Speculum Juris

University of Fort Hare
Together in Excellence

Vol 31 No 2 (2017)
ISSN 2523-2177

The Lawfulness of a Memorandum of Incorporation Clause that Permits a Company Board to Refuse Transfer of Shares Without Reasons: Analysis of *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd*

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Abstract

A critical analysis of Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd provides an opportunity to address the simmering tension between a set of common law principles and some constitutional values. In light of the fact that section 7(a) of the Companies Act 71 of 2008 provides as a key purpose, the application of company law in a manner congruent with the constitutional values in the Bill of Rights, some tough questions in company law now need to be asked and answered. One such question which the court was called upon to answer in this case is whether a board of directors may retain under the new Act a seemingly unfettered discretion to refuse to transfer shares. A second critical question is whether the common law position that directors do not owe a duty to provide reasons for their refusal to register a transfer of shares is still valid under any circumstances. Rogers J ruled in the affirmative in both questions. Thirdly, there is a tension between celebrated common law principles of company law and limitation of individual rights, such as a shareholder's right to dispose of his/her shares. Rogers J ruled that company law principles such as the majority rule principle, the supremacy of the company's constitutional documents and virtues of commercial certainty should trump indefinite notions of fairness. This article demonstrates why the judgment should be found to be inconsistent with an interpretation preferred by the Act, whose interpretation is aligned to constitutional values. The article also addresses the implications of the absence of a provision

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under the Act that requires the board to furnish reasons for its refusal to register a transfer of shares. A relevant proposal to improve the law and promote enjoyment of rights as promoted by section 158(a) of the Act is proposed.

1 INTRODUCTION

A clause in a South African private company's Memorandum of Incorporation (MOI) entitling the board of directors to refuse to transfer shares without giving reasons will more likely than not evoke debate in a constitutional era. The position taken on such a clause by the court in *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd*[1] will surely intensify the debate in light of perceived fairness in terms of public policy[2] and the values underpinning the Companies Act 71 of 2008.[3]

The decision by Rogers J to simply confirm an unclear and, to a certain extent, problematic common-law principle without question leaves unanswered some legitimate questions which have been crying out for clarity from the courts. In addition, in light of the new Act's call for application of company law in a manner congruent with constitutional law imperatives,[4] the decision is likely to give rise to a new set of questions. For example, an old question that remains unanswered pertains to the extent to which a company board can retain an unfettered discretion to refuse to transfer shares under the Act. Another old question that now needs to be answered in the context of the constitutional values underpinning the new Act is whether the common-law position that directors do not owe a duty to provide reasons for their refusal to register a transfer of shares is still valid under any circumstances.[5] It is not clear to what extent the court attempted to resolve the tension between a shareholder's right to freely deal with his property embodied in a share, and to transfer it to whomsoever he/she chooses on the one side, and the board's seemingly unfettered discretion to refuse to register a transfer of shares on the other side. The Act places an obligation on courts to develop the common law beyond precedent as necessary to promote the realisation and enjoyment of rights established by the Act.[6] Could the court perhaps have seized the opportunity presented by the case to develop the common law to do away with a board's unfettered discretion in a manner that unfairly prejudices a party's rights established under the Act and common law?[7] Also, did the *Visser Sitrus* case not provide a window of opportunity for the court to address the implications of the absence of a provision under the Act that requires the board to furnish reasons for its refusal to register a transfer of shares?[8]

This case note critically assesses the lawfulness and desirability of a clause in a company's MOI entitling the board to refuse a transfer of shares to a purchaser without giving reasons, in the aftermath of the outcome in the *Visser Sitrus* case. This evaluation of the *Visser Sitrus* decision is done in the light of the values underpinning the Act, public policy considerations, legal principles considered by the court, and foreign law. The note adopts the traditional FIJI approach, which requires an outline of the facts, consideration of the legal issues, the judgment, and the implications of the case. Before that, the legal framework applicable to the issue of the lawfulness of a board's refusal to transfer shares without giving reasons will be briefly considered. It is also important to consider the interpretation of the Act and to outline the pertinent public policy considerations.

1 2014 (5) SA 179 (WCC).
2 See Kleitman "Board's power to refuse a transfer of shares – *Visser Sitrus* Case" http://financialmarketsjournal.co.za/boards-power-to-refuse-a-transfer-of-shares-visser-sitrus-case/ (accessed 26-03-2017).
3 Hereafter, the Act.
4 Section 7(a) provides as one of the purposes of the Act, the need to "promote compliance with the Bill of Rights as provided for in the Constitution, in the application of company law."
5 See confirmation of this principle by Rogers J in *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd and Others* (supra) at 47.
6 See s 158(b) of the Act.
7 As mandated by s 158 of the Act.
8 Interestingly the court demonstrated that it was aware of the existence of best practice from the United Kingdom (UK) in this regard in the form of a clear provision in s 771(1)(b) in the Companies Act 2006. See reference to this provision by Rogers J in *Visser Sitrus* (supra) 46.

2 TRANSFERABILITY OF SHARES IN A PRIVATE COMPANY: THE LEGAL FRAMEWORK

The case under review concerned the refusal of GHS (the respondent) to transfer shares from one shareholder, VC (the applicant) to another shareholder (MC), following the conclusion of an agreement between VC and MC for the sale of the shares. The concepts *share* and *transferability of shares* need to be briefly explained. The Act defines a share to mean "one of the units into which the proprietary (ownership) interest in a profit company is divided."[9] As incorporeal moveable property, a share or share capital affords a holder a separate right to property. Thus share capital has been held in case law to be the property of a corporation.[10] A share on the other hand is the personal property of the corporator or shareholder.[11] As moveable property,[12] a share can be negotiated, transferred or disposed of in any manner recognised by applicable law[13] and/or as provided for in the company constitution (the MOI in terms of the Act).[14]

A prominent feature that sets private companies apart from public companies is a legal requirement that a private company's MOI must restrict the transferability of its shares.[15] South Africa's law provides different ways of restricting the transferability of private companies' shares. A company has to choose among several alternatives to give effect to section 8(2)(b)(ii)(bb) of the Act. The first method could be to provide in the MOI that shares can be transferred to non-shareholders only with the approval of the board of directors.[16] Secondly, the MOI could make transfer subject to approval by existing shareholders.[17] Thirdly, a very common method employed by private companies to restrict the transferability of shares is through rights of pre-emption.[18] A right of pre-emption restricts an existing shareholder to exercise his freedom to transfer shares by requiring that shares must first be offered to existing shareholders who have a right of first refusal. This right of pre-emption is to be distinguished from the statutory pre-emptive right provided in section 39 of the Act.[19] Application of the section 39 pre-emptive right is reserved for a private company.[20] The effect of this right is that if the company proposes to issue shares, each shareholder has a right before any non-shareholder to be offered the shares and to subscribe for them within reasonable time.[21] Restrictions on transferability of shares serve practical purposes. For example, this allows existing shareholders a measure of control over the identity of the company's shareholders, thereby enabling them to maintain an existing pattern of control.[22] Additionally it may prevent one or more shareholders from obtaining control by purchasing shares from other shareholders.[23]

The corporate form is characterised by tensions, as is evident in the relationship between shareholding and transferability of shares in a private company. The reality is that there is inherent tension between share ownership by a corporator and the board of directors' power to restrict transferability of shares in terms of the law. That a share is the personal property

9 See s 1 of the Act.
10 As a separate legal person to the exclusion of shareholders. Ownership of a share in a company does not entitle a shareholder to ownership or part ownership of a company's assets. Shareholders are nonetheless residual claimants of the assets of the corporation at winding up. See *Stellenbosch Farmers' Winery Ltd v Distillers Corporation (SA) Ltd* 1962 (1) SA 458 (A) 471-472.
11 See *Bradbury v English Sewing Cotton Co Ltd* [1923] AC 744 (HL) 746.
12 Representing a complex of personal rights.
13 See s 35 (1) of the Act.
14 In *Smuts v Booyens; Markplaas (Edms) Bpk v Booyens* (2001) SA 90 (C) the court confirmed that the restricted transferability of shares is an essential attribute of a private company. Such restrictions are to be found in the company's articles (now the MOI in terms of the Act).
15 *Ibid.* For this reason, s 8(2)(b)(ii)(bb) of the Act provides that "a profit company is … a private company if … its Memorandum of Incorporation … restricts the transferability of its securities."
16 Cassim et al. *The Law of Business Structures* (2012) 80.
17 *Ibid.*
18 *Ibid.*
19 See s 39 (2) of the Act.
20 See s 39(1)(b) of the Act.
21 Section 39(2) of the Act provides that the percentage of shares to be issued to the shareholder should be equal to the voting power of that shareholder immediately prior to the offer being made.
22 Hefer "How Transferable are Private Company Shares" http://www.onlinemoi.co.za/how-transferable-are-private-company-shares (accessed 08-04-2017).
23 *Ibid.*

of the shareholder presupposes that when a holder wants to dispose of his/her property, he/she should exercise the freedom to contract with a potential buyer. By freedom of contract is meant that the parties are free to decide the following: whether or not to contract, with whom to contract, and on what terms to contract.[24] Such a right appears to be guaranteed by the constitutional right of freedom of association.[25] However, this right as far as a share in a private company is concerned, is not without limitation. The very nature of a private company as provided for in law[26] is that its MOI must provide for restriction in the manner that shares may be transferred.[27] The dilemma with this is that the restriction of transferability of shares tampers with the right of freedom to contract. Thus a balanced approach needs to be adopted when giving effect to these restrictions in order to ensure justice and fairness to the affected party/parties.

Constitutional values require that when a fundamental right is limited, care must be taken to ensure that the limitation is reasonable and justifiable in a manner that accords with public policy.[28] In *Sindler NO v Gees and Six Other Cases*[29] the court cautioned that the provisions in the company constitution restricting the right to transfer shares must be restrictively interpreted.[30] The *Visser Sitrus* case is evidence that the tension between share ownership and the restrictions on transferability has not yet dissipated. If one throws into the equation public policy considerations, the matter gets further complicated. This demands a new approach to the review of clauses which allow boards to refuse to transfer shares without providing justification.[31]

2 1 Clauses Entitling Boards to Refuse to Register Shares without Reasons

As established above, the company in its constitution can choose from several alternatives on how to give effect to the legal requirement that a private company must provide for restriction on transferability of its shares. A common restriction found in South African and other Commonwealth private companies' constitutions is one that entitles boards of directors to refuse to register a transfer of shares without giving reasons.[32] In South Africa, this appears to have been aided by the Companies Act 61 of 1973, which actively encouraged the inclusion of such clauses in private companies' MOIs.[33] Common law also appears to allow a company constitution to give the directors absolute and uncontrolled discretion to refuse to register shares.[34] The requirement, however, is that the directors must exercise their powers *bona fide* in the best interests of the company only.[35]

24 Hutchison and Pretorius et al. *The Law of Contract in South Africa* 2 ed (2012) 23.
25 Section 18 of the Constitution provides that "everyone has the right to freedom of association." "Everyone" includes both a natural and a juristic person. In this vein s 8(2) of the Constitution aptly provides that "a provision of the Bill of Rights binds a natural or a juristic person if, and to the extent that, it is applicable, taking into account the nature of the right and the nature of any duty imposed by the right."
26 See s 8(2)(b)(ii)(bb) of the Act.
27 Section 35(1) of the Act requires that negotiation, transfer and disposal of a share must be done in a manner recognised by applicable law.
28 See s 36(1) of the Constitution.
29 2006 (5) SA 501 (C).
30 This principle as propounded in the *Sindler* case (supra) n 29 above reflects the constitutional values laid down in s 36 of the Constitution. Section 36 requires that the limitation of any right akin to constitutional rights must be based on considerations such as human dignity, equality between parties, freedoms which parties/individuals have in terms of the Constitution, taking into account a number of factors before limiting a right. Such factors include the consideration of "less restrictive means to achieve the purpose", say of restricting transferability of shares in a private company. See s 36(1)(e).
31 Especially to parties whose rights have been restricted or limited by such a restrictive clause in the MOI.
32 See Kleitman. "Boards power to refuse a transfer of shares."
33 *Ibid.* Table B, schedule 1 of the Companies Act 1973 has a proposed article that provides that "[t]he directors shall have power to refuse to register the transfer of any shares without giving reasons thereof."
34 See Dignam *Hicks & Goo's Cases and Materials on Company Law* (2011) 269-270, quoting from *Re Smith & Fawcett Ltd* [1942] Ch 304, Court of Appeal.
35 This implies that directors must not exercise their powers for any collateral purpose. See *Re Smith & Fawcett Ltd* [1942] Ch 304, Court of Appeal.

The desirability of a clause, which appears to give discretion to a board of directors to refuse transfer without reasons and to unwittingly encourage a lack of transparency while limiting fiduciaries' accountability, is doubtful. That restricting transferability of shares in a private company is required by law is not in question. It is also not to be questioned that directors have the discretion when approving the transfer of shares as empowered in the MOI. What has become controversial in post-apartheid South Africa, given its constitutional dispensation, is the validity of a clause that entitles a board not to give reasons for such a refusal to transfer shares. It becomes even more controversial in situations where the transfer of shares is to happen between current shareholders of a company, where no outsider is involved. This is exactly what makes the *Visser Sitrus* decision an interesting case study in the Companies Act 2008 era where public policy considerations cannot be ignored.

2 2 Relevant Public Policy Considerations

Reference has been made to 'public policy' in the above paragraphs, and it is appropriate at this stage to define this term in light of directors' discretion to refuse a transfer of shares without reasons. Public policy, "while difficult to comprehensively define, can be understood to refer to courts' considerations of what is in the interests of the society or community."[36] In other words, these are values held dearly by a society in transition as demonstrated by Ngcobo J in *Barkhuizen v Napier*.[37] The learned judge remarked that public policy represents the legal convictions or general sense of justice including the *boni mores* of society, as informed by the concept of *ubuntu*. Ngcobo J added that this takes into account the necessity to do simple justice by one individual to another, and that this sense of justice or fairness is informed by *ubuntu*.[38]

In the English case of *Printing & Numerical Registering Company v Sampson*,[39] Jessel MR beautifully linked the concepts of freedom to contract, *pacta sunt servanda* and public policy considerations in the following manner:

> If there is one thing which, more than another, public policy requires, it is that men of full age and competent understanding shall have the utmost liberty of contracting; and that their contracts, when entered into freely and voluntarily, shall be held sacred and enforced by courts of justice.[40]

It is clear from the above dictum by Jessel MR that freedom of contract and *pacta sunt servanda* are revered principles of contract law and are considered essential for regulating contractual relations or transactions. Freedom of contract is understood to mean that parties are free to decide whether to contract, with whom to contract, and on what terms to contract.[41] Thus, the creation of a contract is a product of free choice exercised by parties to a contract, without external interference. It affirms the related notion of autonomy of contracting parties.[42] *Pacta sunt servanda* as a concept related to freedom of contract represents the "sanctity of contract" — the idea that contracts freely and seriously entered into by individuals must be honoured and, if necessary, enforced by the courts.[43] Certainty or predictability is obviously vital for commercial expediency, hence the development of these business-related concepts.

The Bill of Rights under the South African Constitution "is the most recent expression of the values upheld in our society."[44] For this reason, Christie reckons that the Bill of Rights is an "exceptionally reliable statement of seriously considered public opinion."[45]

36 Mupangavanhu "Yet another Missed Opportunity to Develop the Common Law of Contract? An Analysis of *Everfresh Market Virginia (Pty) Ltd v Shoprite Checkers (Pty) Ltd* [2011] ZACC 30" 2013 *Speculum Juris* 156.
37 2007 (5) SA 323 (CC).
38 *Ibid.* paras 28, 51 and 73. Also see Hutchison and Pretorius 31.
39 (1875) LR 19 Eq 462.
40 *Ibid.* para 465.
41 See Hutchison and Pretorius 23.
42 *Ibid.*
43 Hutchison and Pretorius 21.
44 Van der Merwe et al. *Contract General Principles* 3 ed (2007) 18.
45 See Mupangavanhu 2013 *Speculum Juris* 156, quoting Christie "The Law of Contract and the Bill of Rights" in Mokgoro and Tlakula (eds) *Bill of Rights Compendium* (2006) 3H8.

Cameron JA, as he then was, confirmed in *Brisley v Drotsky* that public policy is rooted in the fundamental values of South Africa's Constitution.[46] The content and objectives of public policy include the following: human dignity, achievement of equality, advancement of human rights and freedoms, non-racialism and non-sexism.[47] While public policy clearly encapsulates freedom of contract, it was held to preclude in the same breadth, enforcement of a contractual term with attendant unjust or unreasonable results.[48] In *Brisley v Drotsky*, while accepting the importance of public policy considerations, Cameron JA (as he then was), rejected the notion that the concept could be used to "invalidate contracts on the basis of judicially perceived notions of unjustness or to determine enforceability on the basis of imprecise notions…" such as good faith for example.[49] Interestingly, Ngcobo J expressed disagreement with this view, which appeared to have been commonly held by the Supreme Court of Appeal (SCA) to the effect that the mere fact that a term in a contract is unfair or might operate harshly does not in itself offend a constitutional principle.[50] The view of Ngcobo J appears to suggest that in this constitutional dispensation, even established principles of law such as freedom of contract and sanctity of contract have to be properly weighed up and balanced against relevant considerations such as public policy.[51] The same would go for established principles of company law such as "majority rule and the binding nature of the company's constitutional documents."[52] Thus, the dictum by Rogers J that "well-established principles should not be abandoned in favour of some wholly indefinite notion of fairness" can only be correct in a proper context. While the Act confirms the binding nature of an MOI as a form of contract between a shareholder and the company,[53] an MOI should be found to be consistent with constitutional values at all times.[54] After all, the "Constitution is the supreme law of the Republic; law or conduct inconsistent with it is invalid; and the obligations imposed by it must be fulfilled."[55]

In South Africa, company MOI clauses which empower directors to refuse transfer of shares without giving reasons, have to be necessarily reviewed through the lens of values underpinning the current Companies Act. This may necessitate a departure from the now repealed Companies Act 1973. The tension between share ownership and restriction of transferability of shares needs to be more carefully managed under the current Act than it was treated under the previous company law regime. As already established, the Companies Act 1973 actually encouraged the use of such clauses.[56] It is surely not by mere coincidence that the current Companies Act does not include a proposed clause like the one which was part of table B, schedule 1 of the old Act. The current Act could not have included such a standard clause for the reason that this would have clashed with public policy considerations encouraged by the Act in the application of company law.[57] Thus it can be argued that a clause which allows directors to restrict shareholders' right to deal freely with their property and to transfer it to whomsoever they please without giving reasons may clash with public policy considerations encouraged by the Act. Even case law agrees that the shareholder's freedom to contract "is not to be cut down by uncertain language or doubtful implications."[58]

It accords well with public policy considerations that if the right of a shareholder to deal

46 2002 4 SA 1 (SCA) para 34H-35B.
47 *Ibid.* Also see Mupangavanhu 2013 *Speculum Juris* 156.
48 See *Barkhuizen v Napier* (supra) paras 70-73.
49 *Brisley v Drotsky* (supra) para 32D-F. In *Afrox Healthcare Bpk v Strydom* 2002 (6) SA 21 (SCA) 38C, Brand JA seemed to have agreed with the dictum by Cameron JA.
50 See *Barkhuizen v Napier* (supra) para 72.
51 *Ibid.* para 92.
52 See *Visser Sitrus* (supra) para 60.
53 Section 15(6) provides that "a company's Memorandum of Incorporation, and any rules of the company, are binding – (a) between the company and each shareholder."
54 A relevant purpose of the Act in this regard, as shall be shown in section 2 3 below, is that the Act should "promote compliance with the Bill of Rights as provided for in the Constitution, in the application of company law." See s 7(a).
55 See s 2 of the Constitution.
56 See table B, sch 1 of the Companies Act 1973.
57 See one of the purposes of the Act, which is the harmonisation of company law with constitutional values. See s 7(a).
58 *Re Smith & Fawcett Ltd* [1942] Ch 304, Court of Appeal.

with his/her shares freely as he/she chooses is to be curtailed, this must only be done with satisfactory clarity,[59] fairness and justification. A situation where an existing shareholder is denied information with no reason given can be seen to be disempowering in as far as the need to exercise constitutional rights is concerned. Without information a shareholder whose freedom is curtailed by restrictions on transferability of shares and who cannot transfer his/her shares to an existing shareholder, has no way of knowing whether the directors' powers were exercised *bona fide* or for a collateral purpose.

2 3 Interpretation of Provisions of the Companies Act 2008

The Act prescribes the manner in which its provisions must be applied and interpreted, and thus whenever its provisions are to be interpreted, regard must be had to this approach before the courts strain for guidance from elsewhere. In section 5, the Act provides that the interpretation of its provisions must take place *ex visceribus actus* (from the bowels of the Act).[60] To be precise, the section states that the Act "*must* be interpreted and applied in a manner that gives effect to the purposes set out in section 7."[61] As already established in this note, the first of these purposes of the Act in section 7 is the need to "promote compliance with the Bill of Rights as provided for in the Constitution, in the application of company law."[62] The Companies Act 1973 was not harmonised with constitutional imperatives for the obvious reason that that Act pre-dated the Constitution.[63] The position is completely different under the new Companies Act. A new approach to the interpretation and application of company law in South Africa has to be adopted. The recent case of *Nedbank Ltd v Bestvest 153 (Pty) Ltd* is authority for the assertion that courts are now charged with the duty to interpret the Act in such a way that the founding values of the Constitution are respected and advanced.[64] The *Nedbank Ltd* case furthermore confirmed that the spirit and purposes of the Act must be given effect to when applying its provisions.[65] Thus application of all company law, especially provisions of the Act, now has to comply with the Constitution and be infused with or tempered with public policy considerations.

The appropriate approach to interpretation of provisions of the Act as highlighted above is a text-in-context or a purposive approach. It has to be admitted that *context* is such an elastic concept that should extend beyond the text of the Act in the task of constructing the meaning of a statutory provision. Context demands a more holistic approach and case law has shown that "the entire legislative scheme" approach includes national context, purposes of the Act, within limits, background issues and also consideration of international best practices.[66]

The contextual approach as highlighted above includes consideration of international best practices, where this is appropriate and necessary. It is thus important to note that the Act provides that "to the extent appropriate, a court interpreting this Act *may* consider foreign company law."[67] To a certain extent the Act has confirmed the need for the application of company law in South Africa to be enriched by consideration of beneficial aspects from foreign company law.

59 See *Visser Sitrus* (supra) para 74 where Rogers J quotes with approval a similar principle expressed by Lord Greene MR in *Re Smith & Fawcett Ltd* (supra) para 304.

60 See JR de Ville *Constitutional and Statutory Interpretation* (2000) 142 for use of this expression.

61 Section 5(1) of the Act; (Emphasis added).

62 See s 7(a) of the Act.

63 One of the motivations for law reform which culminated in the Companies Act 2008 was to ensure that company law kept pace with socio-economic and political changes which had taken place in South Africa between 1973, when the previous Act was passed and 2008, when the new Act was passed into law. See Davis *et al. Companies and other Business Structures in South Africa* 3 ed (2013) 4.

64 2012 (5) SA 497 (WCC).

65 *Ibid.* Also see s 158(b) of the Act which provides that the Companies Commission, the Takeover Regulation Panel or a court of law "must promote the spirit, purpose and objects of this Act" when "determining a matter brought before it in terms of this Act or making an order contemplated by this Act."

66 See remarks made by Schreiner JA in *Jaga v Donges NO and Another; Bhana Donges NO and Another* 1950 (4) SA 653 (A) 662.

67 See s 5(2); (Emphasis added).

A court of law must attach differentiated weighting to aspects where a statute employs the words *must* and *may*. It is to be noted that when it comes to the need to interpret and apply the Act in a manner that promotes and gives effect to its purposes, a peremptory word *must* is used.[68] With regard to paying attention to the persuasive value of foreign company law an optional word *may* is employed.[69] Quite clearly, a court of law is under a duty to consider the purposes of the Act as a point of departure before straining for guidance from foreign case law or foreign company law.[70] This is critical for the reason that consideration of purposes of the Act imbues decision-making with the spirit and purposes of the Act.[71] If this happens, the outcome will be a product of the spirit of the law rather than a matter of compliance with the form of the law.[72] Where a court ignores its obligation to begin the construction of meaning from the purposes of the Act, it places itself in a risky position where it may, despite its best intentions and efforts, misdirect its decision-making. In fact, emphasising foreign law ahead of seeking guidance from the 'bowels of the Act' is akin to putting the cart before the horse.

3 THE *VISSER SITRUS* CASE

3 1 Facts

Visser Sitrus (Pty) Ltd (VS),[73] the applicant and a minority shareholder in Goede Hoop Sitrus (Pty) Ltd (GHS), brought an application against GHS, the first respondent, challenging the refusal by GHS to transfer shares to the purchaser of VS' shares. VS had concluded an agreement to sell its shares to another existing shareholder Mouton Citrus (MC).[74] VS's application challenged the legal validity of the GHS board of directors' refusal to approve and register the transfer of shares without giving reasons. The applicant thus sought an order of the court declaring that the clause in GHS' MOI restricting the transferability of its shares be amended.

VS's court challenge arose out of the GHS board's decision on 28 May 2013 to reject VS's motivation/proposition[75] for the approval of transfer of its shares in GHS to MC.[76] The motivation sent by VS to GHS on 26 May 2013 seeking the board's approval to have its shares transferred, followed several attempts by Mr and Mrs Visser (VS's representatives) to lobby members of the GHS board. Some unfruitful overtures had also been made by VS's representatives to have GHS buyback its shares held by VS. The GHS representative had advised VS during such overtures that buying-back shares from VS was most likely not to be considered by the GHS board to be in the best interests of the company. No reasons were provided for the GHS board's decision not to approve the transfer of shares communicated to VC on 30 May 2013.

The Vissers unsuccessfully attempted to get GHS to furnish them with reasons for the decision. Mr. van Eeden, GHS Managing Director told the Vissers upon their inquiry that the company was entitled in terms of its MOI to refuse to transfer shares without giving reasons. The VS then reduced its verbal agreement with MC into writing at its lawyers' advice. Thereafter, attorneys for VS addressed a letter to GHS (in which a copy of its agreement with MC was attached) demanding the transfer of shares within seven days. In the letter, VS's attorneys advised GHS that any refusal to transfer shares without a cogent reason constituted oppressive and unfairly prejudicial conduct towards VS in terms of section 163(1)(a) of the Companies Act 2008.

68 See s 5(1).
69 See s 5(2).
70 It needs to be emphasised that foreign case law and foreign company law is appropriate in circumstances where there is a *lacuna* in existing law and that gap needs to be filled by reference to principles developed elsewhere.
71 As required by s 158(b) of the Act.
72 From this construction, any form of law prescribed by the old Companies Act 1973, if it clashes with the spirit and purposes of the current Act can be said to be antiquated and invalid to the extent of its inconsistence with applicable law. If the proposed article in table B, sch 1 of the old Act clashes with s 7(a) of the Act, as I suspect it does, it can be said to be antiquated.
73 Even though the court surprisingly used the acronym VC. It is important to point out that the main controllers or representatives of VC were Mr and Mrs Visser. See *Visser Sitrus* case (supra) 18.
74 MC was listed as a second respondent, even though MC did not participate in the case and never filed any affidavit.
75 See the *Visser Sitrus* (supra) 26.
76 GHS's decision which was communicated to VC on 30 May 2013. See the *Visser Sitrus* case (supra) 27.

The attorneys' letter to GHS recorded VS's instructions to the attorneys to launch an application for relief at the expiry of the seven days following the delivery of the letter of demand. VS launched this present application when GHS ignored its demand.

3 2 Legal Issues

The application concerned the refusal by the board of the first respondent (GHS) to approve a transfer by the applicant, VS, to the second respondent, MC.[77] The main issue raised by the applicant was the validity of a clause in the respondent's MOI which entitled the board of directors to refuse to transfer shares without giving a cogent reason.[78] Specifically, the applicant sought an order from the court to compel GHS to register the transfer of its shares to MC by way of the section 163 relief.[79] Secondly, the applicant sought an order declaring that clause 6.1.7.3 in GHS' MOI restricting the transferability of its shares be amended.[80] The question of law that the court had to answer is whether the GHS board's decision to refuse to transfer VS's shares to MC in terms of a clause in the MOI entitling directors to do so without reasons amounted to oppressive and unfairly prejudicial conduct that entitled the applicant to relief in terms of section 163 of the Act. By implication the court had to also decide whether the specific MOI clause 6.1.7.3, which restricted transferability of the shares held by VS, was valid.

3 3 The Judgment

The court held that there was nothing repugnant in a clause in the MOI entitling the board to refuse to transfer shares without giving reasons. The court was also not convinced that the applicant had proven its case for relief and similar prayers made, and thus dismissed the application with costs. What follows below is the brief *ratio decidendi* on the key questions of law addressed by the court.

4 KEY QUESTIONS OF LAW

4 1 To Amend or Not to Amend Clause 6.1.7.3?

Rogers J rejected the contention by the applicant, VS, that clause 6.1.7.3 in GHS's MOI is bad in principle and thus dismissed the applicant's request to grant an order for an amendment of the clause.[81] The applicant's request for an order to amend clause 6.1.7.3 has a flavour of public policy considerations, even though there is no clear evidence discernible from the judgment that the applicant's argument was premised on tangible constitutional or company law principles. The judgment of Rogers J appears to suggest that the applicant merely made a proposition that "in the modern era it is objectionable for a company's board to be entitled to refuse a transfer without giving reasons."[82] This proposition by the applicant was complemented by an attack on the relevance and applicability of the leading case of *Re Smith & Fawcett Ltd* in modern company law.[83] The applicant argued that this case and any other cases, which cited the leading case to the effect that a standard power to refuse to approve a transfer is acceptable, is now out of step with modern notions.[84] It is not clear from the judgment of Rogers J whether the court was referred to what the applicant exactly meant by its reference to "modern notions" of company law. It is, however, not difficult for a scholar of company law to realise that this was a reference to public policy considerations. It would nonetheless have been preferable for the applicant to have cited the relevant provisions in section 7 of the Act which oblige the court to consider public policy in decision-making based on provisions of

77 *Visser Sitrus* (supra) para 1.
78 *Ibid.* para 29.
79 *Ibid.*
80 *Ibid.* paras 1 and 41. Applicant sought an order from the court that cl 6.1.7.3 be amended to state the following: "The board may decline to register any transfer of the Ordinary Shares in the securities register of the Company if the transfer of such Ordinary Shares does not comply with the provisions of this Memorandum of Incorporation or the Act."
81 See *Visser Sitrus* (supra) para 50.
82 *Ibid.* para 43.
83 *Ibid.* para 46.
84 *Ibid.*

the Act.[85] The rationale for Rogers J's rejection of the applicant's request for amendment of GHS's MOI clause 6.1.7.3 was essentially that he (Rogers J) did "not see anything repugnant about a clause in an MOI stating that the board does not need to give reasons for its decision on a request to register a share transfer."[86] According to Rogers J, it is not the duty of a fiduciary to account for his actions to those to whom his fiduciary duties are owed, other than disclosing what he has actually done.[87] It would become unwieldly if directors were bound on request to provide reasons for their decisions,[88] Rogers J added. The reasoning of Rogers J was that such a clause is "a common restriction on transfer of shares in the articles of private companies" including in the Commonwealth jurisdictions.[89] The judge supported his assertion by reference to section 8(2)(b)(ii) of the Act, and the standard clause in table B of schedule 1 of the Companies Act 1973.[90]

4 2 Did the Decision to Refuse Transfer of Shares Unfairly Prejudice VS to Entitle it to Relief in Terms of Section 163 of the Act?

Applicant VS sought an order to compel GHS to register transfer of shares by way of relief in terms of section 163 of the Act. In order to arrive at a decision, the court had to determine whether the GHS board's refusal to transfer shares without reason unfairly prejudiced VS and entitled it to the relief sought. Thus the court needed to consider the nexus or inter-relationship between the directors' decision-making and the section 163 relief.[91] According to Rogers J, in order for the applicant to claim successfully the unfair prejudice remedy under section 163, it must be proved that the decision-making by the GHS board amounted to "unlawful corporate conduct."[92] The reasoning by Rogers J was that the section 163 remedy, just like its forerunner, section 252 of the Companies Act 61 of 1973, was available as a remedy for unlawful corporate conduct.[93]

Rogers J first pointed out that in order to succeed in an unfair prejudice claim in terms of section 163 an applicant had to prove not only that the conduct challenged was prejudicial, but that the prejudice or disregard of interests was unfair.[94] To say that prejudice is not unlawful unless it is also unfair sounds quite awkward, given that the word *prejudice* connotes injury or detriment to one's interests or even rights. This is, however, in line with how the relief is phrased in section 163.[95] In terms of section 163, an applicant must prove that "an act or omission … had a result that is oppressive or unfairly prejudicial, or that unfairly disregards the interests of, the applicant."[96] An alternative relevant to this case is proof that "the powers of the company … have been exercised in a manner that is oppressive or unfairly prejudicial to, or that unfairly disregards the interests of, the applicant."[97] Thus prejudice must be unfair in order for an applicant to qualify for relief in terms of section 163.

For the reason that the conduct complained of by the applicant flowed out of an empowering provision in the company's constitution (the MOI)[98] and fell within the required standard of conduct for decision-making,[99] such conduct is lawful.[100]

85 See part 2 2 above for a discussion of the relevant public policy considerations in terms of the Act.
86 *Visser Sitrus* (supra) para 48.
87 *Ibid.* para 47.
88 *Ibid.* para 48.
89 *Ibid.* paras 44 and 45.
90 Also see reference to *Smuts v Booysens* (supra) 15 in para 44.
91 *Visser Sitrus* (supra) para 52.
92 *Ibid.* para 56.
93 *Ibid.* Also see para 54.
94 *Ibid.* para 55.
95 *Ibid.* para 51.
96 See s 163(1)(a) of the Act.
97 See s 163(1)(c).
98 This is with reference to cl 6.1.7.3 of the respondent GHS's MOI. Also see paras 57 – 59.
99 In terms of s 76 of the Act. See para 59.
100 Importantly in the eyes of Rogers J, the directors act lawfully where they "exercise a power conferred on them by the company's constitution (now styled MOI), and in so doing meet the standard imposed by s76…" of the Act. See para 59.

Rogers J is of the conviction that where there is tension between the "unfair-prejudice remedy" and "company law principles, such as majority rule" and the constitutional documents of the company,[101] these "well established principles should not be abandoned in favour of some wholly indefinite notion of fairness."[102] According to the court, sticking to these established principles accords well with the principles of commercial certainty since "keeping promises and honouring agreements is probably the most important element of commercial fairness."[103] Rogers J opined that the starting point in assessing an "unfair remedy" claim should remain the company's MOI.[104] In the absence of exceptional circumstances, "there is no legitimate expectation that the general meeting of shareholders or a board will not exercise whatever powers they are given"[105] by the MOI. Rogers J thus established the principle that the circumstances should really be exceptional before a court could find that a board's decision, which complies with section 76, caused a shareholder prejudice, which qualifies to be so unfair as to justify the granting of the section 163 remedy.

Rogers J ruled that the decision by the GHS directors to refuse to transfer shares without giving reasons met the section 76 standards of conduct to "act in good faith and for a proper purpose"[106] and was taken "in the best interests of the company."[107] The court illustrated the link between the two standards of conduct by stating that "the overarching purpose for which directors must exercise their powers is the purpose of promoting the best interests of the company."[108] Thus, a board could decide in appropriate circumstances, that the company's best interests would be served by not having the proposed transferee as the holder of the shares.[109] Rogers J acknowledged that the exercise of the power granted to directors by its very nature could result in some prejudice to the parties to the proposed transfer.[110] However, in Rogers J's view, the GHS board exercised their powers for a proper purpose, that is, to prevent a shareholder from obtaining increased shareholding where such increased shareholding would be adverse to the best interests of the company.[111] Where directors have exercised their powers within the parameters of any express or implied limitations and in line with section 76, a court should be wary of substituting its own business judgment for that of the persons entrusted with that decision.[112]

In light of the above, Rogers J came to the conclusion that the refusal to approve transfer of shares, met the section 76 standards of conduct, and was thus lawful.[113] Since the section 163 unfair-prejudice remedy is available as a remedy for unlawful corporate conduct,[114] it could not be available to VS since the conduct complained of was lawful.[115] In addition, Rogers J reasoned that no exceptional circumstances existed in the applicant's case where the board's lawfully-made decision could be found to have been nonetheless "unfairly prejudicial."[116]

4 3 Request for an Order to Compel GHS to Register Transfer of Shares

Since the applicant failed in its section 163 claim/remedy and also failed in a bid to get an order for amendment of clause 6.1.7.3 for reasons outlined above, its request for the court to compel GHS to register transfer of shares was equally dismissed.[117]

101 *Visser Sitrus* (supra) para 57.
102 Rogers J supported his reasoning with reference to the view expressed in the English case of *O'Neil v Phillips* [1999] 2Al ER 961G-H & 968 A-B. See Para 61.
103 See reference to the English case — Re *Saul D Harrison* [1995] 1 BCLC 14 (CA) 18 in para 61.
104 *Visser Sitrus* (supra) para 62.
105 *Ibid.*
106 The standard of conduct is provided for in s 76(3)(a) of the Act. Also see paras 83-84.
107 This duty is now codified in s 76(3)(b) of the Act. See para 84.
108 *Ibid.* para 80.
109 *Ibid.* Para 81. In this case, this means that the GHS board was within its rights to decide against approving MC as the transferee of VC's shares, since, as per Rogers J, they acted in the best interests of the company.
110 *Visser Sitrus* (supra) para 81.
111 *Ibid.* para 84.
112 *Ibid.* para 64.
113 *Ibid.* para 95.
114 *Ibid.* para 56.
115 *Ibid.* para 95.
116 *Ibid.* para 96.
117 *Ibid.* para 98.

5 A CRITICAL COMMENTARY

The main focus of this critical commentary is the principles established/confirmed by the court regarding the lawfulness of a clause in a private company's MOI which entitles the board to refuse to transfer shares without giving reasons. As established in parts 2 1 to 2 3 above, some of these principles may clash with public policy considerations which courts are mandated to consider when deciding matters brought before them.[118] Firstly, it is argued that the court could have given more attention to important provisions of the Act relevant to the interpretation and application of the Act.[119] Closer attention to the applicant's argument could have revealed that the applicant was referring to public policy considerations when it made reference to "a standard power to refuse to approve a transfer of shares" without reasons being out of step with "modern notions" of law.[120] Secondly, a case is made for courts to always pay close attention to the appropriate method of interpreting the Act as required by section 5. Thirdly, a gap in the Act exposed by this case will be pointed out. Contrary to Rogers J's view,[121] a clause in the MOI, which entitles the board to refuse to transfer shares without reason, can be seen to be repugnant to public policy. Fourthly, a proposal is made as to how the gap, alluded to above, can be closed in order to properly align company law to public policy considerations as encouraged by section 7.[122]

Rogers J confirmed two principles. One such principle which is as unclear as it is controversial is that fiduciaries have no obligation to account for their actions to those to whom their duties are owed.[123] A related principle espoused by Rogers J is the principle that there is nothing repugnant in a clause in the MOI stating that the board does not need to give reasons for its decision on a request to register a share transfer.[124] The correctness of these principles as general rules applying without modification in modern law is doubtful. The applicant tried to challenge these principles as explained in section 3 3 above. Rogers J rejected the arguments raised by applicant of non-alignment with modern notions of law.[125] Probably, the applicant's reference to the Promotion of Administrative Justice Act 3 of 2000[126] might have been misplaced. However, the reference to a clause being "out of step with modern notions" of law,[127] was a reference to public policy considerations which are rooted in the Constitution.[128] Even if Rogers J could have ended up with the same outcome that he reached in this case, it is suggested that more regard to public policy considerations could have been given. As already demonstrated, section 7 requires that regard must be given to fundamental constitutional values in the application of company law by courts.[129]

It should be emphasised that it is the court's obligation (perhaps not only the litigants' obligation) to interpret and apply provisions of the Act in a manner that gives effect to purposes of the Act and promotes the spirit rather than the form of law.[130] As already demonstrated above, use of the word 'must' in section 5 implies an obligation imposed on a court. In a case where rights are in contest, the court does not have an option regarding whether to consider public policy or not. The Act is very clear in section 7(a), read with section 5(1) that a court has an obligation to promote compliance with the Bill of Rights as provided for in the Constitution in the application of company law. This is a clear reference to public policy considerations. When viewed in light of public policy, it is difficult to see how the two principles espoused by

118 See s 7(a) and s 158(b)(i) of the Act.
119 See part 2 3 for the examination of important provisions of the Act during interpretation.
120 See *Visser Sitrus* (supra) para 46.
121 As expressed in para 48.
122 See s 7(a) and also see part 2 3 above.
123 See *Visser Sitrus* (supra) para 47.
124 *Ibid.* para 48.
125 *Ibid.* paras 46 – 50.
126 *Ibid.* para 49.
127 *Ibid.* para 46.
128 See part 2 2 above.
129 See parts 2 2 and 2 3 where public policy and the interpretation of the provisions of the Act are explained in more detail.
130 If this obligation of the court is not clear from s 5(1), which I really doubt, then s 158 makes it even clearer when it states that: "When determining a matter brought before it in terms of this Act, or making an order contemplated in this Act – (b) the Commission, the Panel, the Companies Tribunal or a court – (i) must promote the spirit, purpose and objects of this Act…"

Rogers J relating to the MOI clause can pass constitutional muster.

A clause in an MOI that empowers a board to refuse to transfer shares between two existing shareholders without reasons can be said to be repugnant to public policy and out of step with modern notions for several reasons. As already alluded to above, restrictions on transfer of shares imposed by law on private companies, create tension with share ownership in corporate law.[131] Case law and the Bill of Rights require that care must be taken when restricting the right of a share owner to dispose of its property. It is required that the less restrictive means must be employed in restricting that right.[132] Thus it can even be argued that private companies should understand that the law requires companies to only restrict transfer of shares and not to necessarily prohibit transfer. There are many ways of giving effect to the law as now expressed in section 8(2)(b)(ii) of the Act of which the right of pre-emption is one of many options.[133] Restrictions should never be confused with prohibitions. Practices which promote arbitrariness or a form akin to that, will convert a *restriction* which is intended by law to a *prohibition* which is not intended by the law. Where a right of freedom to contract has been so curtailed to an extent that an affected party is not even entitled to information to enable him/her to enjoy an exercise of rights, it is difficult to see how such practices cannot be repugnant to public policy. A shareholder who is affected by a board's refusal to transfer shares requires information to enforce an affected right. Without reasons, an affected shareholder is likely not to know whether the board exercised its powers *bona fide*, for a proper purpose and in the best interests of the company as is required by law.[134] A simple provision of reasons where reasons are sought by affected parties could even prevent unnecessary litigation, if the affected party is satisfied with reasons given. There is no prejudice that a company can suffer were it to provide reasons particularly in cases where the board has acted in the best interest of the company.

It is also important to note that while the Companies Act of 1973 provided a standard clause which gives power to the board to refuse to transfer shares without reasons, the current Act does not. The current Act could not simply have provided such a clause for the reason that this could easily have clashed with the alignment of company law with constitutional values which the Act seeks to promote.[135] The old Act could easily "get away" with not being aligned with public policy because it predated the Constitutional dispensation. One of the purposes of the Act, apart from infusion of company law with constitutional values, was to align company law with international best practices, considering South Africa's place as a partner in the global economy.[136] A very important global trade partner and model for law reform, the United Kingdom (UK), now requires more transparency in governance by placing an obligation on directors to furnish reasons for refusing a transfer of shares.[137] The UK's current Companies Act introduces this requirement in Section 771(1)(b).[138] While the Companies Act 2008 does well by aligning the application of company law with public policy, it has left a gap on how best to align the issue of restrictions of transferability of shares with public policy and international best practices. The UK Companies Act 2006 points towards a progressive way in this regard. A provision in the mould of Section 771(1)(b) will close this gap and provide completeness to relevant sections relating to transfer of shares,[139] restrictions in terms of law,[140] directors' exercise of powers[141] and alignment to constitutional values under the Act.[142] It is important to note that Rogers J noted this gap in our law when he remarked that UK law provides for an obligation on directors to furnish reasons while our law does not.[143]

131 See part 2 above.
132 See *Sindler NO v Gees and Six Other Cases* (supra) referred to in part 2. Also see s 36(1)(e) of the Constitution
133 See part 2 above.
134 In terms of statutory duties under s 76(3)(a)–(b) and the equivalent common law duties.
135 See s 7(a) of the Act read in light of s 5(1).
136 See s 7(e) of the Act.
137 Rogers J acknowledges this in para 46.
138 See the Companies Act 45 of 2006 of the UK.
139 That is s 35 of the Act.
140 Section 8(2)(b)(ii).
141 In terms of the empowering clause in the MOI and also as permitted in terms of s 66(1) of the Act and in line with directors' s 76 requirements or obligations.
142 As provided for in s 7 (a) of the Act.
143 *Ibid*. para 46.

6 CONCLUSION

The importance of the *Visser Sitrus* case is that it has confirmed as being still legally valid, a clause in a private company's MOI, which empowers the board of directors to refuse to transfer shares without giving reasons. The case also assists lawyers to understand the interpretation and application of the section 163 remedy. Rogers J confirmed that it is not enough that the conduct complained of was prejudicial – it should also be shown to have been unfair. Rogers J further confirmed that section 163 like its predecessor, section 252 of the Companies Act 1973, is available in case of "unlawful corporate conduct." Thus, where a fiduciary's conduct meets the requirements of section 76, and is in line with the principle of majority rule and an empowering provision in the company's MOI, it is lawful.

It is, however, problematic or doubtful that a clause which empowers directors to refuse transfer of shares without reasons can generally be found to be consistent with public policy.[144] It has been demonstrated in this note, that while such a clause might have been a part of the old Act without much problems, it will not sit well with public policy considerations envisaged by section 7(a) of the Act. As such, the MOI clause encouraged by clause 11 of table B articles in schedule 1 of the old Companies Act 1973[145] can potentially clash with constitutional values under the Bill of Rights.[146] Since the Act promotes alignment with public policy,[147] clauses which empower a board to refuse share transfers without reasons could clash with public policy. The court could have found this to be the case if appropriate consideration was given to the application of section 5 as read with section 7 to give effect to the purposes of the Act.[148] Some of our courts have noted that the judiciary is under a duty to interpret the Act in a manner that ensures that the founding values of the Constitution are respected and promoted,[149] and also to ensure that the interpretation gives effect to the purposes of the Act.[150]

The case also provides a window through which it can be noted that while the Act has promoted the infusion of company law with public policy considerations, it has not provided a means of doing the same to the restrictions on transferability of shares. UK law,[151] unlike the Act, imposes obligations on directors to furnish reasons to affected parties for refusal to transfer shares. If it is considered archaic in advanced economies and jurisdictions like the UK not to provide reasons for the refusal to transfer shares, there is no cogent reason why South Africa should retain an archaic clause from the now repealed Companies Act 1973. Retaining a clause, which entitles a board of directors to refuse to transfer shares without giving reasons to an affected party, in light of section 7(a) values, is tantamount to having new wine in old wineskins. Something is bound to burst.

It is therefore recommended that a new provision be inserted under *Part E on Securities and transfer* of the Act, placing an obligation on directors to furnish reasons to the relevant parties for refusing to transfer shares. This will fully harmonise the Act with public policy considerations reflected in section 7(a) and will also bring our law in line with international best practice jurisdictions like the UK in line with the section 7(e) purpose. The proposed provision which could be housed either under section 51 or alternatively section 53 could read as follows:

> Obligation to Provide Reasons for Refusal to Transfer Shares
> Upon the lodging with the company of transfer of certificated or uncertificated securities, the company must
>
> (i) Register the transfer as requested or
>
> (ii) Give the transferee notice of refusal to register the transfer, and furnish its reasons for refusal within fifteen (15) working days after the date on which transfer is lodged with the company.

144 As discussed in part 2 2 above.
145 See reference to this standard clause in para 44.
146 See s 7(a) of the Act.
147 *Ibid.*
148 As required by s 5(1).
149 See *Nedbank Ltd v Bestvest 153 (Pty) Ltd* (supra) 497.
150 See s 5(1).
151 See s 771(1)(b) of the Companies Act 2006.