delivered by hand, and shall be deemed to have been received, unless the contrary is proved, on the date of delivery provided that such date is a business day or otherwise on the next following business day.

Each party should be entitled by notice in writing to the other to change his domicilium to any other address and provided that such address is within a specified area (e.g. within the Republic of South Africa) and is not a post office box or post restante for the reasons stated above.

Ancillary provisions

All agreements should contain the standard provisions contained in agreements of this nature, these being the following:

- no alteration, cancellation, variation of or addition to the agreement shall be of any force or effect unless reduced to writing and signed by all parties to the agreement or their duly authorised representative;

- the agreement contains the entire agreement between the parties and no party shall be bound by any undertakings, representations, warranties, promises or the like not recorded therein;

- no indulgence, leniency or extension of time which any party may grant or show to any other party shall in any way prejudice or preclude such party from exercising any of its rights in the future.

CONCLUSION

Shareholders' agreements play an important role in regulating the relationship between the company and its shareholders and between the shareholders inter se.

If properly drawn, the agreement serves as an effective means to record the intentions of the shareholders and to resolve disputes which could cause disharmony or a breakdown in their relationship which could result in litigation or the winding-up of the company.

A separate agreement between the shareholders enables them to regulate their affairs privately without members of the public or third parties having access to their internal arrangements (as is not the case of the memorandum and articles of association).

One of the dangers in drafting shareholders' agreements is the use of standard clauses and precedents (of which there is an abundance) without considering the applicability thereof; this is often done by inexperienced draughtsman which may bring about consequences which were never contemplated by the shareholders.