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267/85/AV

IN THE SUPREME COURT OF SOUTH AFRICA
(APPELLATE DIVISION)

In the matter between:

<u>DOUGLAS WAGNER GRAY</u>	1st Appellant
<u>NICHOLAS BROWSE GRAY</u>	2nd Appellant
<u>ANNE DOROTHY GRAY</u>	3rd Appellant

AND

<u>THESING VASTGOED B V</u>	1st Respondent
<u>MICHAEL GINSBERG AMLER & CO</u>	2nd Respondent
<u>KNORHOEK ESTATE (PTY) LTD</u>	3rd Respondent
<u>KNORHOEK FLORA (PTY) LTD</u>	4th Respondent

CORAM: CORBETT, GROSSKOPF, SMALBERGER, JJA, NICHOLAS et
NESTADT, AJJA

HEARD: 6 November 1986

DELIVERED: 21 November 1986

J U D G M E N T

NICHOLAS, AJA

This appeal is concerned with the validity of an

agreement

agreement of sale of shares in a company, having regard to the injunction in s. 38(1) of the Companies Act, No 61 of 1973, that no company shall give any financial assistance for the purpose of or in connection with a purchase of any of its shares.

The company concerned is KNORHOEK ESTATE. (PROPRIETARY) LIMITED ("the company"), which is the owner of KNORHOEK farm near Sir Lowry's Pass in the Cape. Its authorized and issued share capital is R400,00 divided into 200 shares of R2,00 each.

The agreement of sale (which I shall refer to as Annexure "A") was signed on 29 July 1980. Its subject-matter was all the shares in the company.

The sellers were the sole shareholders and directors

of

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of the company, namely Mr. DOUGLAS WAGNER GRAY, who held 194 shares; Mr. NICHOLAS BROWSE GRAY, his son, who held five shares; and Mrs. ANNE DOROTHY GRAY, his wife, who held one share.

The purchaser was THESING VASTGOED B.V., a company which was represented by GEORGE NICOLAAS HONIG.

It was recorded in the preamble to Annexure "A" that simultaneously with the conclusion and execution of the agreement, the company as lessor would enter into a lease (which was annexed) with the purchaser (THESING VASTGOED) in respect of the company's immovable and movable property. The lease will hereinafter be referred to as Annexure "B". It was provided that the lease should form an "integral part" of the agreement

ment being Annexure "A", and it was further recorded that the agreement and the lease were "indivisible": the lease could not come into operation and be binding on the parties without Annexure "A" having been duly concluded and executed; and should Annexure "A" be cancelled, the lease would forthwith terminate and the leased premises would be vacated within one month from the date of termination.

In terms of clause 4 of Annexure "A" the purchaser agreed to purchase 60 shares in the company at R2500,00 per share; and it was provided in clause 8 that the purchaser would be obliged to purchase the remaining 140 shares with-

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in a period of 5 years reckoned from 1 June 1980 at prices computed according to the formula there set out.

Clause 7 provided that DOUGLAS WAGNER GRAY (who will hereafter be referred to simply as "GRAY") should remain a director of the company until the purchaser acquired and paid for all the remaining shares of the company. It continued:

"The said ... GRAY shall be paid by the Company a director's fee and/or Consultancy or Management fee in an amount totalling Eighteen Thousand (R18 000.00) Rand per annum, payable monthly in arrear ..."

In terms of clause 8(f), any payment for shares made by the purchaser after the initial 60 shares had been purchased would reduce pro rata the director's and/or consultancy or management fee payable to GRAY; and in clause 20 it was

recorded

recorded that in the event of GRAY's death before the purchaser had acquired the remaining 140 shares all the amounts payable to him would accrue to and become payable to his deceased estate.

Clause 12 of Annexure "A" was in the following terms:

"12. (a) Simultaneously with the execution of this Agreement the Company shall enter into a Lease with the Purchaser in respect of both the movable and immovable property as defined above. Such Lease shall, notwithstanding the date of its execution be retrospective to the 1st June 1980 and shall endure until such time as the Purchaser obtains the effective control of the Company by purchasing the final 101 shares, or should this Agreement be terminated for any other reason whatsoever, until such time as such prior termination of this Agreement.

The rental payable by the Purchaser to the Company shall be the sum of Twenty-five Thousand (R25 000,00) Rand per annum

plus

plus such further sums as may be found necessary to discharge the Company's liabilities in respect of mortgage bond interest, insurance and Divisional Council rates.

The Company shall be committed to utilise the aforesaid sum of R25 000,00 as follows:-

(i)	Director's and/or Consultancy and/or managing fees to DOUGLAS WAGNER GRAY	R18 000,00
(ii)	Interest on mortgage bonds - approximately	5 000,00
(iii)	Insurance on fixed property, approximately	1 000,00
(iv)	Divisional Council rates (Approximately)	<u>1 000,00</u>
		<u><u>R25 000,00</u></u>

- (b) The payment of the aforesaid sum of R18 000,00 shall be paid monthly in arrear; the first payment of R1500,00 to be made on the 30th June 1980 and thereafter on the last day of each and every succeeding month. (Subject however to the earlier relevant provisions of this Agreement).

The

The said George Nicolaas Honig herewith interposes and binds himself as surety for and co-principal debtor with the Purchaser in respect of all the Purchaser's obligations in terms of the Agreement of Lease referred to above.

- (c) In the event of the Company for whatever reason being required to pay any income tax on the income received by it by way of the rental referred to above, such tax shall be the liability of the Purchaser and shall be forthwith discharged by the Purchaser so as to ensure that the full sum of R1500.00 shall monthly be paid to the said Douglas Wagner Gray and to ensure further the full discharge of the other liabilities of the Company in respect of mortgage interest, insurance and Divisional Council rates and taxes;
- (d) The Purchaser shall be given possession and vacant occupation of the main dwelling house on the immovable property and presently occupied by Douglas Wagner Gray on the 1st November 1980 ... "

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The lease (Annexure "B") is between GRAY "in his capacity as Director of KNORHOEK ESTATE (PTY) LTD, he being duly authorised thereto by a Resolution taken at a meeting of the Board of Directors of the said company", as lessor, and HONIG "in his capacity as Trustee for a Company in the course of formation" as lessee.

In terms of clause 2 of Annexure "B", the company let its immovable property (being KNORHOEK farm) for a period of 5 years from 1 June 1980

"... subject

"... subject however to the proviso that in the event of the Company known as Thesing Vastgoed B.V. purchasing or acquiring the majority shares in the Company known as Knorhoek Estate (Pty) Ltd in terms of an Agreement signed simultaneously with this lease then and in that event this Agreement of Lease shall terminate on the day when the said Thesing Vastgoed B.V. acquired such controlling interest in the Lessor Company."

Clause 3 provided as follows:

"3. The rental payable by the Lessee to the Lessor in respect of the leased premises

.....

shall be the sum of R25 000,00 per annum, plus such further sums as are referred to in Clause 12(a), after (sic) the said sum being arrived at in accordance with the provisions of the agreement entered into by and between the shareholders of the lessor Company and Thesing Vastgoed

B.V.

B.V.. The said rental shall be payable monthly in arrear."

(It is clear that the "clause 12(a)" referred to is clause 12(a) of Annexure "A").

It was provided in clause 5 -

"Notwithstanding anything to the contrary herein contained or referred to it is specifically agreed and recorded that in the event of the agreement entered into between the shareholders of the Lessor Company and the said Thesing Vastgoed B.V. being terminated for whatsoever cause, then and in that event this Agreement of Lease shall likewise come to an end and shall be of no further force and effect and the Lessee and its employees shall be obliged to vacate the leased premises within a period of 30 days after such termination ..."

In

In terms of clause 7, HONIG would be personally considered to be the lessee in the event of the company not being formed within a reasonable time, and, if it was formed, HONIG would bind himself as surety and co-principal debtor for all the company's obligations.

HONIG did not proceed with the formation of the company referred to in Annexure "B". Instead he acquired an existing company, CARLISLE PROPERTIES (PTY) LIMITED (CARLISLE), which became the lessee under Annexure "B".

HONIG duly obtained possession of the farm and continues in possession thereof. The first monthly payments in respect of rental were made by HONIG to the company.

From September 1980, however, and apparently without demur

by either the company or GRAY, CARLISLE paid the monthly

amount

amounts of R1500,00 in respect of his "fee" direct to GRAY.

On 4 July 1984, after the agreement had been in operation for 4 years, and after HONIG has spent a considerable amount of money on improving the farm, GRAY, NICHOLAS BROWSE GRAY and ANNE DOROTHY GRAY as first, second and third plaintiffs respectively, issued a summons out of the Cape of Good Hope Provincial Division of the Supreme Court in which THESING VASTGOED and three other interested parties were cited as defendants. They claimed an order -

- (a) Declaring that the agreement, being Annexure "A", is null and void and of no force and effect, as it is in conflict with the provisions of Section 38(1) of the Companies Act, 61 of 1973.
- (b) Declaring that the agreement of Lease (namely Annexure "B") is of no force and effect and that THESING VASTGOED and CARLISLE are forthwith to vacate the premises leased to them in terms of

Annexure "B";

and an order granting additional relief.

The essence of the plaintiffs' cause of action was contained in paragraph 11 of the Particulars of Claim:

- "11.1 Plaintiffs aver that the agreement, Annexure "A" hereto, is in conflict with the provisions of Section 38(1) of the Companies Act, 61 of 1973 more particularly in that the effect of the agreement was for the company to give financial assistance for the purpose of the purchase by (first) Defendant of Plaintiffs' shares in the company.
- 11.2 In amplification of the averment made in sub-paragraph 11.1 above, Plaintiffs aver that:
 - 11.2.1 First Plaintiff has and does not act (sic) consultant for the Company;
 - 11.2.2 It was never intended by Plaintiffs and (first) Defendant that he should so act; and
 - 11.2.3 The provisions of Paragraphs 7 and 8(f) of the agreement were designed in order to pay Plaintiffs interest on the purchase price of their shares in the company

company out of the assets of the company.

11.2.4"

In its plea, THESING VASTGOED denied each and every allegation contained in this paragraph.

The action was tried by SCHOCK J. In his judgment delivered on 20 June 1985, the learned judge held that the substance of the matter was that the funds for paying GRAY were to be supplied by THESING VASTGOED, and it was not envisaged that the company would give any financial assistance for the purpose of acquiring the shares. He accordingly dismissed the plaintiffs' claims. Costs were awarded on the attorney and client basis in terms of a provision in Annexure "A" that the successful party in any legal proceedings taken by either party against the other arising out of the agreement should be entitled to costs on

the

the attorney and client basis.

Leave having been granted by the trial Court, the plaintiffs now appeal. THESING VASTGOED, which is cited as first respondent, was the only respondent represented at the hearing of the appeal.

The historical background to the transaction, as it appears from the evidence, was this.

GRAY formerly carried on farming operations on KNORHOEK. In about 1975 he leased the property. When the lease expired in 1980, GRAY was in poor health and he did not intend to return to farming. The property was accordingly placed in the hands of an estate agent for disposal. The estate agent introduced HONIG (who resided in Sandton, Johannesburg) as a potential purchaser.

In April 1980, GRAY's attorney, Mr. M M de Villiers, produced the draft of an agreement between the company and

HONIG

HONIG, which was to serve as a basis for negotiation between them. The draft provided for the sale of the farm to HONIG for R500 000,00, which was to be payable in instalments. Interest on the balance of the purchase price outstanding from time to time was to be paid from the date of possession (1 May 1980) at the rate of 10% per annum.

Shortly afterwards DE VILLIERS produced another draft. This provided that GRAY, acting on behalf of the company, sold the farm to HONIG in his capacity as agent of a company which he would designate. Two instalments totalling R150 000 were to be paid in cash, and a liability for R350 000,00 was to be secured by a first mortgage bond, which was to provide for the payment of interest at 10% per annum on any outstanding balance. The purchaser was to have the right to commence

farming

farming operations on the property for its own account on

1 May 1980.

Thereafter, another attorney, Mr. L N MILLER, who appears to have had some experience in international finance, was brought into the picture by HONIG, because it was now contemplated that the proposed transaction would be funded by financial rands. However, a South African resident could not use financial rands, and so it was necessary that the purchaser should be a non-resident. This was THESING VASTGOED, HONIG's company, which was incorporated under the law of the Netherlands, and had its registered office at Bergen in the Netherlands. MILLER considered that the agreement would have to be "restructured" because, he said, in terms of the Exchange Control Regulations

a non-resident was not permitted to incur a debt to a resident.

MILLER accordingly drew up "Heads of Agreement", which bore the date 23 May 1980 and were to serve as the basis for a final agreement to be drawn up later. In terms of the Heads of Agreement THESING VASTGOED would purchase from GRAY 60 shares in the company, with an option to purchase the balance of 140 shares in accordance with the formula there set out. The company was to enter into a lease with THESING VASTGOED at a rental of R25 000,00 per annum, with a provision for an amount of R18 000 to be paid to GRAY as director's salary/ interest/ management fee.

After negotiations the parties then concluded An-

nexure "A"

Annexure "A" on 29 July 1980. It was therein recorded that the agreement was subject to the approval of the Exchange Control Authorities of the South African Reserve Bank as the purchaser wished to pay for the purchase price of the entire issued share capital of the company by the financial rand procedure.

THESING VASTGOED duly obtained the requisite approval.

As appears from paragraph 11 of the Particulars of Claim which is set out above, the attack on the validity of Annexure "A" was based on the provision for the payment to GRAY of an amount of R1500,00 per month or R18 000,00 per annum.

It is clear from Annexure "A" itself, and from the

evidence

evidence, that the amount of R18 000,00 was not related to any services to be performed by GRAY.

Thus, in terms of clause 8(f), the "fee" was to be reduced in proportion to any further shares purchased by THESING VASTGOED; and it was further provided that in the event of GRAY dying before the purchase by THESING VASTGOED of the remaining shares, the payments which would have accrued to him would become payable to his deceased estate.

It was not contemplated that GRAY would perform any services for the company and he did not do so. The company was inactive and there was nothing to be done by a director or a consultant.

The provision was made because GRAY insisted

upon

upon it. He required the payment in order to provide for his living expenses until such time as he received the full purchase price which he could then invest.

Consequently, the description of this payment in clause 7 of Annexure "A" as "a director's fee and/or Consultancy or Management fee" was not a true description.

In the first drafts of the agreement, provision was made for the payment of interest which would have provided GRAY with the income he required. When the basis of the sale was changed after the advent of Mr. MILLER, a stipulation for interest would have been inappropriate, because there would then be no capital sum owing. So the parties agreed on the false label. It is not clear why it was thought necessary to

to give the payment a label at all. It was suggested that it was for purposes connected with income tax, or because of the Exchange Control Regulations, but it is not necessary to go into this aspect: the facts are that a label was given, and it was a false label.

It was argued on behalf of the appellants that where a company undertakes a fictitious obligation towards a seller of shares, in order to effect payment of part of the purchase price out of its own assets, section 38 is clearly contravened. The proposition is unexceptionable. See Albert v Papenfus, 1964 (2) SA 713 (E) and Goss v E C Goss & Co (Pty) Ltd and Others, 1970 (1) SA 602 (D and CLD).

It is correct that in the present case the consideration

tion for the payment by the company to GRAY, the seller of the shares, was non-existent or fictitious consideration.

Nevertheless, for reasons which will appear I am of the opinion that the proposition is not applicable on the facts of this case.

The important question is, what precisely was the obligation (if any) which the company undertook towards GRAY.

Annexure "B" did not itself provide for such payments. The only provision was that contained in clause 12(a) of Annexure "A", to which the company was not in name a party.

Annexures "A" and "B" are separate documents. The

parties

parties to Annexure "A" are named as the three GRAYS as sellers and THESING VASTGOED as purchaser; and the parties to Annexure "B" are described as GRAY acting on behalf of the company, and HONIG in his capacity as trustee for a company to be formed. Nevertheless, it is plain that they are not discrete contracts, but are cross-linked and are interdependent.

The three sellers in Annexure "A" were the sole shareholders and directors of the lessor company in Annexure "B"; and from a practical point of view HONIG was the purchaser under Annexure "A" and the lessee under Annexure "B".

In terms of the preamble to Annexure "A", Annexure "B" was to be concluded and executed simultaneously with, and

was

was to form "an integral part" of Annexure "A". It was recorded that Annexure "A" and Annexure "B" were "indivisible", and clause 5 of Annexure "B" provided that in the event of the agreement recorded in Annexure "A" being terminated the agreement of lease would likewise come to an end.

Clause 12 of Annexure "A" purports to set out the contents of the lease. Annexure "B", however, does not contain all of the provisions of the lease to which reference is made in Annexure "A". Thus, clause 12(c) imposes on THESING VASTGOED the liability for any income tax the company might be required to pay on the income received by it by way of rentals; and clause 12(d) deals with the date on which possession of the main dwelling house on the immovable property was to be given. Although Annexure "B" is silent on both

these

these points it was clearly the intention that in the one case THESING VASTGOED should incur a liability to the company, and in the other case it should acquire a right as against the company.

In my opinion, therefore, clauses 12(c) and 12(d) must, as a matter of construction, be treated as if they had been specifically incorporated in the lease.

Similarly in regard to the provision in clause 8(f):

"Any payment for shares made by the Purchaser after the initial 60 shares have been purchased shall reduce pro rata the directors and/or consultancy or management fee payable by the Company to Douglas Wagner Gray ..."

There is no similar provision in Annexure "B". Nor does

Annexure

Annexure "B" contain any provision for a corresponding reduction in the rental payable to the company by the lessee.

There can, nevertheless, be no doubt, in my opinion, that having regard to the way in which the rental was determined in terms of clause 12(a) (to which specific reference is made in clause 3 of the lease), the parties to both Annexure "A"

and Annexure "B" intended that GRAY should be paid only the amount as reduced pro rata, and that there should be a corresponding reduction in the rental payable to the company. At the date when Annexures "A" and "B" were signed, no rental was being received from the farm.

The company's only income was a small amount by way of interest. It had no assets apart from the immovable property, which was mortgaged. It had recurring liabilities for

interest

interest on the mortgage bonds, insurance premiums and rates. It was contemplated in Annexures "A" and "B" that the rental receivable under the lease should be balanced by the company's commitments. It was specifically provided in clause 12(a) that the rental should be increased by such further sums as were necessary to discharge the company's liabilities, and it must have been intended that if the liabilities were reduced, the rental would be correspondingly reduced.

Similarly, the provision in clause 12(a) regarding the commitment to utilize the rental received by the company in a particular way, is to be treated as if it had been specifically incorporated in the lease.

In my opinion, therefore, the two agreements, regarded as an integral whole and as indivisible, are to be interpreted as imposing on the company an obligation to make the payments thereunder to GRAY out of rental received. The result is that the company became entitled to receive the rent, but at the same time it undertook a commitment to

" utilize

"utilize the aforesaid sum" for payments of the amounts set out in clause 12(a), including R18 000,00 in respect of GRAY's fee.

It is clear from the words quoted that the company's commitment was limited to the making of payment from rentals received: if the lessee defaulted in its payments of rent, the company would have no obligation in respect of GRAY's "fee".

The question then is whether the company's commitment amounted to the giving of financial assistance for the purpose of or in connection with the sale of the company's shares.

In my opinion, it did not. The company was merely to be a vehicle for the transmission of the R18 000,00 from HONIG to GRAY. The position from the point of view of

financial

financial assistance was no different from what it would have been if HONIG had undertaken to make payment to GRAY direct, which direct payment was in fact made by Carlisle after September 1980.

Counsel for the appellants emphasized that it was

common

common cause that Annexure "B" was a valid agreement of lease.

The argument was that under it the company provided a quid pro quo for the rental payable and that "this factor effectively destroys any suggestion that it acted as a mere conduit".

I do not agree. Under the lease the company did, it is true, acquire a right to the rental, but at the same time it committed itself to pay out of it the amount of R18 000,00 per annum to GRAY. It was clear, therefore, that the company could acquire no beneficial interest in that portion of the rent, and that by paying it over to GRAY it would not be providing financial assistance.

It was sought to argue at the hearing of the appeal that the grant of the lease itself constituted the giving of financial assistance by the company. That contention is

not

not open to the appellants. It was not raised in the Particulars of Claim and it was not investigated at the trial.

In my view, therefore, SCHOCK J was clearly right, and the appeal should be dismissed. The appeal constitutes legal proceedings taken by the appellants arising from Annexure "A" and in terms of the provision of Annexure "A" referred to above, THESING VASTGOED is entitled to costs as between attorney and client.

The appeal is dismissed. The appellant is ordered to pay the first respondent's costs as between attorney and client.

H C NICHOLAS, AJA

CORBETT, JA
GROSSKOPF, JA
SMALBERGER, JA
NESTADT, AJA

} Concur