12 Aug 2013

Republic of South Africa

IN THE HIGH COURT OF SOUTH AFRICA
(WESTERN CAPE HIGH COURT, CAPE TOWN)

Not Reportable

CASE NO: 9600/2013

In the matter between:

VERSO FINANCIAL SERVICES (PTY) LTD	Applicant
NICOLAAS ELMAR BURGER	First Respondent
CHRISTOFFEL PHILIPPUS BURGER	Second Respondent
AREND EGBERTUS DE WAAL	Third Respondent
MARTIN JAMES KIFT	Fourth Respondent
PAUL KIRSTEN LOUW	Fifth Respondent
WALTER WILLIAM BORTHWICK	Sixth Respondent
CHRISTOFFEL PHILLIPUS BURGER N O	Seventh Respondent
JOHAN VILJOEN DE KOCK N O	Eight Respondent
ANNELIZE BURGER N O	Ninth Respondent
ELANZA ENGELA DE WAAL N O	Tenth Respondent
ESWE VISAGIE N O	Eleventh Respondent
MARTIN JAMES KIFT N O	Twelfth Respondent
ELSIME VISSER N O	Thirteenth Respondent
PAUL KIRSTEN LOUW N O	Fourteenth Respondent

ALETTE SUSARA LOUW N O	Fifteenth Respondent
PETRUS JACOBUS VAN ROOY N O	Sixteenth Respondent
VERSO INVESTMENT SERVICES (PTY) LTD	Seventeenth Respondent

Court: NYMAN AJ

Heard: 1 August 2013

Delivered: 12 August 2013

JUDGMENT

NYMAN AJ

[1] The primary issue for determination is the lawfulness of the appointments of the third to sixth respondents as directors of the seventeenth respondent ("the Company") by its majority shareholders on 3 June 2013. At heart is the interpretation and applicability of the Companies Act, 73 of 2008 ("the Act") in circumstances where the Company was in the process of conducting negotiations concerning a new Memorandum of Incorporation ("MOI") to comply with the provisions of the Act by 30 April 2013[1].

Factual background

[2] The background to these proceedings is as follows. The applicant holds 48.5% of the shares in the Company, the first respondent holds 18.5%, the second respondent holds 20%, the sixth respondent holds 1% and the remainder of the shares are divided amongst four trusts. Both the Company's articles of association of 23 July 2003 and the shareholders'

[1] In terms of sub-section 225(1) the date of commencement of the Act is 1 May 2011. Section 1 defines this date as the effective date. Practice Note 5(4)(2)(a) permits a pre-existing company to file, without charge at any time within two years immediately following the general effective date, "*an amendment to its Memorandum of Incorporation to bring it in harmony with the Act*".

agreement dated 1 July 2009 make provision for the appointment of directors.

[3] During the month of April 2013, the shareholders conducted negotiations with the objective of adopting a MOI in compliance with subsection 66(4)(a)(i)[2] of the Act. (It is not disclosed on the papers when these negotiations commenced.) Of concern was the need for the shareholders to reach agreement on the MOI before the expiry of the 2 year period on 30 April 2013 as prescribed in paragraph 4(2)(a) of Practice Note 5, a concern expressed in the email dated 18 April 2013 from the applicant's attorneys to the respondents' attorneys. It was furthermore stated in the email that the most urgent aspect that had to be addressed was the appointment and election of directors. A copy of the applicant's instructions in this regard was attached to the email.

[4] In reply to the afore-stated email and on 29 April 2013, the respondents' attorney sent a copy of the first draft of the MOI and addendum to the shareholders' agreement to the applicant's attorney, with the request that the applicant's attorney should obtain instructions after which, the parties' attorneys should hold a meeting. On 30 April 2013, the applicant's attorney sent an email to the respondents' attorney conveying the information that the applicant's attorney was waiting for instructions from his client regarding the draft MOI and addendum.

[5] On 15 May 2013, the respondents' attorney requested a response to the MOI and

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[2] Subsection 66(4)(a)(i) stipulates that:

"*A company's Memorandum of Incorporation—*

(a) may provide for—

(i) the direct appointment and removal of one or more directors by any person who is named in, or determined in terms of, the Memorandum of Incorporation;".

addendum by 22 May 2013 so that he could ascertain whether there were any points in dispute. On 17 May 2013 the applicant's attorney indicated in his reply that due to the unavailability of his clients, they would not be able to provide feedback to him before the first week of June, but there appeared to be a dispute between the parties concerning the appointment and election of directors.

[6] On 31 May 2013 the first respondent sent a proposed resolution to all the shareholders to be voted on in accordance with section 60[3] of the Act, proposing the appointment of the third to sixth respondents as directors to the Company.

[7] On 3 June 2013 the first respondent sent an email to all the Company's shareholders containing the information that the Company had received, "*the required majority of votes in respect of each of the resolutions proposed and accordingly the resolutions have been passed.*"

[8] In response to this round robin election and on even date, the applicant's attorney described the respondents' conduct as "improper" on the bases that the directors had not been consulted and because the shareholders were still in the process of finalising the MOI by agreement.

[3] Sub-section 60(3) provides that: "*An election of a director that could be conducted at a shareholders meeting may instead be conducted by written polling of all of the shareholders entitled to exercise voting rights in relation to the election of that director.*"

[9] On 4 June 2013 the respondents' attorneys of record denied that their clients had acted in an improper manner for the reason that in terms of the Act, the Company's shareholders were entitled in law to elect at least 50% of the Company's directors.

Urgent application

[10] On 20 June 2013 the applicant launched an urgent application requesting the issue of a rule *nisi* with the following interim relief:

> "*2.1 The appointment of the Third - Sixth Respondents during May/June 2013 as directors of the Seventeenth Respondent was unlawful.*
>
> *2.2 The names of the Third - Sixth Respondents shall be removed from the Seventeenth Respondent's register of directors.*
>
> *2.3 The First and Second Respondent shall take all necessary steps to ensure that the names of the Third - Sixth Respondents be removed from the Companies and Intellectual Property Commission's records of the Seventeenth Respondent's directors.*
>
> *2.4 The Third - Sixth Respondents may not act as directors of the Seventeenth Respondent pursuant to their appointment during May/June 2013.*"

[11] On 10 July 2013 the parties reached an agreement which was made an order of court, *inter alia*, that the matter be postponed to 1 August 2013 for hearing on the semi-urgent roll and that:

> "*Until the hearing of this matter on 1 August 2013, the Seventeenth Respondent's board of*

directors shall not meet and shall not make any decisions unless all the shareholders of the Seventeenth Respondent agree thereto in writing."

The parties' contentions

[12] The applicant advanced two contentions in its founding affidavit why the appointment of the third to sixth respondents as directors ("additional directors"), is unlawful. The first contention is that the four directors, who held office immediately prior to 1 May 2013, continue to hold office in terms of paragraph 7(1) of Schedule 5[4] of the Act. Given that the shareholders' agreement is only inconsistent with the Act in respect of the appointment and not election of directors, the provisions regulating appointments should be amended in future when vacancies arise. No vacancies contemplated in section 70 and sub-paragraph 7(3) of Schedule 5 has arisen and consequently, there was no necessity to appoint additional directors to the four existing directors. If and when a vacancy arises in future, it must be filled at the Company's annual general meeting, as required by article 26 of the articles of association.

[13] The second contention is that at the time of the appointments, the shareholders were in the process of negotiating the future composition of the board of directors, to ensure compliance with the Act, at the time when they attempted to finalise the MOI. The first respondent, who was acting in his capacity as the Executive Chairperson of the Company when he facilitated the appointment of the additional four directors, failed to consult with the other members of the board in this regard.

[4] Schedule 5.7 stipulates: "*Company finance and governance.—(1) A person holding office as a director, prescribed officer, company secretary or auditor of a pre-existing company immediately before the effective date, continues to hold that office as from the effective date, subject to the company's Memorandum of Incorporation, and this Act.*"

[14] In answer, the respondents argue that the majority shareholders' right of appointment of the additional directors rests on two provisions. Firstly, article 58 of the articles of association permits the shareholders to appoint directors of the company by way of a vote, which is permitted to be conducted in terms of the Act by way of a circulated round-robin resolution. To the extent that clauses 11.1 and 11.2 of the shareholders' agreement are in conflict with the articles of association, these provisions were no longer lawful or binding on the shareholders with effect from 1 May 2013.

[15] Secondly, sub-section 66(4) of the Act entitles the shareholders with effect from 1 May 2013 as of right to vote; whether at a meeting or through a round-robin resolution, for the appointment of at least 50% of the directors of the company.

[16] It is the respondents' contention that existing negotiations concerning the MOI does not "*detract from nor vary in any way the right of the company's shareholders to appoint further directors*".

Analysis

[17] The Company falls within the definition of a pre-existing company in terms of sub-section 1(b) of the Act because it was in existence and recognised as an existing company in terms of the Companies Act No. 61 of 1973.

[18] The transitional arrangements are contained in Schedule 5 of the Act. Sub-paragraph 4(4) of Schedule 5 stipulates that:

(4) During the period of two years immediately following the general effective date—

(a) if there is a conflict between—

(i) a provision of this Act, and a provision of a pre-existing company's Memorandum of Incorporation, the latter provision prevails, except to the extent that this Schedule provides otherwise;

(ii) a binding provision contemplated in sub-item (3), and this Act, the binding provision prevails; or

(iii) a provision of an agreement contemplated in sub-item (3A), and this Act or the company's Memorandum of Incorporation, the provision of the agreement prevails, except to the extent that the agreement, or the Memorandum of Incorporation, provides otherwise; and

(b) despite Chapter 7, until a pre-existing company has filed an amendment contemplated in sub-item (2) (a), neither the Commission nor the Panel may issue a compliance notice to that company with respect to conduct that is—

(i) inconsistent with this Act; but

(ii) consistent with a provision that prevails over this Act in terms of paragraph a)."

[19] Section 15 of the Act provides that:

"15 Memorandum of Incorporation, shareholder agreements and rules of company.—(1) Each provision of a company's Memorandum of Incorporation—

(a) must be consistent with this Act; and

(b) is void to the extent that it contravenes, or is inconsistent with, this Act, subject to section 6 (15)."

[20] In my view, the central issue for determination is whether the provisions in the articles of association that regulate the appointment and election of directors, are consistent with the Act. If this is the case, these provisions remain in full force and effect and if the

respondents did comply with these provisions, the additional appointments should be found to be lawful.

[21] Article 58 of the articles of association that regulates the appointment and removal of directors specifies that:

> *"The directors shall be appointed and shall be subject to removal from office by notice in writing to the company signed by the holders of a majority of such part of the issued share capital of the company as confers the right for the time being to attend and vote at general meetings of the company. A corporation being the holder of share capital may sign such appointment or removal by its chairman or by any one of its directors."*

[22] Clause 11 of the shareholders' agreement reads as follows:

> *"11 DIRECTORS OF THE COMPANY*
>
> *11.1 The Company shall initially have 4 (four) Directors of which ~*
>
> *11.1.1 VFS shall be entitled, but not obliged, to appoint, remove and replace 3 [three) Directors. VFS hereby confirms the Initial appointment of 2 [two) directors, being Christ Franken and Wouter Hugo; and*
>
> *11.1.2 both Burger 1 and Burger 2 shall be entitled, but not obliged, to appoint, remove and replace 1 (one) Director each. Burger 1 and Burger 2 hereby confirm the Initial appointment of Christo Burger for Burger 1 and Nico Burger for Burger 2; and*

The shareholders confirm that they are (as at the Signing Date) satisfied with these appointments. However, notwithstanding anything to the contrary contained herein, should the shareholding in the Company change for whatever reason, each shareholder shall be entitled to appoint 1 (one) Director for each complete 10 % (ten percent) shareholding held in the Company, other than the initial Directors.

11.2 The Shareholders shall exercise their votes as members of the Company to procure the appointment of the Directors envisaged in 11.1 and 11.2 above."

[23] It is common cause that as at 1 May 2013, the four initial directors of the Company were Christiaan Jacobus Franken and Wouter Hugo who were appointed by the applicant in terms of clause 11.1.1 of the shareholders' agreement and the first and second respondents, who appointed themselves in terms of clause 11.1.2 of the shareholders' agreement.

[24] Subsection 66(3) of the Act provides the following:

"*A company's Memorandum of Incorporation may specify a higher number in substitution for the minimum number of directors required by subsection (2).*

(4) A company's Memorandum of Incorporation—

(a) may provide for—

(i) the direct appointment and removal of one or more directors by any person who is named in, or determined in terms of, the Memorandum of Incorporation;

(ii) a person to be an ex officio director of the company as a consequence of that person holding some other office, title, designation or similar status, subject to subsection (5) (a); or

(iii) the appointment or election of one or more persons as alternate directors of the company; and

(b) *in the case of a profit company other than a state-owned company, must provide for the election by shareholders of at least 50% of the directors, and 50% of any alternate directors.*"

[25] Section 1 of the Act defines a "Memorandum", or "Memorandum of Incorporation", to mean the document,

"*as amended from time to time, that sets out rights, duties and responsibilities of shareholders, directors and others within and in relation to a company, and other matters as contemplated in section 15 and by which—*

(a) the company was incorporated under this Act, as contemplated in section 13;

(b) a pre-existing company was structured and governed before the later of the—

(i) *effective date; or....*"

[26] To my mind, the Company's articles of association constitute the MOI as defined in section 1 because it is the document in terms of which the Company was incorporated prior to the date of commencement of the Act. In consequence, to the extent that the relevant provisions in the shareholders' agreement may be at variance with the articles of association, I am of the view that I should have regard to the articles of association. Article 58 entitles the majority of the shareholders the right to appoint an unlimited number of directors. This right is not inconsistent with sub-section 66(4)(b) of the Act, which compels the shareholders to

elect at least 50% of the directors. In my view, the usage of the word "must" in sub-section 66(4)(b) places it in the category of an "unalterable provision" which is defined in section 1 as:

> '*a provision of this Act that does not expressly contemplate that its effect on any particular company may be negated, restricted, limited, qualified, extended or otherwise altered in substance or effect by a company's Memorandum of Incorporation or rules*"

[27] Sub-section 66(4)(b) therefore constitutes a "mandatory core provision" which, according to Cassim[5], is "generally designed to protect the interests of shareholders". I agree with Mr Muller who appeared for the respondents that the legislature sought to strengthen the principle of majoritarianism by making it peremptory for shareholders to elect at least 50% of the directors. In *Communicare v Khan* 2013 (4) 482 at 485 G-H Swain AJA noted the principle of majoritarianism as one of the two general principles of company law.

[28] The legislative source for the election of the additional directors rests in sub-section 66(4)(b) that compels shareholders to elect 50% of the directors. This election has nothing to do with situations where a vacancy arises on the board as contemplated by section 70 of the Act. The fact that no vacancies have arisen on the board does not vitiate the election of the additional directors because the applicant did not appoint the additional directors in terms of section 70.

[29] In my view, in terms of article 58, the majority shareholders were permitted to elect the additional directors in terms of article 58 read with sub-section 66(4) of the Act. In the light of my findings, it is not necessary for me to consider whether clause 11 of the

[5] *Contemporary Company Law*, 2 ed, at 4.3.1, p123 para 3)

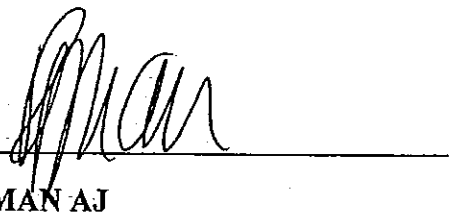
shareholders' agreement is consistent with the Act or whether its amendment is necessitated by the relevant provisions of the Act, given that in terms of the scheme of the Act, a company's articles of association trump the shareholders' agreement.

[30] It therefore follows that the applicant's second contention holds no merit. It is my view that the respondents' conduct in respect of the negotiations concerning the draft MOI, cannot detract from a mandatory provision that requires the majority shareholders to act in terms of the relevant provisions of the Act.

[31] In his submissions at the hearing of this matter, Mr van Rooyen advanced the argument that the remedies envisaged in chapter 7 of the Act should be considered. In my view, on the facts of this case, chapter 7 does not find application. On the applicant's version, the parties were still in the process of negotiating a MOI when the additional directors were appointed. The correspondences between the parties' attorneys show that there appeared to be a dispute regarding the appointment and election of directors. In any event, in terms of the *Plascon Evans* test, the respondents' version to this effect should be accepted. I do not support Mr van Rooyen's submission that the first respondent was in breach of his fiduciary duties as a director when he set in motion the election of the additional directors, given that his conduct fell within the bounds of lawfulness, and not conduct envisaged by section 156[6].

[6]Section 156 reads: "*Alternative procedures for addressing complaints or securing rights.—A person referred to in section 157 (1) may seek to address an alleged contravention of this Act, or to enforce any provision of, or right in terms of this Act, a company's Memorandum of Incorporation or rules, or a transaction or agreement contemplated in this Act, the company's Memorandum of Incorporation or rules, by—*
(a) attempting to resolve any dispute with or within a company through alternative dispute resolution in accordance with Part C of this Chapter;
(b) applying to the Companies Tribunal for adjudication in respect of any matter for which such an application is permitted in terms of this Act;
(c) applying for appropriate relief to the division of the High Court that has jurisdiction over the matter; or

[32] For these reasons, the application is dismissed with costs.



NYMAN AJ

ACTING JUDGE OF THE HIGH COURT

(d) filing a complaint in accordance with Part D of this Chapter within the time permitted by section 219 with—
(i) the Panel, if the complaint concerns a matter within its jurisdiction; or
(ii)the Commission in respect of any matter arising in terms of this Act, other than a matter contemplated in subparagraph (i)."