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RESTRICTION OF RIGHTS OF TRANSFER OF SECURITIES:

Does section 8 (2) (b) (ii) (bb) of the Companies Act 71 of 2008 create a pactum de non cedendo?

by

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SUMMARY OF MINI-DISSERTATION

This paper attempts to give an alternate view to the findings in the *Smuts v Booyens: Markplaas* case (‘*Smuts case’*) and to propose that the restriction of the rights of transfer of securities in terms of s 8(2)(b)(ii)(bb) of the Companies Act 71 of 2008 (‘the Act’) is inappropriate.

It is argued that the judge erred in that a *pactum de non cedendo* cannot relate to a restriction on the transferability of a share unless the restriction is inherent in the share which, in the *Smuts case*, it was not. Likewise, it is argued that the purported restriction contained in s 8(2)(b)(ii)(bb) is inappropriate for the same reason.

To substantiate this position, this paper explores the difference between defining a share in terms of the common law and the Act. It is argued that there is a fundamental difference between these definitions: a share in terms of the Act is merely described as one of the units into which proprietary interest in a profit company is divided; further, a share is described as movable property transferable in any manner provided for in the Act or other legislation. In contrast, in terms of the common law a share is a personal right entitling the owner to a *spes* to the profits and assets of a company. As such shares can be freely transferred without the securities register being altered. Common law also dictates that a share is both a movable incorporeal entity and a bundle of personal rights to which the share gives rise. What is of significance is that, in terms of the Act, a share must be authorised before it is issued; prior to issue the share has no rights attributed to it. The preferences, rights, limitations and other terms associated with a share must be set out in the Memorandum of Incorporation (MOI). This is an unalterable provision and any changes to the character of the share must be affected via an amendment to the MOI. It is argued that this is the first flaw in the *Smuts case*: if the restriction on transferability is not included in the description of the share, the nature of the share cannot be altered by either section 8 (2)(b)(ii)(bb) or a later *pactum de non cedendo*.

This paper also investigates the manner in which shares are transferred in terms of the Act and the common law. It illustrates how, in terms of the Act, a share is transferred from one shareholder to another merely by updating the share register; whereas in terms of common law, a share is transferred via cession and no formalities are required. It is contended that ownership in terms of the Act does not transfer merely because the share register has been updated, but that cession does in fact transfer ownership. This then is the

second flaw in the *Smuts case*: the *pactum de non cedendo* referred to transferring the share in terms of the Act (s 91 of the Companies Act 61 of 1973 ('the 1973 Act')) but the court omitted to take into account that the Act merely refers to the technical transfer (substitution of one shareholder for another) and not the full transfer of ownership per cession, which transfers ownership.

This paper further illustrates the difference between a shareholder and a beneficial owner and that the two concepts are not the same, as much as 'member' and 'shareholder' are two distinct concepts in the 1973 Act. It is pointed out that a shareholder is merely the person whose name is in the securities register and that this does not denote ownership, whereas the beneficial owner is the holder of the bundle of personal rights to which the share gives rise. The beneficial owner only obtains the additional incorporeal movable rights when he or she is registered as a shareholder. This is the third flaw in the *Smuts case*: the court treated the shareholder (beneficial owner in the Act) as if he was the member (beneficial owner in the Act) where the *pactum de non cedendo* related to the member and not the shareholder.

This paper also addresses the MOI and establishes who is bound by the MOI. It is argued that only shareholders, and not beneficial owners, are bound by the MOI. It is further postulated that shareholders are only bound in their capacity as shareholders in the narrow sense. This then is the fourth flaw in the *Smuts case*: the court erred in finding that the Articles of Association (MOI in the Act) bind a beneficial owner where it does not.

Finally this paper investigates whether the shareholders' agreement in terms of the Act can change the position and restrict transferability or create a *pactum de non cedendo*. It is suggested that since the shareholder's agreement in terms of the Act may not deviate in any manner from the MOI, it cannot restrict transferability of a share nor create a *pactum de non cedendo.*

In summary, this paper argues that the only way to restrict the transferability of a share is if the nature of the share together with all the rights, limitations and preferences is fully set out and described in the MOI at the time that the share is created, i.e. at the stage of authorisation but prior to issue, and that this is the first instance of the share which cannot be altered by either a *pactum de non cedendo* in the MOI nor by s 8(2)(b)(ii)(bb). It is concluded that neither a *pactum de non cedendo* nor s 8(2)(b)(ii)(bb) furthers the purpose of the Act.

Key terms

pactum de non cedendo

transferability of securities

memorandum of incorporation

nature of a share

transfer of share

shareholder

beneficial owner

restriction on transferability of a share

Companies Act 71 of 2008

Smuts v Booyens: Markplaas

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I.CHAPTER 1: GENERAL INTRODUCTION

a) Introduction and purpose

The purpose of this paper is to explore the position and application of s 8(2)(b)(ii)(bb) of the Companies Act 71 of 2008 ('the Act') with specific reference to the purported restriction on the transferability of a private company's securities. The discussion is limited to shares and does not consider other forms of security.

The Van Wyk De Vries commission was appointed in 1963 and since that date there has been no comprehensive reform of company law in South Africa. It is for this reason that in November 1997 the DTI issued 'South African Company Law for the 21st Century: Proposed Guidelines for Competition Policy 2004'. The guidelines outlined a broad legislative reform programme that included a review of existing securities regulations; institutions with principal oversight of corporate structures; and current practices and regulations in the area of corporate governance. The scope of the review was the reform of South African company law, which would involve an overall review of company law including the Companies Act, 1973, the Close Corporations Act, 1984, and the common law relating to these corporate entities.[1]

As a result of the review the Companies Act 71 of 2008 was signed into law on 8 April 2009 and came into effect on 1 May 2011 after substantial amendment by the Companies Amendment Act 3 of 2011. The Act specifically states: 'This Act must be interpreted and applied in a manner that gives effect to the purposes set out in s 7.'[2] The Act further stipulates that 'the Commission, the Panel, the Companies Tribunal or court must promote the spirit, purpose and object of this Act and that if any provision of this Act, or other document in terms of this Act, read in its context, can be reasonably construed to have more than one meaning, one must prefer the meaning that best promotes the spirit and purpose of this Act.'

It is within the ambit of s 7 of the Act referred to above that this paper explores the position and application of s 8(2)(b)(ii)(bb) with specific reference to the purported restriction on the transferability of a private company's shares.

[1] Corporate Reform Policy (Notice 1183 GG 26493 of June 2004)
[2] Section 5 (1) of the Companies Act 71 of 2008 (the Act)

b) Methodology

i.Problem statement

In terms of the Act a 'share means one of the units into which the proprietary interest in a profit company is divided.'3 In terms of common law, as confirmed in the case of *Liquidators, Union Share Agency v Hatton*, a share is a '*ius in personam*, a right of action, the extent and nature of which and the liability attaching to the ownership of which depends on statute, the ownership of which passes by cession.'4 Given the accepted common-law nature of the share and the fact that ownership passes by cession, can one ever restrict transfer of ownership? In other words, can s 8(2)(b)(ii)(bb) of the Act create a *pactum de non cedendo*? The nub of the question is whether the statutory provision overrides the common-law principle of a share being freely transferable.

The following points need to be clarified:

1. What is the difference between the common law and statutory nature of a share and do they conflict?
2. In a private company complying with s 8(2)(b)(ii)(bb) is the restriction on transferability of a share appropriate or even possible?
3. What is the nature of the relationship between the shareholders and their shares and the beneficial owners and their shares with specific reference to the rights and obligations in the transferability of their shares?
4. Can the MOI change the nature of a share as defined in the Act and common law, and can the MOI create a *pactum de non cedendo*?
5. Is a shareholders' agreement capable of circumventing any restriction on the transferability of a share as defined in the Act or common law?

ii. Ambit of study

Given that this paper attempts to give an alternate view to the findings in the case of *Smuts v Booyens: Markplaas*5 and to propose that the restriction of the rights of transfer of securities in terms of s 8(2)(b)(ii)(bb) of the Act is inappropriate, the study investigates the nature of a share in terms of both the Act and common law. The mode of transfer of a share is also investigated to point out the differences between each type of transfer and its impact on

[3] Section 1 of the Act
[4] *Liquidators, Union Share Agency v Hatton* 1927 AD 240 250
[5] *Smuts v Booyens, Markplaas (Edms) Bpk & Others v Booyens* 2001 (3) All SA 536 (A) (*Smuts case*)

ownership of the share. The relationship between the company, the shareholder, and the beneficial owner is also explored to fully understand the underlying legal relationship, obligations and rights *inter se*. An understanding of the nature and extent of the legal relationships created in the MOI is expanded on to discover whether the nature of the share may be changed in the MOI and if so, how. Lastly, the shareholders' agreement as prescribed in the Act is considered in order to understand if the shareholders' agreement may change the nature of a share.

Although the research includes various academic textbooks and journals, it places more emphasis on primary sources, to wit, the Act and legal precedents both South African and English.[6] When examining the points requiring clarification, the purpose of the Act[7] is considered and applied.

iii. Significance of the research

Company law is one of the cornerstones of any economy that can either promote economic growth or stifle it. The Act was welcomed, as the Companies Act 61 of 1973 ('the 1973 Act') had been amended 42 times in the 37 years of its existence.[8] Although welcome, the Act introduced new concepts into South African law that require judicial clarity. South Africa has a proud common-law history stretching back to antiquity. Profound common-law principles have been clarified and confirmed through the courts. It is common cause that statutory law should not alter the existing law more than is necessary, and the Act is no exception. This supposition enhances legal certainty and manifests esteem for the worth of the common law as the outcome of historical evolution.[9]

To quote Wessels J in *Casserley v Stubbs*:

> 'It is a well-known canon of construction that we cannot infer that a statute intends to alter the common law. The statute must either explicitly say that it is the intention of the legislature to alter the common law, or the inference from the ordinance must be such that we can come to no other conclusion than that the legislature did have such an intention.'[10]

This paper suggests a view that may create legal certainty around the issue of the transferability of a share in a private company. Given the importance of private companies in

[6] Section 5 (2) of the Act
[7] Section 7, Section read with section 5(1) and section 158 (b)
[8] Cassim et al *Contemporary Company Law* (2016) 2 ed. Juta: Claremont (Cassim et al) 3
[9] Du Plessis *Interpretation of Statutes and the Constitution* (1986) Butterworths
[10] *Casserley v Stubbs* 1916 TPD 310 312

the South African economy, and the purpose of the Act (to promote development of the South African economy by, inter alia, encouraging entrepreneurship, flexibility and simplicity of companies and to reaffirm the concept of the company as a means of achieving economic and social benefits),[11] legal certainty for any investor is imperative. 'The business of business is business'[12] and the last thing any investor needs when purchasing a share is to be caught up in a legal wrangle about the technical transfer of his or her share in terms of the Act.[13]

iv. Structure of mini-dissertation

This paper consists of seven chapters.

Chapter one contains a general overview of the paper inclusive of the introduction and purpose of the research. The methodology is explained together with the problem statement, ambit of the study and significance of the research.

Chapter two deals with the nature of a share. The difference between the nature of a share in terms of common law and the Act is explained with reference to both the statutory provisions and legal precedents.

Chapter three illustrates the methods of transfer of shares in terms of both the Act and common law. Any restriction on transfer is dealt with in Chapter five.

Chapter four investigates the relationship between a company and its shareholders and the company and beneficial owners. This chapter emphasises that the nature of the share dictates the relationship with the holder.

Chapter five elaborates on the legal status of the MOI and the relationships created in the MOI. This chapter also unpacks the rights and restriction conferred in the MOI and attempts to answer the question of whether a MOI containing a *pactum de non cedendo* can fundamentally change the nature of a share from inception. *Smuts v Booyens: Markplaas (Edms) Bpk* is reviewed.

Chapter six demonstrates the status of a shareholders' agreement in terms of the Act and in terms of the law of contract and investigates whether a shareholders' agreement can regulate the transferability of a share.

[11] Section 7 of the Act
[12] Milton Friedman (1912–2006) American economist who received the 1976 Nobel Memorial Prize in Economic Sciences
[13] Section 51– 53 of the Act

Chapter seven contains conclusions about the various points that required clarity and illustrates the importance of the need for clarity in promoting the purpose of the Act.

II.CHAPTER 2: THE NATURE OF A SHARE

This chapter discusses the nature of a share in terms of the Act and the common law. With reference to the nature of a share in terms of the Act, emphasis is placed on the first instance of a share and how the nature of the share may be restricted. This chapter also introduces the fundamental difference illustrated in the case of *Tigon v Bestyet,*[14] where the court distinguished between the share itself (that is the incorporeal entity that is movable) and the bundle of personal rights to which the shares gave rise.

a) Introduction

As stated by Cilliers,[15] it is not an easy task to define the nature of a share. A 'share' means a share in the share capital of a company. It is a proprietary interest in the company and not in the company's assets. A share is made up of various rights. There are distinct legal consequences attached to the rights of a share as defined in the Act and a share as defined in terms of common law. In terms of common law, in *Randfontein Estates Limited v the Master* with reference to shares, the court held that:

> 'they are simply rights of action – *jura in personam* – entitling the owner to a certain interest in the company, its assets and its dividends. As between those in whose names they are registered in the books of the company, and any other person with whom the registered holder deals, they may be freely assigned, even though the original registration remains unaltered. And that is the ordinary way in which such shares are dealt with [sic]; they pass from hand to hand and form the subject of many transactions without the original registration in the books of the company being disturbed.'[16]

The nature of a share was also defined in the matter of *Borland's Trustee v Steel Brothers and Company Ltd* in which the court found that:

> 'a share is the interest of a shareholder in the company, measured by a sum of money, for the purpose of liability in the first place and interest in the second, but also

[14] *Tigon v Bestyet* 2001 4 SA 634 (N) (*Tigon case*)
[15] Cilliers et al *Cilliers and Benade Corporate Law* (2000) 3rd ed LexisNexis: Durban (hereinafter Cilliers et al) 224
[16] *Randfontein Estates Limited v the Master* 1909 TS 978 at 981 followed in *De Leef Family Trust & Others v Commissioner for Inland Revenue* 1993 (3) SA 345 (A) 356

consisting of a series of mutual covenants entered into by all the shareholders inter se.'17

Given the above definition, it is clear that the shareholder has a liability, also found in the Act, to pay for his or her shares before shares are issued; thereafter his or her interest gives him or her the right to attend meetings, vote, receive dividends and receive a return on capital when the company is wound up. The rights to these interests are contained in the Act.

b) Nature of a share in terms of the Act

The Act defines a share as 'one of the units into which the proprietary interest in a profit company is divided'.[18] It is important to note that a share is merely one unit to denote interest in a profit company, and that other units such as debentures and debt instruments may also denote an interest in the company and, together with shares, fall under the auspices of 'securities'.[19]

We also find that 'a share issued by a company is movable property, transferable in any manner provided for or recognised by this Act or other legislation'.[20] Of importance is that the legislature recognises that the 'share' may not represent the owner of the rights to that share, and so the Act differentiates between the registered shareholder and the beneficial owner.[21]

A share is movable property in terms of the Act; it may be corporeal or incorporeal. In the context of common law, the share is incorporeal as it represents a complex of incorporeal rights and duties.

In terms of the Act an authorised share that has not been issued has no rights associated with it until it has been issued.[22] This is the first instance of a share. Prior to having any rights attributed to it, it exists. In terms of the Act, subject to later clarification of certain shares,[23] the MOI must define the preferences, rights, limitations and other terms associated with a share.[24] This is an unalterable provision of the Act and is therefore prescriptive. The Act further stipulates that should there be any changes to the preferences,

[17] *Borland's Trustees v Steel Brothers and Company* Ltd 1948 1 KB 116 (CA) (*the Borland case*) 288
[18] Section 1 of the Act
[19] Section 35 (1) of the Act
[20] Section 35 of the Act
[21] Section 56 of the Act
[22] Section 35 (4) of the Act
[23] Section 36 (1) (d) of the Act
[24] Section 36 (1) (b) (ii) of the Act

rights, limitations and other terms associated with a share, a Notice of Amendment of the MOI must be filed.[25] The Act further stipulates that a person acquires the rights associated with a particular security when that person becomes a shareholder.[26] The rights so obtained are therefore the rights and limitations, if any, contained in the description of the share and not elsewhere.

A share may either be issued by the company,[27] in which case there is a subscription of shares, or transferred between a shareholder and either another shareholder or a third party via a sale of shares.[28]

Although the share is incorporeal, the share certificate is a tangible document. However it only evidences the legal relationship existing between the company and the shareholder. In a person's capacity as shareholder, certain rights and duties accrue, namely the right to dividends when declared and to participate in a distribution on liquidation. The shareholder also has certain duties such as honouring the provisions of the MOI.[29]

Depending on the preferences, rights and other limitations imposed on a share,[30] voting rights may also accrue to the share. Voting rights, with respect to any matter to be decided by a company, means the rights of any holder of the company's securities to vote in connection with that matter.[31] The Act makes provision for general voting rights,[32] exercised generally at a general meeting of the company, and personal voting rights, which can always be exercised by the shareholder to vote on any proposal to amend the preferences, rights, limitations and other terms associated with those shares.[33] Personal voting rights are irrevocable.

The courts jealously guard voting rights, as evidenced in the matter of *SA Mohair Brokers v Louw*[34] where the chairman of the company's meeting rejected voting proxies. The court set aside this resolution as it found that the rejection of the proxies was unlawful since they were validly given.

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[25] Section 36 (4) of the Act
[26] Section 37 (9) (a) (i) of the Act
[27] Section 38 and 39 of the Act
[28] Chapter 2 Part E of the Act
[29] Cilliers et al 225
[30] Section 37 of the Act
[31] Section 1 of the Act
[32] Section 64 of the Act
[33] Delport et al *Henochsberg on the Companies Act* (2011) 16[t] ed (Delport et al) 168 –169
[34] *SA Mohair Brokers v Louw* 2011 ZASCA (*SA Mohair case*) 87

A shareholder is the holder of a share issued by a company and who is entered as such in the certificated or uncertificated securities register, as the case may be.[35] The definition of the shareholder however stipulates that the definition is expanded for purposes of Part F (governance of companies) to include a person who is entitled to exercise any voting rights in relation to the company.[36] The expanded definition of 'shareholder' only relates to Part F and not the entire Act.

Regarding the significance of a share certificate, King J found in *Standard Bank of SA Ltd v Ocean Commodities Inc.*[37] that there is a fundamental difference between movable and immovable property, whether corporeal or incorporeal, and that in respect of registered shares a court can go behind the register to ascertain the identity of the true owner. The court further found that the fact that shares are registered in the name of a shareholder (as defined in the Act) does not mean that the shareholder is the true owner of the shares.[38] The preference in rights between the registered shareholder and beneficial owner was emphasised. To summarise: the Harris brothers were the beneficial owners of certain shares and had ceded ownership to Ocean Commodities. The nominee shareholder, Standard Bank, was called upon to transfer the shares to a third party. The Court of Appeal ruled in favour of the Harris brothers. The court found that they had the right to sell the shares even though they were not the registered shareholders. The sale was affected via a cession of rights to Ocean Commodities. The court further found that the fact that the beneficial owners were not able to deliver the share certificates did not invalidate the transfer of ownership. The new beneficial owner, Ocean Commodities, demanded the share certificates. The court ruled that the certificates were to be registered in the name of Ocean Commodities via a partial *rei vindicatio* in opposition to a 'true' *rei vindicatio,* since the Harris brothers did not have full and unfettered ownership of the shares.

Similarly, in the case of *Oakland Nominees (Pty) Ltd v Gelria Mining & Investments Co (Pty) Ltd*[39] the beneficial owner of the shares was not the shareholder. The shareholder was merely a nominee shareholder. The nominee shareholder then sold the shares. The beneficial owner launched an action against the person in possession of the shares for delivery of the share certificates. The court granted the relief and confirmed that the

[35] Section 1 of the Act
[36] Section 57 (1) of the Act
[37] *Standard Bank of SA Ltd v Ocean Commodities Inc* 1980 (2) SA 175 (T) (*Standard Bank case*)
[38] Pretorius et al *Hahlo's South African Company Law through the cases* (1999) 6 ed (Pretorius et al) 192
[39] *Oakland Nominees (Pty) Ltd v Gelria Mining & Investments Co (Pty) Ltd* 1976 (1) SA 441 (A) (*Oakland Nominee case*)

beneficial owner, not being the shareholder, is entitled to an action to assert its right of possession of the share certificates. It must be mentioned that this case also dealt with the mandate that the principal, the beneficial owner, had given to the agent, the nominee shareholder. It was found that the mandate was limited and did not include the right to transfer the share certificates. The court went so far as to say that a share certificate in respect of a share with a signed blank share transfer form is not a negotiable instrument.

To further illustrate the nature of a share in terms of the Act, the status of a shareholder and the accompanying share certificate, one is referred to the *Tigon case*[40] in which the issue of the correct use of the spoliation process was determined. In this case the shareholder's name was removed from the share register due to a contractual dispute. The shareholder launched a spoliation application demanding restitution of his name in the shareholder register. It was argued that the spoliation application was the incorrect form because the act of removing the shareholder's name from the register did not deny the shareholder any form of possession and did not deprive the shareholder of any rights relating to possession. The reason was that a shareholder's rights are personal and not real. It was further argued that restoring the shareholder's name in the register would not affect the shareholder's incorporeal rights. The counter-argument was that by removing the shareholder's name from the register, the shareholder was denied the benefits of being a registered shareholder. The court determined that the following principles were applicable:

> '(a) the *mandament van spolie* was a possessory remedy and its aim was to restore the status quo ante, irrespective of the parties' actual rights (at 641F); and (b) an incorporeal right was capable of being possessed and such possession was effected by the exercise of the right. (At 641J)'

Applying the above principles, the court found that one must distinguish between the share itself, that is the incorporeal entity that is movable, and the bundle of personal rights to which the share gives rise. The court held that a holder of a share does not have purely personal rights and that possession of shares, being incorporeal movable property, was exercised by negotiating, pledging and otherwise dealing with the share and also by being registered in the register of members. Once registered, in terms of the Articles of Association the member obtains rights to dividends and to vote. The court found that expunging the shareholder's name and cancelling the issued shares denied the shareholder the rights in terms of the Articles of Association and the rights of beneficial use.

[40] *Tigon case*

From the *Standard Bank case*, the *Oaklands Nominee case* and *Tigon case* one can conclude that being listed in the register of shareholders does not confer ownership rights per se but is merely a further statutory right a holder of a share may enjoy. This contention is used later in this paper when discussing the transferability of shares in terms of s 8(2)(b)(ii)(bb).

c) Nature of a share in terms of common law

When discussing the nature of a share in terms of common law, one needs to emphasise that a share is an *ius in personam*, a personal right, that it is movable and incorporeal. This is echoed in all legal precedents, such as in *Cooper v Boyes*[41] where the court reiterated that a share has a complex of characteristics which are peculiar to it.

> 'The gist thereof is that a share represents a complex of personal rights which may, as an incorporeal movable entity, be negotiated or otherwise disposed of. It is certainly not a consumable article, such as money, even though a money value can be placed on it. Nor can it, by any analogy, be likened to a debt which may give rise to a claim of some kind or another, even though the debt and related claim may eventuate in an award of money being made to the claimant in respect of such debt.'

Beuthin[42] continues in this vein by stating that no matter that the value of a share in a company may fluctuate, one cannot change the essential nature of a share and the nature of a share cannot be converted from an interest or conglomerate of personal rights into an article that will be consumed by its very use and enjoyment.

Corbett JA states in the *Standard Bank case*[43] that a share in a company consists of a bundle, or conglomerate, of personal rights entitling the holder thereof to a certain interest in the company, its assets and dividends.

The common-law nature of a share is a personal right that is further fixed in the constitution of the company, the MOI, which affords the owner (shareholder or true owner) the right to dividends when declared; the return of capital on the winding-up of the company (or authorised reduction of capital); and the right to attend and vote at meetings of shareholders.[44] The rights may however be limited if statute decrees.

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[41] *Cooper v Boyes* 1994 (4) SA 521 (C) *(Cooper case*) 535
[42] Beuthin & Luiz *Beuthin's Basic Company Law* (1999) 3 ed. LexisNexis: Durban
[43] *Standard Bank case* 188
[44] *Trinity Management (Pty) Ltd v Investec Bank Ltd* 2007 (5) SA 564 (W) 17 quoted in Delport et al 157

Given that a share is an incorporeal movable it has no domicile, but for purposes of law a bearer share is situated at the place where the company is incorporated.[45] However a share that is registered in the name of a member in the securities register is situated at the place where such register is kept. For purposes of confirming jurisdiction in a matter pertaining to a share, the law of such place is the *lex situs* of the share.[46]

d) Conclusion

Defining the nature of a share is complex. It is clear that there is a distinct difference in defining a share in terms of the Act and the common law.

A share in terms of the Act is merely described as one of the units into which proprietary interest in a profit company is divided. A share is further described as movable property transferable in any manner provided for in the Act or other legislation. The Act stipulates that a share must be authorised before it is issued and that prior to issue the share has no rights attributed to it. The preferences, rights, limitations and other terms associated with a share must be set out in the MOI. This is an unalterable provision and any changes to the character of the share must be affected via an amendment to the MOI. In terms of the Act a shareholder (registered as such in the securities register) is not necessarily the owner of the share.

In terms of the common law a share is merely a personal right entitling the owner to a *spes* to the profits and assets of a company. Shares can be freely transferred without the securities register being altered.

A share certificate denotes who is the shareholder but not the owner. Common law dictates that a share is both a movable incorporeal entity and a bundle of personal rights to which the shares give rise.

[45] *Randfontein Estates Gold Mining Co Ltd v Custodian of Enemy Property* 1923 AD 576 580–583 quoted in Delport et al 158
[46] *Standard Bank case* 181

III.CHAPTER 3: TRANSFER OF SHARES

This chapter sets out the different ways in which rights are transferred and the formalities required for such transfer to be valid. This chapter is important as it investigates the manner, given the nature of the share both in terms of the Act and the common law, in which rights associated with a share are capable of being transferred. As noted in Chapter two, in terms of the Act a share has certain rights associated with it which are not required in common law, such as a share certificate. It is also noted in Chapter two that there is a difference between a shareholder and a beneficial owner of a share, depending on the context of the relationship. The transfer of shares in terms of the Act and common law is discussed in this chapter; limitations on transfer are discussed in Chapters four, five and six.

a) Introduction

A subjective right is a protectable interest that a legal subject has to a particular legal object. Subjective rights can be divided into four categories: real rights (rights to a thing); immaterial/intellectual property rights (rights in relation to the products of creativity); personality rights (rights as objects to a person's personality); and personal rights (rights to claim another to perform in terms of an obligation).

Depending on the nature of the right, they are transferred in different ways. Real rights, where the object of the right is corporeal and movable property, are transferred by delivery or by registration if the corporeal property is immovable. Personal rights are transferred by way of cession. [47]

b) Transfer in terms of the Act

In terms of the Act, a share is movable property issued by a company and is transferable in any manner provided for or recognised by the Act or other legislation.48 The procedure for the transfer of a share is merely entering the transfer into the company's security register; the only proviso is that the transfer must be evidenced by a proper

[47] LAWSA Vol 27 (2014) 2nd LexisNexis: Durban
[48] Section 35 (1) of the Act

instrument of transfer delivered to the company or proof that the transfer was effected by operation of law.[49]

The Act does not differentiate between the rights pertaining to the transfer of uncertified[50] and certified shares, and thus the share register is the primary source when determining who the shareholders of the company are.

As is evident from the above, the company issues the share and enters any change in the issued share via transfer and in the share register. A share certificate may be issued. However, the share certificate and share register are only prima facie evidence of a shareholder's title to such shares; they are not conclusive evidence. In the *Standard Bank case*,[51] the court explained an important legal difference between the registration of immovable and movable property. It explained that registration of immovable property is conclusive proof of ownership, but this is not the case in respect of movable property (which is what registered shares are). This means that, in the case of shares, a court can look behind the register to ascertain the identity of the true owner.[52]

Given the above, it stands to reason that the transfer of a share in terms of the Act does not necessarily transfer ownership of the share. This is acknowledged in the Act, which states that a securities register, or an uncertified securities register, maintained in accordance with this Act is sufficient proof of the facts recorded in it, in the absence of evidence to the contrary.[53] This implies that the shareholding as recorded in the share register may be rebutted.

The fact that the transfer of the share in terms of the Act does not necessarily transfer the rights (ownership) of the common-law definition of a share is pertinent in the context of the purported legal prescript for a private company to restrict the transferability of its securities.[54] The issue of the restriction on transfer of a share in terms of s 8(2)(b)(ii)(bb) of the Act, the MOI or the shareholders' agreement is dealt with in Chapters four, five and six.

[49] Section 51 (5)-(6) of the Act
[50] Section 52 of the Act
[51] *Standard Bank case*
[52] Muthundinne 'The Registration of Securities under the new Companies Act 71 of 2008' (2010) *Acta Juridica* (hereinafter Muthundinne) 73–86
[53] Section 50 (4) of the Act
[54] Section 8 (2) (b) (ii) (bb) of the Act

c) Transfer in terms of common law

As confirmed in various legal precedents, a share, in common law, is a personal right. Personal rights are transferred via cession. Cession involves the substitution of a new creditor (the cessionary) for the original creditor (the cedent); the debtor remains the same.[55]

In general, no formalities are required for a cession and a cession is valid even if made orally or tacitly. This lack of formality is valid even if the rights ceded form part of a written agreement. This was not always the position, and for many years a cession of rights created by a written document was regarded as incomplete unless the document was delivered by the cedent to the cessionary. In this regard De Villiers CJ states:

> 'Where a right of action exists independent of any written instrument, the cession of such a right may be effected without corporeal delivery of any document. Where however, the sole proof of a debt is the instrument which records it, the cession of the debt is not complete until the instrument is delivered to the cessionary.'[56]

Fortuitously the matter had been settled by the Appellate Division in the *Botha case,*[57] in which case the court distinguished between a right of action which cannot exist independently of the document in which it is embodied (such as a negotiable instrument) and a right of action which exists independently of the document which evidences it (such as a share in a company). The former cannot be ceded without delivery of the document, but the latter can.[58] Confirmation that shares are transferred via cession was repeated in the Supreme Court of Appeal in *Gaffoor N.O. & Others v Vangates Investment (Pty) Ltd & Others* where the court stated, 'A share is a collection of personal rights which is transferred by cession.'[59]

Cession is a method of transfer and, although it is brought about by agreement, it is not itself a contract. The agreement that brings about a cession is called an 'obligationary agreement'. It obliges the cedent to transfer the right and constitutes the underlying reason for the cession.[60] The agreement that constitutes the actual transfer of the personal right is the cession itself and is known as the 'real agreement' or the 'transfer agreement'.

Cession may have different consequences depending on the intention of the parties; the personal right may be transferred and vest in the estate of the cessionary or, as in the case

[55] Christie & Bradfield *Christie's The law of contracts in South Africa* 6 ed. LexisNexis: Durban (Christie et al) 481
[56] *Jacobsohn's Trustee v Standard Bank* (1899) 16 SC 201
[57] *Botha v Fick* 1995 (2) SA 750 A *(Botha case)*
[58] Christie et al 486
[59] *Gaffoor NO & another v Vangates Investments (Pty) Ltd & others* [2012] JOL 28790 (SCA) 16
[60] *Botha case*

of a cession *in securitatem debiti*, it may look like an absolute cession, and may even be expressed as being absolute. Evidence is admissible to prove that it was intended to be by way of security only.[61]

It is important to note that in accordance with the *nemo plus iuris* rule[62] the cessionary cannot be in a better or worse position than that in which the cedent was. Freedom of transferability of a personal right may be subject to certain limitations either by statute or agreement.

For purposes of this paper, a discussion of cession would be incomplete if the matter of cession of a *spes* were not dealt with. The courts have already ruled that a share does not entitle the owner to profits or assets of the company, but only to a dividend when declared and the distribution of assets on liquidation, as 'shareholders are not in the eye of the law, part owners of the undertaking. The undertaking is something different from the totality of the shareholders.'[63] Shareholders thus merely have a *spes.*

The issue of whether a future right or *spes*, such as an expectation of dividends when declared, can be ceded has long been debated in our courts. The practical need for parties to be able to cede future rights is trite. Given that the act of cession has two distinct processes, the obligatory agreement and the transfer agreement, it follows that one solution is to draft the cession in such a way that obligatory agreement and a transfer agreement *in anticipando* are effective at the same time. This would give legal certainty, as no further agreement of transfer is required when the right does materialise.

It goes without saying that for the cession *in anticipando* to be valid, the agreement must comply with all the substantive and formal (if any) requirements of a transfer agreement. To be substantively compliant, the right to transfer must be certain or ascertainable and the cedent must possess the capacity and right to cede. The cession *in anticipando* cannot be *contra bones mores*.[64]

[61] *National Bank of South Africa Ltd v Cohen's Trustees* 1911 AD 233 246
[62] *Nemo plus iuris ad alium transferre potest quam ipse haberet*
[63] *Short v Treasury Commissioners* 1948 1 KB 116 (CA) 122
[64] LAWSA Vol 3 (2013) 3 LexisNexis: Durban 163

d) Conclusion

A share in terms of the Act is movable property, transferable in any manner provided in the Act and other legislation. The Act merely takes note of the transfer of shareholding by the entry of the new shareholder in the securities register. The Act does not consider who the owner of the beneficial interest in the share is. It is recognised in the Act that a shareholder may not be the owner of the share and that the record in the share register may be rebuttable.

In terms of common law, a share is a personal right transferable via cession. There are no formalities for cession of a share since it is movable property. A *spes* emanating from a personal right may also be ceded. Common law recognises that a share certificate does not denote ownership and that there is a distinction between a right of action that cannot exist independently from a document in which it is embodied and a right of action that exists independently of the document.

IV.CHAPTER 4: THE RELATIONSHIP BETWEEN A COMPANY, ITS SHAREHOLDERS AND THE BENEFICIAL OWNER IN TERMS OF THE ACT

This chapter illustrates the difference in the legal relationship between a company and its shareholders on the one hand and the company and the beneficial owner on the other. It also explores the fundamental differences in the company's relationship with a shareholder and a member, and shows that although 'member' as defined in the 1973 Act is no longer included in the Act, it is still relevant in deciphering the rights vis-à-vis the company. The specific restrictions placed on shareholders or holders of beneficial interests in the company that may be contained in the MOI are discussed in Chapter five.

a) Introduction

Cilliers[65] explains that there are two facets to a company; one is that it is a separate legal entity and exists apart from its members, and the other is that it is, in essence, an association of its members. Cassim[66] points out that the terms 'shareholder' and 'member' have been used interchangeably, which is not entirely accurate because traditionally a 'member' was only regarded as such once they were registered in the company's security register (the equivalent of the definition of 'shareholder' in the Act).[67] Cilliers goes further to explain that the concept of membership is more relevant to the right of the shareholder to participate in the exercise of control by the general meeting, whereas the concept of shareholder denotes a right to dividends, when declared, and to participate in the distribution of the assets of the company on liquidation.

The Act has done away with the term 'member' in respect of a shareholder. The term 'member' is now defined to refer to membership in a non-profit company. Membership of a close corporation and any other entity means a person who is a constituent part of that entity.[68]

Although the Act no longer recognises the term 'member' to denote the right of a person other than a shareholder to participate in the exercise of control by the general

[65] Cilliers et al 240
[66] Cassim et al 356
[67] Section 1 of the Act
[68] Section 1 of the Act

meeting, the Act makes specific reference to a holder of a beneficial interest in a company and the rights that this holder, who is not a shareholder, has.[69] This chapter thus explores the differences in the legal relationship between the company and the shareholder on the one hand and the company and the beneficial owner on the other, and the relationships *inter se*.

b) The company and the shareholder

A shareholder is defined in the Act[70] as someone who is the holder of a share issued by a company (i.e. is in possession of a share certificate if shares are certified) and who is registered as such in the share register. The Act then lists the various rights that the shareholder has vis-à-vis the company. Given the nature of the share, however, when analysing the relationship between the holder of the share and the company one cannot limit this definition to that defined in the Act.

The court found in the *Tigon case*[71] that there is a clear distinction:

> 'between the share itself, which is the incorporeal moveable entity, and the bundle of personal rights to which it gives rise … The incorporeals, consisting of the shares, are, by statute, moveable property and possession is exercised by the holder negotiating, pledging, bequeathing or otherwise dealing in the shares.'

It is clear then that there must be a distinction between the rights depending on the capacity of the holder at the time of analysing the rights either as a holder of the share being the incorporeal moveable entity and/or as a holder of the share being the bundle of personal rights to which it gives rise. The rights that constitute a share are also those rights that a shareholder has against a company, as distinct from the personal rights that he or she has as a member against other members.[72]

Given the above, the definition of a share[73] and the legal nature of a share,[74] the relationship between the company and the shareholder in terms of the Act must be limited to the holder of the share being the *incorporeal movable entity*. In other words, the legal relationship between the company and the shareholder pertains only to the governance of the company and not the personal rights of the share being *the bundle of personal rights to which it gives rise.*

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[69] Section 56 of the Act
[70] Section 1 of the Act
[71] *Tigon case* 642–643
[72] Delport 'Pre-emptive rights and the sale of shares' *SA Mercantile Law Journal* 2000 (5) (*Delport: SAMLJ*) 264–270.
[73] Section 1 of the Act
[74] Section 35 (1) of the Act

These rights (attached to the *incorporeal movable entity*) are defined in Part F of Chapter two of the Act. These sections clearly identify two bodies of a company; the directors and the shareholders. Greer LJ describes the relationship between the bodies as follows:[75]

> 'A company is an entity distinct alike from its shareholder and its directors. Some of its powers may, according to its articles, be exercised by its directors, certain other powers may be reserved for the shareholders in general meeting.'

The Act refers to a nominee[76] and our courts have recognised a 'nominee' as simply a person nominated or appointed by a person to hold shares in his or her name and on his or her behalf, and who usually stands in the position of an agent who will take instructions from the beneficial owner. This being so, that nominee will have no authority to transfer the shares he or she holds unless this is given to him or her by the beneficial owner.[77] The nominee however has all the rights as a shareholder in the company.

The rights of a registered shareholder are important and distinct from the rights of a beneficial owner, as decided in the *Tigon case*[78] where the court held that:

> 'the holder also exercised possession by being registered in the register of the members. Once the requirements of section 103 (2) were fulfilled (a holder's agreement to become a member and the entry of the holder's name in the register of members), the shareholder became entitled to and possessed of all the rights of membership in terms of the company's memorandum and Articles of Association and of the Companies Act.'

c) The company and the beneficial owner

In terms of the Act a company's issued shares may be held by, and registered in the name of, one person for the beneficial interest of another person.[79] Cassim et al[80] state that this right to be registered is independent of the ownership of the shares. The nature of the relationship between the company and the shareholder, and the company and the holder of the beneficial interest, is therefore distinct.

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[75] *John Shaw and Sons (Salford) Ltd v Shaw* 1935 2 KB 113 (CA) approved in *Letseng Diamonds Ltd v JCI Ltd; Trinity Asset Management (Pty) Ltd v Investec Bank Ltd* 2007 (5) SA 564 (W)
[76] Section 1 of the Act
[77] *Oakland Nominees case*
[78] *Tigon case* 636
[79] Section 56 (1) of the Act
[80] Cassim et al 357

The MOI may restrict the right to appoint a holder of a beneficial interest.[81] The Act places certain obligations on a shareholder vis-à-vis the holder of the beneficial interest[82] and further grants certain voting rights, subject to disclosure requirements to holders of beneficial interests.[83] Given the status and rights of the holder of a beneficial interest, we can conclude that the holder of a beneficial interest is manifestly the same as a 'shareholder' in the 1973 Act, and 'member' in the 1973 Act may be equated with a shareholder in the Act.

d) Conclusion

A shareholder is merely the person whose name is in the securities register. The relationship between a shareholder and the company is in relation to the share as an incorporeal movable entity and not in relation to the shareholder as the holder of the bundle of personal rights vested in the share. As such the shareholder is entitled to certain statutory rights such as the management of the company.

The relationship between the company and the beneficial owner is dependent on the rights that have been ceded to the beneficial owner. There are certain disclosure obligations on the shareholder vis-à-vis the identity of the beneficial owner. The beneficial owner is the holder of the *bundle of personal rights to which the share gives rise* and only obtains the additional incorporeal movable rights when he or she is registered as a shareholder.

[81] Section 56 (1) of the Act.
[82] Section 56 (3)-(8) of the Act
[83] Section 56 (9)

V.CHAPTER 5: LEGAL RELATIONSHIP CREATED IN THE MEMORANDUM OF INCORPORATION

This chapter investigates the legal status of the MOI and unpacks the legal obligations and rights the MOI creates and the status thereof with specific reference to the MOI of a private company. The chapter also elaborates on who is bound by the MOI and investigates the question of whether a *pactum de non cendendo* can be created in a MOI. It also attempts to answer the question of whether the *pactum de no cedendo* morphs the original incident of the share from being freely transferable to restricting the transferable nature of the share from inception, as found in the matter of the *Smuts case*.

a) Introduction

A company is a separate legal entity, as confirmed in *Salomon v Salomon*[84] which ruled that as long as the company is validly formed the company is distinct from its shareholders; that nominee shareholders are acceptable; that shareholders are entitled to be secured creditors; and that the liabilities of the company are not the liabilities of the shareholders. The Act stipulates that a company comes into existence from the date of incorporation[85] and that the registration certificate is evidence that all the requirements for incorporation are met and that the company is incorporated.[86] In line with the purpose of the Act, that is to promote the development of the South African economy,[87] and more specifically Part B of the Act, anyone has the right to incorporate a company. The requirement is merely to complete and sign a MOI[88] and file a Notice of Incorporation.[89]

[84] *Salomon v A Salomon and Co Ltd* [1897] AC 22
[85] Section 19 (1) of the Act
[86] Section 14 (4) of the Act
[87] Section 7 (b) of the Act
[88] Section 13 (1) of the Act
[89] Section 13 (2) of the Act

b) Legal status of the memorandum of incorporation

The MOI is the founding document of the company and it sets out the rights, duties and responsibilities of the shareholders, directors and others within and in relation to the company, together with various other matters.[90]

The MOI must comply with the Act, which contains alterable provisions that may be excluded from the MOI and unalterable provisions that must be either included as stipulated in the Act or included on more onerous terms.[91]

c) The parties to the MOI

In terms of the Act the parties that are bound in terms of the MOI are limited.[92] Bearing in mind that a company is a creature of statute and common law, where applicable, the restriction on how and to what extent they are bound in the MOI is critical for the further analysis of the potential *pactum de non cendendo*.

The MOI only forms a legal bond between the company and each shareholder; between and among the shareholders of the company *inter se*; between the company and the directors or prescribed officer, in the exercise of his or her functions within the company; and between the company and any other person serving the company as a member of a committee of the board, in the exercise of his or her functions within the company.[93] It is clear from this that holders of beneficial interests in a share and third parties are not bound by the MOI.

A pressing matter is the question of whether the shareholders are bound by the MOI only to the extent that the rights conferred, or obligations imposed, on them affect them in their capacity as shareholders; and further, to what extent the MOI binds the peculiar rights between the shareholder and his or her share given the duality of the nature of a share. In other words, does the MOI bind the shareholder as the holder of the rights in the *incorporeal movable entity* or as the holder of the *bundle of personal rights to which the share gives rise*?

The question of whether the shareholders are bound by the MOI only to the extent that the rights conferred, or obligations imposed, on them affect them in their capacity as

[90] Cassim et al 122
[91] Section 15 (2) (a) (iii) read with section 15 (2) (d)
[92] Section 15 (6) of the Act
[93] Section 15 (6)

shareholders was answered in the matter of *Eley v Positive Government Security Life Assurance Co.*[94] In this case, having inserted in the Articles of Association a provision to the effect that he should be the company's attorney, Mr Eley unsuccessfully sought to rely upon it as a contract with himself in an endeavour to maintain himself in that position. The rationale was that the Constitution is binding only to the extent that it confers a right on the relevant shareholder in his capacity as a shareholder, whereas the clause inserted conferred a right on a shareholder in his capacity as an attorney. This is significant to the debate in the *Smuts case*, which is dealt with later together with the question of to what extent the MOI binds the peculiar rights between the shareholder and his or her share in the section Rights and restrictions conferred in the MOI.

The MOI further binds the shareholder *inter se.* However the Act is silent on whether the MOI binds the shareholders *inter se* only where they are affected specifically in their capacity as shareholders[95]. Since the Act is silent, one must rely on common-law principles which have found that the shareholders are bound by the MOI but only insofar as it affects them *qua* shareholders.[96]

The question of whether, given that the MOI binds the shareholders *inter se*, the shareholders can enforce the MOI directly against each other or whether it must be executed via the company was deliberated in *Rayfield v Hands,*[97] in which case the court found that direct action could be taken on the proviso that the shareholder's interest was a 'personal and individual right'. However should the interest not be direct and personal, a derivative action would need to be sought.[98]

It may be argued that not only does one need to establish whether the rights are affected *qua* shareholders but what the dimensions of the relationship between the shareholder and the share are that are capable of being regulated by the MOI, i.e. the shareholder as holder of the *incorporeal movable entity* or the *bundle of personal rights to which it gives rise*. This aspect is dealt with under section 5.4.

[94] *Eley v Positive Government Security Life Assurance Co* 1876 1 ExD 88
[95] Cassim et al 146
[96] Cassim et al 147
[97] *Rayfield v Hands* 1960 1 Ch 1; [1958] 2 All ER 194
[98] Cassim et al 146

d) Rights and restrictions conferred in the MOI

The MOI must comply with the Act;[99] where it contravenes or is inconsistent with the Act, it is void.[100] As discussed above, the MOI may alter the alterable provisions of the Act but where there are unalterable provisions the MOI must either incorporate the provisions as is or alter them on the basis that they are more onerous. The MOI may even couple any restrictive condition in the MOI with a particular method of amendment or have absolute prohibition on its amendment.[101] The letters RF (ring-fenced) must be inserted if such prohibitive clauses are inserted to alert third parties;[102] this is a limited application of the doctrine of constructive notice.[103]

Notwithstanding the right to alter the alterable provisions and to incorporate the unalterable provisions as aforesaid, the Act stipulates that the MOI for inter alia private companies must contain a prohibition from offering any of its securities to the public and must contain the proviso that the company restricts the transferability if its securities.[104]

This proviso that the company restricts the transferability of its securities is the main thrust of this paper and has been debated by the courts for some time. As explained, the debate is limited to the restriction on transferability of a share. The central issue to be determined is whether this proviso to restrict transferability of a share creates a *pactum de non cendendo*.

To concisely answer the question of whether the restriction on transferability morphs the share from being freely transferable to restricted, one needs to look carefully at the nature of a share. In terms of the Act a share is merely movable property, the rights to which are evidenced, *prima facie*, by the share register; this movable property is transferable in any manner provided for or recognised by the Act or other legislation.

Transfer of a share is regulated[105] and transfer as stipulated in the Act brings about the technical transfer of the share, i.e. the change in the name of the shareholder on the share certificate (if applicable) and in the share register. The Act does not deal with the full and

[99] Section 15(1)(a) of the Act
[100] Section 15(1)(b) of the Act
[101] Section 15(2)(b) of the Act
[102] Section 11(3)(b) of the Act
[103] Cassim et al 128
[104] Section 8(2)(b)(ii) (aa) and (bb)
[105] Section 51 – 53 of the Act

technical transfer which Rumpff JA describes in *Inland Property Development Corporation (Pty) Ltd v Cilliers*[106] as follows:

> 'In regard to shares, the word 'transfer', in its full and technical sense, is not a single act but consists of a series of steps, namely an agreement to transfer, the execution of a deed of transfer and, finally, the registration of the transfer.'

In the light of the above, 'in an agreement to transfer ownership of shares pursuant to an obligatory agreement the beneficial ownership passes to the buyer and only registration in the name of the buyer is regulated' by the Act.[107]

The importance of the nature of the share as defined in the Act[108] needs repeating. The Act states that a share is movable property, therefore ownership passes by mere cession without registration. Only if the transfer is to be registered does it need to conform to the prescripts of the Act. There are no prescripts that regulate the way in which beneficial ownership will pass.

In the light of the above it may be argued that there can be no restriction on the transfer of the *bundle of personal rights* to which the share gives rise, and only the registration of the transfer is regulated by the Act. It is also worth remembering that, in the words of Lord Greene in *Greenhalgh v Mallard*:[109]

> 'In the case of the restriction of transfer of shares I think it right for the court to remember that a share, being personal property, is prima facie transferable … If the right of transfer, which is inherent in property of this kind, is to be taken away or cut down, it seems to me that it should be done by language of sufficient clarity to make it apparent that that was the intention.'

A further aspect that needs exploring is the statutory creation of the share. In terms of the Act, prior to the issue of any share, a share must be authorised.[110] The exact extent of the preferences, rights, limitations and other terms associated with the share must be set out in the MOI. Any changes to those features of the share must be affected by a change in the MOI and a Notice of Amendment to the MOI must be filed.[111] It is important to note that issued

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[106] *Inland Property Development Corporation (Pty) Ltd v Cilliers* 1973 (3) SA 245 (A) at 251
[107] Delport *SAMLJ* 267
[108] Section 35 (1) of the Act
[109] *Greenhalgh v Mallard* 1943 2 All ER 234 (CA) 237
[110] Section 36 of the Act
[111] Section 36 (4) of the Act

share's features cannot be so amended.[112] Should the defined features of the authorised share then not contain any restriction on transferability, it would seem that a change to the feature as proposed to restrict the transferability of a private company's shares[113] is not permissible unless the restriction on transferability is set out in the features of the share itself.

It has been suggested that the nature of a private company emulates that of a partnership and that the reason for the restriction on the transferability of the shares and why it is appropriate may be to preserve the closed relationship between the shareholders and to keep outsiders from entering into the partnership. This was confirmed in the matter of *Ebrahimi v Westbourne Galleries Ltd*,[114] where the court treated the company as a domestic company or quasi-partnership. In this case the House of Lords stated that:

> 'there is room in company law for the 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.'[115]

However the mere fact that a company is small and private does not suffice for a court to recognise it as a domestic company or quasi-partnership.[116] The onus is on the applicant to disprove the existence of a company, especially in view of the confirmation of the legal status of a company in terms of the Act.[117] If however the applicant succeeds in getting the court to recognise that the company is indeed a domestic company or quasi-partnership, then the cessionary merely acquires the right to receive the profits from the partner. The cessionary may be admitted to the partnership in place of the partner only if the other partners agree and a new contract of partnership is entered into to that effect.[118] It bears mentioning that shareholders do not owe any fiduciary duties *inter se* and that there is thus no legal onus on them to act in the best interest of each other. Partners, on the other hand, do owe a duty to each other.

If the parties intended a partnership, then it goes without saying that the company should be deregistered and a partnership agreement entered into. To restrict the transferability of a share, both the incorporeal entity that is movable and the bundle of personal rights to

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[112] Section 36 (3) of the Act
[113] Section 8(2)(b)(ii)(bb) of the Act
[114] *Ebrahimi v Westbourne Galleries Ltd* 1972 2 All ER (*Ebrahimi case*) 492
[115] Ebrahimi case at 500 approved by the Appellate Division in *Hulett v Hulett* 1992 (4) SA 291 (A) 307
[116] Cassim et al 51
[117] Section 19 of the Act
[118] LAWSA Vol 4(1) (2012) 2 ed. LexisNexis: Durban 68

which the share gives rise, in order to morph the company into a partnership is disingenuous and contrary to the purpose of the Act.

It is also important to make the distinction between a restriction on the transfer of shares as an obligation *qua* shareholders and a *pactum de non cendendo* that could be part of the share.[119]

In *Capespan (Pty) Ltd v Any Name 451 (Pty) Ltd*[120] the court made an important distinction between a *pactum de non cendendo* of a right which, by means of the *pactum* itself, was created *ab initio* as a non-transferable right on the one hand, and a *pactum de non cendendo* that prohibits the cession of an existing right. Applying this principle to the purported restriction on transferability of shares contained in the MOI of a private company, one finds that for the *pactum* to be created *ab initio*, the restriction should be contained in the description of the preferences, rights and limitations of the share[121] itself. The description of the features of the share should include both aspects of the share, to wit, an incorporeal entity that is movable, and the bundle of personal rights to which the shares gave rise.

The question then is what the cessionary can do to become registered as the shareholder, i.e. demand the technical transfer prescribed by the Act. In this regard we note that in *Standard Bank of South Africa Ltd v Ocean Commodities Inc.*[122] the court said that an agreement to sell shares does not mean that the seller must procure registration of the transfer into the name of the purchaser. It explained that the seller's duty is completed when he or she has done all in his or her power to put the transferee in a position to demand transfer from the company. Until registration of transfer, however, the transferor or his or her nominee is a trustee of the shares of the transferee.[123] In the same vein and in *Botha v Fick*,[124] the court ruled that shares are transferred by cession alone and delivery of a share certificate is not required, as the share certificate does not result in the transferee obtaining ownership of the shares.

Given the above, the transferee may demand registration in the technical sense and the company through its directors would be obliged to act in the best interest of the company.[125]

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[119] Delport et al 52 (8)
[120] *Capespan (Pty) Ltd v Any Name 451 (Pty) Ltd* 2008 (4) 510 (C) 518
[121] Section 37 of the Act
[122] *Standard Bank case* 181-2
[123] Muthundinne 83
[124] *Botha case*
[125] Section 76(3)(b) of the Act

In this sense 'the company' is defined as the current and future shareholders,[126] which would include the transferee. It is important to note, however, that the criteria for 'best interest of the company' are what the directors and not the court deem to be the best interest.[127]

e) Smuts v Booyens: Markplaas (Edms) Bpk

Smuts v Booyens: Markplaas Edms Bpk[128] deserves special mention, since the court took a divergent view on the issue of the *pactum de non cendendo* and the aim of this section is to analyse the case to advance the position of this paper.

Facts

A shareholder, Roux, entered into an agreement with a third party, Booyens, whereby Booyens would buy Roux's shareholding in Markplaas. This agreement was entered into without another shareholder, Smuts', knowledge and was in conflict with a right of pre-emption in the Articles of Association of the company. Roux was sequestrated. Roux subsequently delivered the share certificate to Booyens. Smuts' objection to the sale agreement was founded on the ground that Roux had failed to adhere to Markplaas' Articles of Association regarding the sale of shares.

Cameron JA delivered the unanimous judgment.

The judge explained that a private company is obliged to place restrictions on the right to transfer its shares. Cameron JA made it clear that the restriction on transfer in the 1973 Act meant that 'transfer' in the 'full' and 'technical' sense of the word is restricted. Transfer, the judge said, comprises a series of steps: an agreement to transfer, the execution of a deed of transfer, and the registration of the transfer. If the restrictions imposed by the Act and the Articles of Association of the company (which encompass this threefold meaning of the term 'transfer') are not complied with, then according to the judge, the shares are not transferable at all. The judge stated that articles 21–24 of the model Articles of Association contained in Table B of Schedule 1 of the Act contain restrictions on the transfer of shares. He stated that if a private company adopts the model Articles of Association, a contract is created between the shareholders and according to s20, their right to transfer the company's shares is limited by the requirement that the stated procedure in articles 21–24 be first

[126] *Greenhalgh v Ardene Cinemas* 1951 CH 286; 1950 2 All ER 1120 (CA)
[127] *Re Smith & Fawcett Ltd* 1942 Ch 304 at 306
[128] *Smuts case*

complied with before the shares may validly be transferred to a party who is not a shareholder. Cameron JA cautioned that if the procedure is not complied with, no rights in respect of the shares could be transferred to a purchaser. The reason was that in such a case the right would 'from its inception, lack the attribute of transmissibility'. In finding favour with the argument of Smuts the judge held that Table B of Schedule 1 therefore contains an absolute prohibition in the form of a *pactum de non cedendo.*

Critique

The first challenge to the judgement is that Cameron JA concluded that s 91 of the 1973 Act dealt with the full transfer of all the rights of a share. It did not. Section 91, just like the Act,[129] regulates only the registration of the shareholder and not the true owner. Beneficial ownership of the share is thus not dealt with in the 1973 Act or the Act.

The second challenge is the fact that the statuses of a shareholder and of a member in terms of the 1973 Act are distinct. A shareholder is the holder of the '*bundle of conglomerate rights that entitle him to a certain interest in the company, its assets and dividends*.'[130] The shareholder, should he or she become a member, is entitled to additional rights and obligations as a member that are distinct from the bundle of conglomerate rights. The rights that were restricted in the articles of Markplaas were the rights of the members and not the shareholders. The right to cede was a shareholder right, as it pertained to the bundle of conglomerate personal rights and not the additional rights and obligations as a member.[131]

Thirdly, and with reference to the Act, it may be argued that a restriction in the MOI creating a pre-emptive right is void if the restriction is not contained in the feature of the share itself.[132] the description must restrict not only the transfer of the shareholder's right to technical transfer, i.e. the change of the shareholder's name in the securities register, but also the cession of the bundle of personal rights to which the share gave rise.

f) Conclusion

The MOI of a company is the founding document that regulates certain relationships. The MOI may alter the alterable provisions of the Act and may only alter the unalterable provisions if they are more onerous than stipulated.

[129] Section 51–53 of the Act
[130] *Standard Bank case* 288
[131] Delport, SAMLJ 264–270
[132] Section 36(1)(b)(ii) read with 36(4)

The MOI binds the company and each shareholder, and the shareholders *inter se,* but only in their capacity as shareholders in the narrow sense. The MOI does not regulate the relationship between a beneficial owner and a share. The MOI must provide for the features of a share prior to a share being issued. The features of the share may only be amended by a special resolution and no issued share's features can be altered.

The *Smuts case* has had a profound impact on the legal certainty of the status of a purported *pactum de non cedendo* created in a MOI. It may be argued that Cameron erred in finding that the 1973 Act dealt with transfer in its full and technical sense, whereas the 1973 Act, like the Act, merely regulates the registration of the shareholder and not the change of ownership of the share. Cameron may also have erred in not finding that the rights that were restricted in the articles of Markplaas were the rights of the members and not the shareholders and that the right to cede was a shareholder right as it pertained to the bundle of conglomerate personal rights. Finally, and with reference to the Act, it may be argued that the features of a share are created in the description of the preferences, rights, limitations and other terms associated with the share and that any restriction to the share must be contained in said description.

To fully and completely restrict the transfer of a share one would have to disallow beneficial ownership, prohibit the technical transfer of shareholding and prohibit the cession of the bundle of personal right to which the share gives rise.

VI. CHAPTER 6: LEGAL RELATIONSHIPS CREATED IN THE SHAREHOLDERS' AGREEMENT

This chapter investigates the legal status of the shareholders' agreement and examines whether the shareholders' agreement will have any effect on the restriction of the transferability of a share. The chapter also considers who the parties of a shareholders' agreement are and comments on the possibility that a shareholders' agreement could fundamentally change the nature of a share, and whether the shareholders' agreement can expand on the nature of the legal relationship between the shareholders.

a) Introduction

Save for reference in the Act that a shareholder may apply to court for relief in the event that they are treated oppressively or unfairly,[133] shareholders owe no fiduciary duties to either the company or each other as held in *Living Hands (Pty) Limited and Another v Ditz and Others* where the court stated:

> 'In our jurisprudence and common-law jurisdictions such as England, Australia and New Zealand it is settled that a shareholder owes no fiduciary duty to the company in which he is a shareholder, and has no duty of care to the company in his capacity as such.' [134]

later confirmed in *ABSA Bank Limited v Eagle Creek Investments 490 (Pty) Ltd.*[135] It is for this reason that shareholders enter into a shareholders' agreement to regulate their legal and commercial relationship. It is also important to note that the MOI binds the shareholder *inter se;* however, only insofar as it affects them *qua* shareholders.[136] Under the 1973 Act the shareholders' agreement was useful not only in regulating the relationship between the shareholders but also in displacing various provisions of the company's Articles of Association. Most pre-2011 shareholders' agreements contain a preamble to the effect that the shareholders' agreement took precedence over the Articles of Association and in the event of a conflict, the provisions of the shareholders' agreement would prevail. This was

[133] Section 163(1) of the Act
[134] *Living Hands (Pty) Limited and Another v Ditz and Others* 2013 (2) SA 368 (GSJ) 377D [21].
[135] *ABSA Bank Limited v Eagle Creek Investments 490 (Pty) Ltd* 2014 ZAWCHC
[136] Cassim et al 147

confirmed in *Gohlke & Schneider v Westies Minerale (Edms) Bpk*,[137] which stated that in the event that a shareholders' agreement contradicts the Articles of Association those contradictory provisions are binding on the parties of the shareholders' agreement. Sanctity of contract thus prevailed.

All this changed with the introduction of the Act, and currently a shareholders' agreement may be entered into and contain 'any matter relating to a company'.[138] It is thus uncertain if the shareholders' agreement may contain matters not relating to the company; however, given the common-law principles of sanctity of contract, it probably may. The Act specifically prevents any deviation from its legal prescripts in the shareholders' agreement and any inconsistency with the Act or the MOI is void.[139]

b) Legal status of the shareholders agreement in terms of the Act

Unlike the 1973 Act, the Act specifically recognises a shareholders' agreement.[140] According to the Act regarding the shareholders' agreement ('Statutory SHA'), it is the shareholders who may enter into the agreement limited to any matter relating to the company, but the agreement must be consistent with the Act and the MOI and is void if this is not complied with. According to the Act and unlike the previous situation, the company is not a party to the agreement.

Given the fact that the MOI and the Statutory SHA must be consistent, one wonders what the practical application of a Statutory SHA may be. It would seem that the two documents are merely duplications.

As discussed above the MOI may alter alterable provisions of the Act and may further amend unalterable provisions to the extent that the amendment is more onerous than the legal prescript. Given the mandate that the Statutory SHA cannot deviate from the MO, no further amplification or alteration can be made to the Statutory SHA.

This is pertinent when it comes to the preferences, rights, limitations and other share terms.[141] In terms of the Act, the nature and rights pertaining to a share must be contained in the MOI and as such the Statutory SHA cannot deviate from these terms. The Statutory SHA

[137] *Gohlke & Schneider v Westies Minerale (Edms) Bpk* 1970 (2) SA 685 (A) 692–693
[138] Section 15(7) of the Act
[139] Section 15(7) of the Act
[140] Section 15(7) of the Act
[141] Section 37 of the Act

therefore cannot, in terms of the Act, agree between the shareholders on the rights, inclusive of the transferability or method of transfer of a share, if it is not contained in the MOI.

c) Legal status of the shareholders' agreement in terms of law of contract

A shareholders' agreement is merely a form of agreement that is governed by the basic principles of the law of contract.[142]

As discussed in previous chapters, a shareholder is defined as the holder of a share issued by a company and who is entered as such in the securities register.[143] Being a shareholder thus does not necessarily denote ownership of a share. It is for this reason, in my view, that true owners of shares ('common law shareholders'), not being statutory shareholders, may enter into an agreement that does not have to comply with the Act ('Common Law SHA').

The content of the Common Law SHA may then deal with matters that are not inconsistent with the MOI but that fall outside the ambit of the Act, such as the transfer, through cession, of the common law component of the share (the bundle of personal rights to which it gives rise), but not the statutory share (the incorporeal moveable entity) that is regulated.

Furthermore the company may be a party to the Common Law SHA and the parties may then fully regulate any matter.

d) Conclusion

A shareholders' agreement must conform to the Act and the MOI and should there be any deviation, the provision in the shareholders' agreement is void. The shareholders' agreement is further limited to matters concerning the shareholders *qua* shareholders. The issue of matters being dealt with between shareholders falling outside the matters concerning shareholders *qua* shareholders is thus uncertain.

Beneficial owners, not being shareholders, are not bound by the shareholders' agreement and it is therefore prudent to draft a Common Law Shareholders' agreement should one wish to regulate the position between interested parties and on matters falling

[142] Delport et al 78(4)
[143] Section 1 of the Act

outside matters strictly reserved for shareholders, such as restraint of trade or other matters of a fiduciary nature, since shareholders and beneficial owners have no fiduciary obligation *inter se*.

VII.CHAPTER 7: CONCLUSION

As we have seen, defining the nature of a share is complex. On one hand the Act defines a share as one of the units into which proprietary interest in a profit company is divided, and also states that a share is movable property transferable in any manner provided for in the Act or other legislation. This certainly does not encapsulate the real nature of a share, which has been recognised in our common law a bundle of personal rights to which the share gives rise which exists separately from any document, transferable via cession with no formalities required.

This distinction is important as it highlights the fact that in terms of the Act a shareholder does not denote ownership of the share.

In terms of the Act a share comes into existence in the MOI where a share is authorised, before it is issued. The nature, rights and limitations inclusive of any limitation to the transferability of the share must thus be clearly stipulated in the description in the MOI and cannot be amended via a provision elsewhere in the MOI or in a shareholders' agreement.

A shareholder is merely the person whose name is in the securities register. The true owner is the beneficial owner who is the holder of the *bundle of personal rights to which the share gives rise* and only obtains the additional incorporeal movable rights when he or she is registered as a shareholder.

The MOI binds only the company and each shareholder, and the shareholders *inter se,* but only in their capacity as shareholders in the narrow sense. The MOI does not regulate the relationship between a beneficial owner and a share.

The *Smuts case* has had a negative impact on the legal certainty of the pactum *de non cedendo* purportedly created in a MOI. It may be argued that Cameron erred in finding that

the *pactum de non cedendo* related to the prohibition of cession of a shareholder's bundle of personal rights to which the share gives rise.

Section 7(l) of the Act aims to 'provide a predictable and effective environment for the efficient regulation of companies.' It is within this context that the purported restriction on the transferability of shares must also be measured. It is clear that the Act cannot regulate the bundle of personal rights that is entrenched in the share, and in the light thereof any suggestion that the share as defined in the Act includes the bundle of personal rights is inappropriate.

Section 7(b) dictates that the purpose of the Act is to 'promote the development of the South African economy by – i) encouraging entrepreneurship and enterprise efficiency; ii) creating flexibility and simplicity in the formation and maintenance of companies; and iii) encouraging transparency and high standards of corporate governance as appropriate, given the significant role of enterprises within the social and economic life of the nation.*'* To this end investment in the form of capital in companies, especially private companies, is paramount. A restriction on the transferability of shares would stifle investment. The confusion of the status and ambit of the transferability requirement for private companies is unnecessary. On a proper interpretation of s 8(2)(b)(ii)(bb) with the ambit of s 7, the restriction on transferability should be limited to a process for capturing the transfer of the shares and not relate to the underlying personal rights embedded in the share *ab initio*.

Section 7(d) and (e) stipulates that the purpose of the Act is to '(d) reaffirm the concept of the company as a means of achieving economic and social benefits; (e) continue to provide for the creation and use of companies, in a manner that enhances the economic welfare of South Africa as a partner within the global economy.' Our company law has a long history, part statutory and part common law. In the light thereof and of the fact that the legislature did not expressly denounce common-law principles relating to the nature of a

share, the common-law principles on the transferability of a share (the bundle of personal rights) through cession must prevail and cannot be altered. Any mention of the intention of the restriction being to exclude outsiders from the ‘partnership’ is misguided. If one wishes to have a partnership with a commensurate ‘closed shop’ arrangement, then one should not use the company vehicle.

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