REPORTABLE
IN THE HIGH COURT OF KWAZULU-NATAL,
PIETERMARITZBURG

Case No 6550/08

In the matter between :

EDWARD GRAHAM RICHARD HUGHES	Plaintiff/Respondent
and	
MALCOLM BERWYN RIDLEY	First Defendant/First Excipient
JOHN DORY TRUCKING (PTY) LTD	Second Defendant/Second Excipient
LYNNE WENDY RIDLEY	Third Defendant/Third Excipient

Delivered : 12 June 2009

J U D G M E N T

LEVINSOHN AJP

[1] This is a judgment on exception.

[2] The plaintiff instituted an action against the three defendants claiming the following relief in his particulars of claim :-

> "(a) First defendant is directed to render an account of the partnership transport business (carried on in Second Defendant or without) and an account of the gross and net asset value thereof as at 29th November 2009.

(b) First defendant is directed to debate the account with Plaintiff alternatively conduct a debatement thereof before this Honourable Court,

(c) First Defendant is directed to make payment of one half of the net asset value of the said transport business as at 29th November 2007.

(d) Second and Third Defendants are directed to allow full and complete access to Plaintiff and First Defendant to the business records of Second Defendant for the purpose of rendering the account and debating it as aforesaid.

(e) Costs of suit against First Defendant and, in the event of Second and Third Defendant defending this action against all Defendants jointly and severally."

[3] In support of the relief claimed the plaintiff averred the following.

[4] During 2002 the plaintiff and the first defendant concluded an oral alternatively a tacit agreement. In terms of this agreement they would operate a transport business for profit in equal shares.

[5] The plaintiff's principal contribution to the contemplated transport business was a close corporation, John Dory Transport CC of which the plaintiff was the sole member.

[6] This CC was possessed of assets including goodwill contacts, equipment and staff. The first defendant in turn would contribute working capital and finance to the contemplated business.

[7] It was a further term of the agreement that the plaintiff would be employed by the business as its operations manager while the first defendant as its administration and financial manager.

[8] It was further agreed that the contemplated business which is now alleged to be a "partnership" would be operated in the form of a limited liability company.

[9] Upon dissolution of the partnership the plaintiff and first defendant would be obliged to account to each other in "respect of the financial value of the partnership transport business, whether it was in the form of a company or any other form". Paragraph 7.7 alleges :

> "Upon dissolution or termination of the partnership Plaintiff and First Defendant would be obliged to account to each other respectively in respect of the financial value of the partnership transport business whether it was in the form of a company or any other form;"

[10] The plaintiff proceeds to aver that he performed his obligations in terms of the agreement. The contemplated company was formed and the business was carried out in its name. The third defendant was issued with a nominal shareholding.

[11] The plaintiff alleges that the first defendant acted in material breach of the agreement by causing the company to dismiss him. These actions are alleged to constitute a repudiation of the agreement alleged and it is said that the existing partnership terminated.

[12] The plaintiff unsuccessfully sought to wind up the company. He now claims that pursuant to the alleged partnership agreement he is entitled to

claim a statement of account and debatement thereof from the first defendant and also certain consequential relief from the other defendants.

[13] The defendants now except to the particulars of claim on the footing that these are bad in law and lack averments which are necessary to sustain the plaintiff's cause of action.

[14] The defendants contend principally that the allegations made by the plaintiff proclaim that the contemplated business would be a limited liability company and it is clear from the particulars of claim that the business is that of the second defendant. Thus the alleged contributions were to be made to the second defendant and not to any partnership.

[15] There are further exceptions taken which are headed "second and third exceptions respectively". In the view I take of this matter it is unnecessary to traverse those exceptions.

[16] In order to properly get to grips with the legal issues that arise herein it is necessary to re-state trite principles of our law of partnership and companies. In the often quoted case of ***Joubert v Tarry*** 1914 – 1915 TPD the Court accepted Pothier's formulation of the *essentialia* of partnership.

> "Now, what constitutes a partnership between persons is not always an easy matter to determine. The definitions which have been quoted to the Court differ to some extent. But I think we are safe if we adopt the essentials which have been laid down by Pothier on Partnership, borne out as these are by the definitions which he gives of partnership. These essentials are fourfold. First, that each of the partners brings something into the partnership, or binds himself to bring something into it,

> whether it be money, or his labour or skill. The second essential is that the business should be carried on for the joint benefit of both parties. The third is, that the object should be to make profit. Finally, the contract between the parties should be a legitimate contract."

[17] This definition has been accepted by the Appellate Division in ***Purdon v Muller*** 1961(2) SA 211 at 218 C – G per Ogilvie-Thompson JA (as he then was).

[18] I focus on the second and third requirements that a partnership must be carried on for the joint benefit of both parties and the object of the partnership is to make a profit. Wessels J (as he then was) in ***Joubert****'s* case *supra* said at 282

> "We have here two persons who undertake a joint business ……. they are partners."

[19] Insofar as the element of profit is concerned, that must be the immediate aim of the parties to an agreement.

[20] What is immediately apparent on a reading of the particulars of claim is that the allegations made therein superficially disclose that an agreement was concluded which is consistent with that of a partnership. However, that conclusion becomes somewhat bedevilled by the averments that the "carrying on of a business" element is to be through the medium of a limited company.

[21] Now once again trite principles of the law come into play./ In the very well known case of ***Dadoo, Ltd and Others v Krugersdorp Municipal Council*** 1920 AD 530 at 550 Innes CJ said the following : -

> "A registered company is a legal *persona* distinct from the members who compose it. In the words of LORD MACNAGHTEN (*Salomon v Salomons & Co.,* 1897, A.C., at p 51), 'the company is at law a different person altogether from the subscribers to its memorandum; and though it may be that, after incorporation, the business is precisely the same as it was before, and the same persons are managers, and the same hands receive the profits, the company is not in law the agent of the subscribers or a trustee for them'. That result follows from the separate legal existence with which such corporations are by statute endowed, and the principle has been accepted in our practice. Nor is the position affected by the circumstance that a controlling interest in the concern may be held by a single member. This conception of the existence of a company as a separate entity distinct from its shareholders is no merely artificial and technical thing. It is a matter of substance; property vested in the company is not, and cannot be, regarded as vested in all or any of its members."

[22] The fundamental principle that the company is a separate corporate entity has important consequences. The company's assets and liabilities are separate from that of its members. If the company is liquidated its creditors can only seek to satisfy their claims out of the assets of the company. They cannot look to shareholders to make good. However, on the other hand, if the business was being carried on as a partnership the situation is entirely different.

The creditors could satisfy their claims not only from the assets of the partnership in the first instance but also pursue the individual partners jointly and severally. They could sequestrate not only the partnership but the individual partners as well. Another important difference is that the profits made by the company do not accrue to the shareholders but rather to the company itself. Members' rights to receive a share of the profits as dividends are determined by the articles of association of the company. Mere membership of the company does not qualify one to act on behalf of the company. It is the articles of association that appoints the representatives of the company. The latter can bind the company. This in contrast to a partnership where an individual partner can bind the partnership if he or she is acting within the scope of such partnership business.

[23] If two persons agree that they wish to form a company, that each is to become a shareholder, each is to make a separate specific contribution to the company and the company is to carry on a business, that agreement is in my view not consistent with a partnership. The formation of a limited liability company presupposes an agreement by the individuals concerned to submit to the articles of association of such limited liability company. If they so wish, they may conclude a shareholders' agreement which will regulate their relationship *inter se*. Thus, viewing the above definition of partnership and also the specific principles of company law, it is not two individuals carrying on a business jointly and for profit. What we find is rather a company which is wholly separate from the individuals who operate it which carries on the business, owns the assets, incurs liabilities to its creditors, makes profits or losses and is able to declare such profits as dividends to be distributed to its

shareholders. Thus, it is company law which regulates and determines the respective rights and obligations.

[24] In my view this is what occurred herein, given a simple interpretation of the particulars of claim. Applicant and first respondent agreed that they would form a company. The company would carry on the transport business. It was obviously contemplated that from the moment of its formation shares would be issued. The applicant and the first respondent would then become members of the company and their rights and obligations *inter se* would be submerged within the company structure.

[25] It would follow therefore that the rights and obligations of shareholders *inter se* would principally be governed by the articles of association or a shareholders' agreement where such has been concluded. Any breach would give rise to remedies in the company law context. In this regard the remedy of winding up on the grounds of just and equitable come to mind. That is a remedy which lies in the hands of a member of the company who, for example, alleges a deadlock or loss of probity and the like. The leading cases, both in South Africa and England, proclaim clearly that in considering whether to wind up a private company on the basis of just and equitable the Court would be entitled in an appropriate case to apply by analogy principles of partnership. In other words, the Court would recognise that the individual members of the company are possessed of rights which fall outside the company structure. Equity dictates that these rights and obligations be accorded recognition. Lord Wilberforce in his speech in ***Ebrahimi v Westbourne Galleries and Others*** [1973] AC 360 set forth this principle very clearly at p 379 to 380 and I quote extensively from the speech : -

“My Lords, in my opinion these authorities represent a sound and rational development of the law which should be endorsed. The foundation of it all lies in the words 'just and equitable' and, if there is any respect in which some of the cases may be open to criticism, it is that the courts may sometimes have been too timorous in giving them full force. The words are a recognition of the fact that a limited company is more than a mere legal entity, with a personality in law of its own: that there is room in company law for recognition of the fact that behind it, or amongst it, there are individuals, with rights, expectations and obligations *inter se* which are not necessarily submerged in the company structure. That structure is defined by the Companies Act and by the articles of association by which shareholders agree to be bound. In most companies and in most contexts, this definition is sufficient and exhaustive, equally so whether the company is large or small. The 'just and equitable' provision does not, as the respondents suggest, entitle one party to disregard the obligation he assumes by entering a company, nor the court to dispense him from it. It does, as equity always does, enable the court to subject the exercise of legal rights to equitable considerations; considerations, that is, of a personal character arising between one individual and another, which may make it unjust, or inequitable, to insist on legal rights, or to exercise them in a particular way.

It would be impossible, and wholly undesirable, to define the circumstances in which these considerations may arise. **Certainly the fact that a company is a small one, or a private company, is not enough. There are very many of these where the association is a purely commercial one, of which it can safely be said that the basis of association is adequately and exhaustively laid down in the articles. The superimposition of equitable considerations requires something more**, which typically may include one, or probably more, of the following elements: (i) an association formed or continued on the basis of a personal relationship, involving mutual confidence - this element will often be found where a pre-existing partnership has been converted into a limited company; (ii) an agreement, or understanding, that all, or some (for there may be 'sleeping' members), of the shareholders shall participate in the conduct of the business; (iii) restriction upon the transfer of the members' interest in the company - so that if confidence is lost, or one member is removed from management, he cannot take out his stake and go elsewhere. It is these, and analogous, factors which may bring into play the just and equitable clause, and they do so directly, through the force of the words themselves. To refer, as so many of the cases do, to 'quasi-partnerships' or ' in substance partnerships' may be convenient but may also be confusing. It may be convenient because it is the law of partnership which has

developed the conceptions of probity, good faith and mutual confidence, and the remedies where these are absent, which become relevant once such factors as I have mentioned are found to exist: the words 'just and equitable' sum these up in the law of partnership itself. And in many, but not necessarily all, cases there has been a pre-existing partnership the obligations of which it is reasonable to suppose continue to underlie the new company structure. But the expressions may be confusing if they obscure, or deny, the fact that the parties (possibly former partners) are now co-members in a company, who have accepted, in law, new obligations. **A company, however small, however domestic, is a company not a partnership or even a quasi-partnership and it is through the just and equitable clause that obligations, common to partnership relations, may come in."**

(Emphasis added)

[26] The ***Westbourne Galleries***' case has been followed by our Courts.

See ***Hulett and Others v Hulett*** 1992 (4) SA 291 SCA at 307 H

Apco Africa (Pty) Ltd and Another v Apco Worldwide Inc 2008 (5) SA 615 SCA at 623, paragraph [17].

[27] Counsel for the plaintiff in his written heads of argument quoted the following passage from Cilliers & Benade, **Corporate Law**, Third Edition, at page 14 : -

> "In the event of an underlying partnership intention between the parties, that intention may be recognised by the courts even though the parties formed accompany to carry their intention into effect."

[28] He went on to submit that "this principle has been recognised by the Supreme Court of Appeal (Appellate Division)" in two cases, namely ***Bellairs v Hodnet and Another*** 1978 (1) SA 1109 (AD) at 1130 and the ***Hulett*** case, *supra.* In my opinion counsel has misconstrued this case law. ***Bellairs*** case was decided on its own particular facts. The Court applied partnership principles by analogy to the relationship of the two individuals concerned, namely Bellairs and Hodnet, as well as to the company in question. The Court found that the fact that they conducted their business through a company did not in any way detract from an existing fiduciary duty that Bellairs owed to his co-shareholder. In the ***Hulett***, case, *supra*, Hoexter JA recognised that applying the ***Westbourne Galleries*** case, *supra,* that principles of partnership law applied to the respective shareholders' relationship.

[29] In my view the statement made by the learned authors quoted by counsel should not be understood to go any further than emphasising as Lord Wilberforce did in ***Westbourne***, that because of particular background circumstances the rights and obligations of the individual members of the company can be determined by principles of law analogous to partnership. For example, this may apply in a situation where one member seeks to wind up the company on the basis of just and equitable. The Court will then examine all the circumstances particularly having regard to the background relationship of

the individual members and it may then apply equitable principles akin to partnership.

[30] It follows therefore that I have concluded that on a proper construction of the particulars of claim the plaintiff has not alleged a cause of action which can give rise to the relief that he claims. More particularly he has not succeeded in alleging that a partnership agreement properly so-called came into being. The allegations as indicated above are consistent with an intention to form a company and that company was to carry on business as an independent and separate entity.

[31] The following order is issued : -

(a) The first exception is upheld.

(b) The plaintiff is given leave to amend its particulars of claim within ten (10) days from the date of this order.

(c) The plaintiff is directed to pay the costs of the exception, such costs to include the costs consequent upon the employment of two counsel.

DATE OF JUDGMENT :	12JUNE 2009
DATE OF HEARING :	20 FEBRUARY 2009
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