Case No. 288/98

In the matter between:

JONATHAN DAVID PETERS NO **First Appellant**
EDWIN MARCUS LETTY NO **Second Appellant**
LEONARD CAREL VAN VUGHT NO **Third Appellant**
in their capacity as the trustees of the Jonty Peters family trust
JONATHAN DAVID PETERS NO **Fourth Appellant**
DERRICK STUART PLANTING NO **Fifth Appellant**
MICHAEL STEPHEN EDY **Sixth Appellant**
in their capacity as the trustees of the Derrick Planting Family Trust

and

THERESA SCHOEMAN **First Respondent**
CATHERINA SUSARA ABRAHAM **Second Respondent**
MüLLER LOUW **Third Respondent**
MARIETHA MAGDA LUTTIG **Fourth Respondent**

Coram: HEFER ADCJ, GROSSKOPF, MARAIS, SCHUTZ JJA and MPATI AJA
Heard: 11 SEPTEMBER 2000
Delivered: 10 NOVEMBER 2000

Company law - Contravention of s 38 of Act 61 of 1973 - Scheme for avoiding of - court to have regard to true nature of agreement and disregard parties' description thereof

JUDGMENT

MPATI AJA/

MPATI AJA:

[1] The main question in this appeal is whether a written deed of sale concluded in 1997 is hit by s 38 of the Companies Act 61 of 1973 ("the Act") which prohibits the rendering by a company of any financial assistance for the purpose of or in connection with a purchase of its shares. The appellants acted as trustees for two family trusts, which were the sellers. Roux J, sitting in the Transvaal Provincial Division, concluded that the parties had failed to avoid the operation of the section, indeed that their attempts to do so amounted to mere camouflage. Consequently he refused the appellants' claim for an order that the respondents comply with their obligations as buyers, particularly to pay the final instalment of the price. Subsequently Roux J granted leave to appeal to this court.

S 38(1) provides:

> "(1) No company shall give, whether directly or indirectly, and whether by means of a loan, guarantee, the provision of security or otherwise, any financial assistance for the purpose of or in connection with a purchase or subscription made or to be made by any person of or for any shares of the company, or where the company is a subsidiary company, of its holding company."

[2] The company (Carpe Diem Properties (Pty) Ltd) owned immovable property in Mpumalanga. Had the immovable property of the company been mortgaged to provide financial assistance to enable the respondents to pay the price or any part of it for the shares in the company, there would have been a clear contravention of s 38. The conversion of the company into a close corporation by the trusts, followed by the giving of financial assistance by the close corporation in order to enable the respondents to pay for the members' interest so created, would not have offended against s 38. By contrast with the

Companies Act, s 40 of the Close Corporations Act 69 of 1984 ("the Close Corporations Act") allows a close corporation to give financial assistance for the purpose of the acquisition of a member's interest. But here there was another impediment. Section 27 of the Close Corporations Act requires every member of a company which is to be converted to a close corporation to be a member of the corporation, while s 29(1) provides that only natural persons may be members of a corporation. The members of the company were the trusts which each owned 50% of the shares. They were not qualified to become members of the close corporation. The parties were quite frank about their problems and their proposed solution, as the preamble to the deed of sale contained the following:

> "2.1 The Purchasers are prohibited by law from purchasing the shares in the Company;
> 2.2 The Sellers may not convert the Company to a Close Corporation and hold a members interest therein as they are not natural persons;
> 2.3 To facilitate this transaction the Sellers have agreed to transfer the shares to the Purchasers on the terms set out hereunder and thereafter to convert the Company to the Close Corporation;
> 2.4 After conversion of the Company to the Close Corporation the mortgage bond will be registered and the purchase price for the members' interest paid to the Sellers."

[3] The manner in which the parties gave effect to the purpose just stated was the following: The purchase price of R1 000 000 was

payable by means of an initial deposit of R100 000, a further deposit of R450 000 within 10 days of signature (clause 6.2), and by the utilisation of a bank loan of R450 000 to repay the sellers' loans totalling R250 000, and to pay the sellers R200 000 in settlement of the buyers' remaining indebtedness on the price. Clause 3.1 provided that after the first R450 000 had been paid "the sellers will *transfer* the *shares* [in the company] and cede the claims to the purchasers in consideration for the purchase price" (emphasis supplied). In terms of clause 3.3 the share certificates and written cessions of the claims would be held in trust by the attorneys Deneys Reitz on behalf of the sellers. Clause 3.4 provided for the pledging of the shares and claims with the sellers as security for the buyers' compliance with their obligations. The pledge was to be effected simultaneously with the transfer. In terms of clause 4 the sellers would take the necessary steps to convert the company into a corporation once the deposit of R450 000 (clause 6.2) had been paid and the transfer of the shares and cession of the claims had been effected. The buyers were to co-operate in the effecting of the conversion. Once all of this had been done, clause 5 would come into operation. It reads:

> "The sellers *sell* to the purchasers who purchase the *members' interest* and the claims in equal shares . . ." (emphasis

supplied).

[4] Some time after the transaction the buyers refused to proceed with it, contending that s 38 had been contravened so that the sale was void *ab initio.*

[5] As I have stated, Roux J considered the form in which the parties' agreement was cast as amounting to camouflage. I do not agree if by that the learned judge meant that the parties had deliberately camouflaged their real agreement. It was not alleged in the affidavits that the transaction reflected in the written agreement was a simulated one in that sense. There are two classes of "simulated" transaction known to our law. The first is one in which the parties have set out to conceal the real agreement by dressing it up in the guise of another. The second is one in which the parties have mistakenly characterised their real agreement as something which, when juristically analysed, it is not. In the first, the simulation is deliberate; in the second, it is unwitting. In both instances a court will have regard to the true nature of the agreement and disregard the description given to it by the parties. As I have said, there is no suggestion in the affidavits that the transaction was simulated in the first sense. What was argued, was that to the extent that the written agreement purported to characterise the transaction as a sale of members' interest, and to exclude a purchase of shares in the company, it was not an accurate reflection of the real agreement between the parties. In other words, it was argued that it was a simulation in the second sense. Whether the agreement was camouflage in that sense has to be considered. The judge *a quo* characterised the agreement as "a deliberate attempt to avoid the prohibition contained in s 38 ...". No doubt it was, but that does not mean that there was a contravention, because as Miller JA said, in dealing with the predecessor of s 38 in *Lipschitz NO v UDC Bank Ltd* 1979 (1) SA 789 (A) at 806F:

> "No doubt the matter was so arranged with the very object of ensuring that s 86 *bis* (2) was not contravened, but it is trite law that that would not be improper, provided only that the agreement was genuine and not disguised in order to conceal the true agreement."

[6] The essential contention of the buyers is that a purchase of

the shares was inherent in the transaction. The court *a quo* accepted this

argument and said:

> "Whatever one chooses to call it the Respondents 'purchased' the shares in Carpe Diem from the Applicants. The Respondents had to acquire ownership or control of the rights attaching to the shares to convert Carpe Diem to a Close Corporation. This was a vital step in the scheme of things, as the Applicants could not be members of a Close Corporation."

That conclusion appears to me to be correct for the following reasons.

[7] In this Court Mr Cilliers, for the respondents, conceded during argument that the trusts would have been entitled to transfer the shares in the company to a third party for the sole purpose of converting the company to a close corporation and thereafter transferring the members' interest so created to the respondents, in return for which the trusts would be paid the sum of R1 000 000 to be raised by mortgaging the immovable property owned by the close corporation. Mr Cilliers conceded further that in such circumstances the respondents would have had no case. However, the parties did not do that. They avoided the interposition of a third party by agreeing to transfer the shares directly to the appellants to give them *locus standi* to effect the conversion themselves and so become members of the close corporation. It is quite

clear that what the purchasers wished to acquire ultimately was the members' interest in a close corporation into which the company had been converted. That is why Clause 5 of the deed of sale provides for the sale of the members' interest by the sellers (trusts). Paradoxically, in my view, that is where the difficulty in the way of concluding that the shares were not sold, arises. The trusts are incapable in law of creating or acquiring members' interest in a close corporation and therefore can have no members' interest to sell. The agreement requires the purchasers to **create** themselves the very thing which the sellers purported to sell in terms of Clause 5.

[8] One is therefore driven to the conclusion that, on a proper construction of the deed of sale in its totality, what was in reality being sold were the shares in the company and the sellers' claims. But the sale of the shares was only one facet of a multi-faceted transaction the ultimate object of which was to enable the respondents to become the owners of members' interest in a close corporation which would acquire the company's assets and the question still remains: does the transaction offend against the provisions of s 38(1) of the Act? In terms of the deed of sale, after payment by the respondents of the deposit of R550 000, the shares will be transferred and the claims ceded to them. Thereafter the company will be converted to a close corporation with the respondents as its members in equal shares. It is true that financial assistance is to be given to enable the balance of R450 000 to be paid and that the conversion will facilitate the giving of that assistance. But it is to be given only after the conversion, ie after the company has ceased to exist and its assets have become those of the close corporation. While the company is in existence, its financial position will remain untouched by the arrangement. It will make no loan and its assets will not be encumbered. The position of its creditors will not be prejudiced in any way. Compare *Lewis v Oneanate Pty Ltd and Another* 1992(4) SA 811

(A) at 818 D. It is true that one of the assets which it now owns and which will in due course become that of the close corporation will be encumbered to enable the purchasers to pay the balance of the purchase price of the shares but that will happen only after the company has ceased to exist, and it will be the close corporation which is providing financial assistance and not the company. That is not prohibited by the Act or the Close Corporations Act. 8

[9] In *Lewis v Oneanate, supra,* it was said that the object of s 38(1) of the Act is to protect the creditors of a company "who have a right to look to its paid-up capital as the fund out of which their debts are to be discharged". The purpose is to avoid the employment and depletion of that fund or exposing it to possible risk in consequence of transactions concluded for the purpose of or in connection with the purchase of its shares (at 818 B-C). In my view, the present deed of sale is simply not within the mischief at which s 38(1) is aimed.

[10] Mr Cilliers had a second string to his bow. He submitted that the appellants had cancelled the agreement. They had exercised an election to cancel on three occasions, so it was argued: first by letter dated 18 April 1997, secondly by telephone during May 1997 and thirdly by letter dated 6 May 1997. In the first letter, written by the appellants' attorneys to the respondents' attorney, the appellants threatened to cancel the sale if the signed agreement was not received by them by close of business on 21 April 1997. From the contents of the letter of 6 May 1997 it appears that the respondents' attorney had replied to the first letter and advised, *inter alia*, that the agreement was with "the fourth party" for signature by him or her. In the last paragraph of the letter of 6 May 1997 the following is said:

> ". . . our client instructs us that if the fourth party has not signed the agreement and we are not paid the second deposit by close of business on 8 May 1997, we will be instructed to cancel the land sale agreement."

[11] As to the alleged cancellation by telephone, the fourth respondent merely states in the answering affidavit that the applicants, through their legal representative, confirmed the "cancellation" (contained in the first letter) to the respondents' attorney during May

1997.

[12] Whether or not an innocent party has made an election to cancel is a question of fact to be decided on the evidence. See the passage in *Segal v Mazzur* 1920 CPD 634 at 644-5, quoted in Christie in *The Law of Contract in South Africa* 3ed at 598.

[13] After receiving the respondents' response to the first letter, the appellants' attorneys wrote the second letter clearly indicating that no election to cancel as threatened in the first letter had been exercised. The second letter certainly does not purport to cancel. It merely states that the appellants will give instructions to cancel if the "fourth party" has not signed the agreement by close of business on 8 May 1997 and the second deposit not paid. No such instructions seem to have been given. I am in any event of the view that none of the letters referred to can be said to constitute a clear and unequivocal notice of cancellation. See *Putco Ltd v TV and Radio Guarantee Co (Pty) Ltd and Other Related Cases* 1985 (4) SA 809 (A) at 830 E; *Kragga Kamma Estates CC and Another v Flanagan* 1995 (2) SA 367 (A) at 375 C-D.

[14] The appeal must therefore succeed. The following order is made:

(1) The appeal is upheld with costs.

(2) The order of the trial court is set aside and the following is substituted:

(a) The respondents are ordered to pay to the applicants, within 20 days of date of this order, the sum of R450 000 pursuant to clause 6.2 of the Memorandum of Sale dated 9 May 1997;

(b) The respondents are ordered to comply with their further obligations under the Memorandum of Sale dated 9 May 1997;

(c) The respondents are ordered to pay the costs of the application, jointly and severally, the one paying the other to be absolved.

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ACTING JUDGE OF APPEAL

AGREE:

HEFER ADCJ
GROSSKOPF JA
MARAIS JA
SCHUTZ JA