

SHAREHOLDERS' RIGHTS AND THE ACQUISITION OF CONTROL IN A COMPANY

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SUMMARY

The shareholders in general meeting and board of directors are the main governing organs of a company. Control of the general meeting theoretically ensures control of the composition of the board of directors who are usually empowered by the articles to manage the day-to-day administration of the company. The company acts by shareholders and directors voting and passing resolutions in general meeting and board meetings respectively. Controlling sufficient votes to pass resolutions in general and board meetings is therefore the essence of corporate control. A shareholder's right to vote in general meeting is a proprietary legal right, severable from the other incidents of share ownership. By aggregating voting rights, or limiting the scope of the voting rights of some shareholders, or restricting ownership of voting rights to certain specified persons, voting control in the general meeting may be acquired.

This dissertation is dedicated to Julia

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Chapter 1 - Introduction

In order to understand the concept of corporate control¹ it is necessary to first analyse the two main governing organs of the company, namely the board of directors² and the shareholders in general meeting.³ Secondly, it is necessary to analyse the articles of association of a company and the division of managerial powers between these two organs.⁴ The ultimate control in a company is exercisable by the shareholders voting for and passing special resolutions in general meeting.⁵ Every shareholder who is a registered member of the company is entitled to attend and vote at general meetings.⁶ The effectiveness of the control conferred by the right to vote depends on the terms of the articles and of any contract entered into by the shareholders in respect of this right.

It will be submitted that in order to acquire control in a company it is necessary to either acquire ownership of or control of the required majority of shares,⁷ or to acquire de facto control in the company,⁸ or to acquire control of the management of the company. Often, the board of directors, who control the day-to-day administration of the company also exercise control over the general meeting either through the proxy-making machinery⁹ or through control of or ownership of the required majority of shares in the company. Furthermore, it will be submitted that the decision whether to acquire ownership of the shares or control of the management will depend on the size of the company and the number of shareholders of the company.

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- 1 *See 2.4 below.*
2 *See 2.1.1 below.*
3 *See 2.1.2 below.*
4 *See 2.1.3 below.*
5 *See 2.2 below.*
6 *See 2.3 and 2.1.2 below.*
7 *See 2.3 below.*
8 *See 4 below.*

The various forms of control discussed below¹⁰ may be categorised into legal and de facto¹² forms of control. The legal forms of control arise either from ownership of shares¹³ or from the articles¹⁴ or ex contractu.¹⁵ It will be submitted that shareholders' rights contained in an agreement provide shareholders with greater protection than the articles, but are also subject to greater abuse.

- 9 *See 3.3.3 below.*
- 10 *See 3 and 4 below.*
- 11 *See 3 below.*
- 12 *See 4 below.*
- 13 *See 2.2, 3.1 and 3.4 below.*
- 14 *See 3.2 below.*
- 15 *See 3.2 below.*

Chapter 2 - Control of a company

2.1 The governing organs of a company

A company as a separate juristic entity is created when the prescribed documents have been lodged with the Registrar of Companies¹, the prescribed fees, duties and taxes have been paid, and the memorandum of association² and articles of association³ have been registered with the date and certificate of registration endorsed thereon by the Registrar.⁴

A company is a statutory fiction which cannot act on its own,⁵ but can only act through human agents properly authorised so to act in terms of its articles.⁶ The governing organs,⁷ whose acts are deemed to be those of the company, and whose powers, rights and duties are set out in the articles, are inter alia the board of directors⁸ and the shareholders⁹ in general meeting.¹⁰ The role of the board of directors is often only supervisory in nature, as extensive powers may be delegated in terms of the articles to a managing director,¹¹ single directors, managers or other officers of the company.¹²

1 Hereafter referred to as "the Registrar".

2 Hereafter referred to as "the memorandum".

3 Hereafter referred to as "the articles".

4 S 63(1), s 64(1) and s 65(1) of the Companies Act, 61 of 1973 hereafter referred to as "the Act". References to sections shall be references to sections of the Act.

5 J T Pretorius (gen ed), P A Delpont, Michele Havenga and Maria Vermaas Hahlo's South African Company Law through the cases 5th ed (1991) ("Hahlo") 285; S J Naudé Die Regsposisie van die Maatskappydirekteur (1970) 46-7; Daimler Company Ltd v Continental Tyre and Rubber Co (Great Britain) Ltd [1916] 2 AC 307 at 340 and 345.

6 See 3.2 below; see J H Farrar, N E Furey, B M Hannigan and P Wylie Farrar's Company Law 2nd ed (1988) ("Farrar") for a discussion on the nature and effect of the articles.

7 Farrar 311; Peter G Xuereb The Rights of Shareholders (1989) ("Xuereb") 52; L C B Gower, J B Cronin, A J Easson and Lord Wedderburn of Charlton Gower's Principles of Modern Company Law 4th ed (1979) ("Gower") 139; P M Meskin (ed), M S Blackman, M D Glaser, I E Konyn and S F Mullins Henochsberg on the Companies Act 4th ed (1985) ("Henochsberg") 272-3 and 325.

8 See 2.2.1 below; the "board" or "the directors" being the collective term used to designate the directors when they act together as such; R v Kritzinger 1971 (2) SA 57 (A) at 59.

9 The term "shareholder" shall, for the purpose of this dissertation, mean the beneficial owner of the share who is registered as, or is deemed to be, a member of a company, unless the context indicates otherwise.

10 See 2.2.2 below.

11 G Leveson Company Directors Law & Practice (1970) ("Leveson") 89; Lennard's Carrying Co Ltd v Asiatic Petroleum Co Ltd [1915] AL 705; [1914 - 1915] ALL ER 280 (HL); Moresby White v Rangeland Ltd 1952 (4) SA 285 (SR).

12 Hahlo 463 - 5; Farrar 311; Gower 153.9.

2.1.1 The board of directors

Directors are the natural persons¹ who manage the day-to-day administration of the company.² They are, in terms of the articles, empowered to exercise all the powers of the company except those powers which have to be exercised by the company in general meeting.³

Therefore any person who can appoint "nominee" directors, in other words, directors who will act in accordance with his instructions,⁴ can at least influence and at most control absolutely the management of a company.

A public company must have at least two directors, and a private company at least one.⁵ Until directors are appointed, every subscriber to the memorandum shall be deemed for all purposes to be a director of the company.⁶ A director must be appointed as a director before he may occupy the office of director.⁷ However, if there is some defect or irregularity in his appointment, this will not affect the validity of his acts, as he will then be regarded as a "de facto" director.⁸ A "director" means any person occupying the position of director or alternate director, by whatever name he may be designated.⁹ Only in certain circumstances,¹⁰ is a person in accordance with whose directions or instructions the directors of a company are accustomed to act, deemed to be a director. In England such a director is aptly termed a "shadow" director.¹¹

The power to appoint directors is usually conferred by the articles upon the shareholders in general meeting,¹² or upon a particular class of

1 S 218(1)(a).
2 *Hahlo 327; Henochsberg 324; Xuereb 53.*
3 *Hahlo 327; Farrar 311; see 2.1.3 below.*
4 *See infra "shadow directors".*
5 S 208(1).
6 S 208(2).
7 S 210; *Henochsberg 9 and 325-7.*
8 S 214; *R v Mall 1959 (4) SA 607 (N) at 622; Hahlo 329; Henochsberg 9.*
9 *S I sv "director".*
10 *See S 1(2).*
11 *Hahlo 327 and 445.*
12 *Hahlo 446; Farrar 311.*

shareholder.¹³ It may also be conferred upon a third party either by the articles or by agreement between whoever can exercise such power under the articles and the third party.¹⁴

A director may therefore be a mere puppet,¹⁵ appointed and controlled by anonymous persons whose identity in practice is almost impossible to ascertain. The appointment as director by a third party, however, of a puppet or mere tool who has no idea what he is doing, is illegal and punishable as fraud.¹⁶

For purposes of criminal law persons deemed to be directors also include any person who "controls or governs" a corporate body, or who is a member of a body or group of persons which "controls or governs" that corporate body or, where there is no such body or group, is a member of that corporate body.¹⁷ The concept of "control" is difficult to define.¹⁸ Control does not necessarily mean either complete or effective control, and may vary in meanings from merely guiding or influencing to commanding or ruling.¹⁹

A director may vacate his office by failing to hold the specified number of qualification shares,²⁰ resigning, removal by ordinary resolution,²¹ disqualification²² or death.

13 See 3.2.2 footnote 1 below.

14 *Hahlo 330; Gohlke & Schneider v Westies Minerale (Edms) Bpk 1970 (2) SA 685 (A); Fisheries Development Corporation v Jorgenson 1980 (4) SA 156 (W); British Murac Syndicate Ltd v Alperton Rubber Company Ltd [1915] 2 Ch 186; See 2.2.4 and 2.2.5 below. The terms "shareholder", "member", "director" and "general meeting" in the text are used in relation to a company whereas the term "third party" is used to refer to any person linked to the company indirectly or not at all.*

15 *Hahlo 445.*

16 *H S Cilliers & M L Benade Corporate Law (1987) ("Cillier & Benade") 231; Henochsberg 391; Fisheries Development Corporation of SA Ltd v Jorgenson 1980 (4) SA 156 (W) at 163; S v Shaban 1965 (4) SA 646 (W) at 651-2; Sage Holdings Ltd v Unisec Group Ltd 1982 (1) SA 337 (W) at 354.*

17 *S 332(10) of the Criminal Procedure Act 51 of 1977; S v Vandenberg 1979 (1) SA 208 (D) at 216-7; Hahlo 327, 498-450; Henochsberg 9.*

18 *Pickering MA "Shareholder's voting rights and company control" (1965) 81 Law Quarterly Review ("Pickering") at 248.*

19 *Hahlo 327; S v Marks 1965 (3) SA 834 (W) at 842.*

20 *S 213(1)(a); Henochsberg 333.*

21 *S 220; and see 2.1.3 below.*

22 *Ss 218-9.*

The board of directors act as an autonomous²³ governing organ of a company by the directors voting and passing resolutions at meetings of the board of directors of which proper notice must be given to all directors, and at which a quorum must be present.²⁴ The articles usually stipulate the voting rights of the directors and the procedures to be followed at board meetings and confer upon the chairman of the board a casting vote in the event of a "deadlock".²⁵

2.1.2 The members in general meeting

A "member" of a company is any person who is entitled to be registered in the company's register of members¹ and is, in fact, so registered.² A person becomes entitled to be so registered by subscribing to the memorandum,³ or by allotment⁴ or transfer of shares⁵ to him⁶ and will remain a member until his name is removed from the register.⁷

"Allotment" of shares is the appropriation of shares to a person by the company with the result that the person acquires the right to be included in the company's register of members in respect of the shares.⁸ The company must keep a register of allotments.⁹ Allotments of fully paid-up shares¹⁰ can be made by the directors only with the prior approval of the general meeting.¹¹ It is also an offence for directors to authorise to

23 *Henochsberg* 325.

24 *Hahlo* 454; *Leveson* 58-9; *Cillier & Benade* 219; see 2.1.3 below.

25 *Cillier & Benade* 219.

1 *Ss* 105 - 115. A company cannot purchase its own shares - s 38, or be a member of itself - *Trevor v Whitworth* (1887) 12 AC 409 HL at 424, or be a member of its holding company - s 39, and see 3.4.1 below.

2 *Hahlo* 221; *Henochsberg* 166.

3 *S* 103(1).

4 *S* 103(2); *Hahlo* 249 - 257.

5 See 1.3 below on the nature and meaning of "shares".

6 *Hahlo* 220, 257 - 271.

7 *Hahlo* 220; *Brown v Nanco (Pty) Ltd* 1976 (3) SA 832 (W), 1977 (3) SA 761 (W).

8 *S* 103(2).

9 *S* 93.

10 *S* 69.

11 *S* 221; *Hahlo* 250.

allot shares or debentures¹² to any director of the company or to his nominee or to any body corporate of which either such director or his nominee is a shadow director, or to a body corporate where such director or his nominee is entitled to exercise or control the exercise of one-fifth or more of the voting power at a general meeting, or to any subsidiary of such body corporate, unless, inter alia, the general meeting specifically approves the allotment.¹³

A share is a bundle of incorporeal rights in personam¹⁴ and consists of a right to dividends, capital and to vote. The share certificate issued by the company is prima facie evidence of the shareholder's title to the shares specified in it, but is not conclusive evidence.¹⁵ Shares are movable property transferable in the manner provided by the Act and the articles.¹⁶ There are three stages of a transfer of a share, namely, an agreement to transfer, the execution of a deed of transfer and, finally, the registration of the transfer.¹⁷

Shares are transferred by means of a contract of cession and the cessionary will become owner of the shares on completion of the contract of cession provided the necessary intent to pass ownership is present.¹⁸ There is no necessity for the cedent to deliver the share certificate to the cessionary, or to execute a deed of transfer, or for the cessionary to have his name entered in the register of members for ownership of the shares to pass to him.¹⁹

Failure to register the transfer of a share with the company has a number of important consequences:

12 See 2.3 below for the meaning of "share" and 3.2.1 below for the meaning of "debenture".

13 S 222(1)(a); see also s 222(1)(b), (c) and (d), and s 223.

14 See 2.3 below.

15 *Hahlo* 214 - 5.

16 S 91; *Hahlo* 257.

17 *Hahlo* 257; *Henochsberg* 150; *Inland Property Development Corporation (Pty) Ltd v Cilliers* 1973 (3) SA 245 (A) at 251.

18 *Henochsberg* 166; *Moosa v Lalloo* 1957 (4) SA 207; *Jeffery v Pollak and Freemantle* 1938 AD 1 at 22.

19 *Standard Bank of S A Ltd v Ocean Commodities Inc* 1980 (2) SA 175 (T) at 180; *Labuschagne v Denny* 1963 (3) SA 538 (A).

- 2.1.2.1 The cessionary will not be registered as a member of the company and the name of the cedent will remain in the company's register of members. Accordingly, the register of members may not accurately record the names of the shareholders of a company.²⁰ The cessionary may either retain his anonymity or apply to rectify the register of members and have his name recorded as a member therein.²¹
- 2.1.2.2 Only the person whose name is entered as a member in the register of members will be regarded by the company as the person entitled to exercise the rights comprising the share.²² A shareholder whose name is not recorded in the register of members therefore cannot have his vote recorded in general meeting should he personally attend and vote.²³
- 2.1.2.3 The existing share certificate will not be cancelled by the company and will reflect the name of the cedent of the share and not the name of the cessionary, or true owner, of the share.²⁴
- 2.1.2.4 Although a company has no right to enter into the question of the beneficial ownership of the shares,²⁵ the Minister of Industries, Commerce and Tourism can.²⁶ In his investigation into who has an interest in the shares, the Minister has regard to any person who has the right to vote in respect thereof or is able materially to influence the exercise of such voting right.²⁷

A shareholder may therefore upon transfer of a share to him choose either to exercise his rights himself or to exercise them through another

²⁰ *Hahlo* 259 - 260; *Henochnsberg* 166.

²¹ *S* 115; *Hahlo* 210 - 3 and the authorities cited; *Henochnsberg* 179-81.

²² *Hahlo* 223, 259 - 260; *Henochnsberg* 167; *Pickering* 250 footnote 7; *Standard Bank of SA Limited v Ocean Commodities Inc* 1983 (1) *SA* 276 (AD) at 289; *Sammel v President Brand Gold Mining Company Ltd* 1969 (3) *SA* 629 (A) at 666; *Pender v Lushington* (1877) 6 *Ch D* 70 at 78; *Wise v Lansdell* [1921] 1 *Ch* 420.

²³ See 2.3 below.

²⁴ *Hahlo* 215.

²⁵ *Hahlo* 221; *Pender v Lushington* (1877) 6 *Ch D* 70 at 78.

²⁶ *S* 1 *sv* "Minister"; *s* 255(1); *Hahlo* 260.

²⁷ *S* 255(2); *Henochnsberg* 405; *Hahlo* 260.

person. In order to exercise his rights against the company himself, a cessionary can claim delivery of the share certificate and completed transfer forms from the cedent of the share and register the transfer with the company, or he may apply to rectify the register of members, in which event he discloses his identity to the company and to the world at large.²⁸ The right of a shareholder to have his name entered in the register of members of a company is independent of the ownership of the shares.²⁹ If, on the other hand, a shareholder wishes to remain anonymous, he could authorise another person, such as a nominee³⁰ or a trustee,³¹ to be registered in his place.

A shareholder of a public company can also retain his anonymity through the use of share warrants to bearer. A public company may, if so authorised by its articles, issue a warrant, termed a share warrant, stating that the bearer thereof is entitled to the shares or stock specified therein.³² The bearer of a share warrant may, if the articles so provide, be deemed to be a member either for all purposes or for such purposes as may be specified in the articles.³³ Therefore, if the articles do not so provide, the bearer of a share warrant will not be a member and will not be registered as such.³⁴ The holder of a share warrant is a shareholder, but not necessarily a member, of a public company.³⁵

The reason why a private company cannot create share warrants to bearer is that it must restrict the right to transfer its shares³⁶ and bearer shares are negotiable instruments which are freely transferable.³⁷ The transfer of shares of a private company are usually restricted by

28 *Ss 133ff; Hahlo 258; Moosa v Lalloo 1956 (2) SA 237 (D) at 238.*

29 *S 133(3); Hahlo 221; Henochsberg 179; Xuereb 16; Waja v Orr 1929 TPD 865 at 871-872; Davis v Buffelsfontein Gold Mining Company Ltd 1967 (4) SA 631 (W); Jeffery v Pollak & Freemantle 1938 AD 1 at 18.*

30 *Hahlo 223; Henochsberg 167; a "nominee" is merely the agent of the shareholder, nominated by the shareholder, and registered as the member in the place of the shareholder; Sammel v President Brand Gold Mining Company Ltd 1969 (3) SA 629 (A) at 666.*

31 *See 3.3.2 below.*

32 *S 101(1); Hahlo 186; Henochsberg 163 - 164; Gower 440 - 441.*

33 *S 103(4); s 213(1)(b).*

34 *S 105.*

35 *Hahlo 221.*

36 *S 20(1)(a); Hahlo 257 and 261; Henochsberg 163.*

37 *S 101(2); Hahlo 186; Henochsberg 149; Webb Hale & Co v Alexandria Water Co Ltd (1905) 93 LT 339 KB.*

providing in the articles for a right of pre-emption in favour of the existing shareholders.³⁸ The existing shareholders of a private company may agree to waive their right of pre-emption in favour of a third party who wishes to acquire shares in that company. Therefore, when a shareholder withdraws from the company he can offer all or some of his shares first to the remaining shareholders who, in terms of their agreement, will refuse the offer, then to the third party. The directors, however, have a discretion to refuse to register the transfer of the shares to the third party if the articles so provide.³⁹

2.1.3 The division of powers

Rights of corporate control¹ are usually exercisable by the company in general meeting acting upon the votes of the shareholders, by the board of directors acting upon the votes of directors, and by the managing or executive directors in the exercise of the executive powers delegated to them.² The relationship between the board of directors and the general meeting is contractual in nature³ and is based on the articles which determine the extent of the division of powers between the two governing organs.⁴

The general meeting is the primary and residual organ⁵ which can, by special resolution,⁶ make major decisions regarding the structure and fate of the company.⁷ The shareholder or shareholders, hereafter referred to as the "controlling shareholders",⁸ who can muster sufficient

38 Table B, articles 21-4; Hahlo 257 - 264 and the authorities cited; Rudolph de Bruin "The right of pre-emption - selling shares of private companies" (1979) 8 *Businessman's Law* 173.

39 S 139; B G Pettet "Share Transfers and Pre-Emption Provisions" (1985) 48 *The Modern Law Review* 220 at 221 and 223-4; Farrar 151; Xuereb 130-2; Henochsberg 150.

1 See 2.4 below.

2 Pickering 248.

3 Farrar 311; Henochsberg 100 and the authorities cited; Hahlo 113 and the authorities cited.

4 Hahlo 446.

5 Gower 152 and 556; Hahlo 288 - 290; Xuereb 55.

6 See 2.2 below.

7 Hahlo 285.

8 Nigel A Eastaway and Harry Booth *Practical Share Valuation* (1983) ("Eastaway & Booth") 17-8; *IRC v B W Noble Ltd* (1926) 12 TC 911 at 926.

votes to pass a special resolution in general meeting will control that general meeting and will have the power to, inter alia,⁹ alter the memorandum¹⁰ and the articles,¹¹ increase or reduce capital,¹² vary shareholders' rights,¹³ convert any shares, whether issued or not, into shares of another class,¹⁴ dispose of the undertaking or major assets of the company,¹⁵ appoint and remove directors¹⁶ and prescribe the rights and duties of directors in the articles.

In theory, the general meeting could control the directors of the company if the articles so provided. Such control would be impracticable because the administration and control of a company should be vested in the hands of a small number of people who can meet at short notice, debate the company's problems and make quick decisions.¹⁷ The controlling shareholders determine the content of the articles¹⁸ and prescribe the duties of the directors in the articles.¹⁹ The directors usually exercise in terms of the articles all the powers of the company except those powers which have to be exercised by the general meeting.²⁰ The board of directors therefore becomes the most important autonomous organ of control in the day-to-day administration of the company's affairs.²¹

The general meeting usually retains few, if any, managerial powers and, except in matters specifically allotted to it, cannot direct the management of the company's affairs or overrule any decision arrived at by the board

9 See *Xuereb* 64 - 67 where the powers exercisable by the general meeting are set out.

10 S 55 and s 56.

11 S 62; *Farrar* 111 - 121.

12 S 75 and s 83.

13 S 56(5) and s 102; cf s 252; *Henochnsberg* 164 - 166.

14 S 75(1)(i); *Hahlo* 194.

15 S 228.

16 S 220.

17 *Leveson* 85.

18 S 62.

19 *Hahlo* 285.

20 See 2.1.1 footnote 3 above.

21 *Pickering* 248.

of directors in the conduct of the management of the company.²² Therefore, although the general meeting has ultimate control, the extent and the effectiveness of its powers to manage the company can vary greatly, depending upon the provisions in the articles.²³

In theory only, and sometimes in practice, the "ultimate" control of the general meeting will lie in its ability to appoint²⁴ and remove the directors,²⁵ thus giving it the power to control the composition of the board of directors. Notwithstanding anything contained in the memorandum or articles, the general meeting can, by ordinary resolution, remove any director from his office before the expiration of that director's period of office.²⁶ No provision in the memorandum or in the articles or in any agreement between the company and its directors which attempts to neutralise the power of the general meeting to remove directors by ordinary resolution, will be valid.²⁷ There is, however, nothing to prevent the shareholders from agreeing with each other, either with or without the directors, not to remove directors by ordinary resolution but in some other way, for example, by a resolution requiring a higher percentage of votes than is required for an ordinary resolution, or in certain specified circumstances only.²⁸

Any resolution by the general meeting purporting to remove a director in a manner contrary to the manner set out in the shareholders' agreement would constitute a breach of that agreement. Section 220 of the Act only authorises the disregard of provisions in the articles and in agreements between the company and its directors which attempt to neutralise it, and should not be interpreted so as to authorise a breach of a shareholders' agreement.²⁹

22 *Farrar* 311 -3 and especially footnote 5; *Gower* 146; *Hahlo* 446; *Xuereb* 55-6; *Shaw (John) & Sons (Salford) Ltd v Shaw* [1935] 2 KB 113 at 134, [1935] ALL ER 456 at 464; *Scott v Scott* [1943] 1 ALL ER 582; *Quin & Axtens v Salmon* [1909] AC 442.

23 *Pickering* 248.

24 *S* 209, s 210 and s 212.

25 *S* 220; *Farrar* 307 - 10; *Gower* 148 - 9.

26 *S* 220; and see 2.2 below.

27 *Henochsberg* 348 and the authorities cited.

28 See 2.3 below.

29 *Stewart v Schwab* 1956 (4) SA 791 (T); *Amoils v Fuel Transport (Pty) Ltd* 1978 (4) SA 343 (W) at 347.

Not infrequently, however, the directors have complete control of the general meeting, either because they are majority shareholders or because they have control of the proxy voting machinery.³⁰ The reservation of the ultimate authority in the general meeting therefore seldom proves a real safeguard.³¹ Inevitably, in a large company with a widely dispersed group of shareholders, the directors will have control of the voting machinery, especially the proxy machinery.³² Therefore it is submitted that depending on the number of shareholders it may be advisable to acquire control of the management of the company, in other words, control of the board of directors, rather than to acquire ownership of the company, in other words, ownership of the shares.

The general meeting is also vested with residual or default powers.³³ This means that the general meeting can exercise all powers which are not delegated to the directors in terms of the articles, or if there are no directors or if the directors are incapacitated or otherwise unable to act, the general meeting can act in their stead.³⁴

The general meeting can validate acts of the directors which are irregular, but are not illegal, ultra vires the company, or a fraud of the minority.³⁵ Furthermore, the directors require prior approval of the general meeting for certain acts, such as the allotment or issue of shares.³⁶ If the directors of a company do not obtain the prior approval of the general meeting, the allotment or issue of shares will be invalid and may only be validated by the court.³⁷ The general meeting cannot validate the allotment or issue retrospectively.³⁸

30 *Leveson* 105.

31 *Leveson* 85.

32 *The proxy form invariably invites the nomination of the directors for the purpose of exercising the absent shareholders vote; see s 189(5); Leveson* 86.

33 *Farrar* 312; *Gower* 147; *Cillier & Benade* 173 - 174 and the authorities cited.

34 *Hahlo* 288-9; *Bamford v Bamford* [1970] Ch 212; [1969] 1 ALL ER 969 (CA) at 237-8; *Barron v Potter* [1914] 1 Ch at 903.

35 *Cilliers & Benade* 173; *Farrar* 313.

36 *S* 221.

37 *S* 97.

38 *Henochsberg* 350.

2.2 Ordinary and special resolutions

The company acts through the general meeting by the shareholders voting for and passing ordinary or special resolutions in general meeting. The courts will not overturn a resolution validly passed or interfere with the internal management of companies acting within their powers unless a fraud has been perpetrated upon the minority.¹ It is essential for the acquisition of control in a company to understand how a valid special resolution can be passed.

There are certain statutory requirements for the passing of valid ordinary and special resolutions.² Resolutions are passed at general meetings of shareholders, which, subject to the articles, may be held from time to time.³ Usually the articles confer the power to convene general meetings on the directors.⁴ However, two or more shareholders holding not less than one-tenth of the issued share capital may call a general meeting.⁵ The directors are also obliged to call a general meeting on the requisition of one hundred shareholders or of shareholders holding not less than one-twentieth of its voting capital.⁶ If the directors fail to call the general meeting the requisitionists may call the meeting themselves.⁷ The Registrar⁸ and the court⁹ may also call meetings of shareholders. Therefore the shareholders are not entirely dependent upon the directors to call a general meeting.

Unless the articles otherwise provide, notice of meetings must be served on shareholders in the manner prescribed in Table A art 35 or Table B art 34 of Schedule 1, whichever is applicable.¹⁰ Twenty-one days notice is required for the passing of a special resolution, and fourteen days for the passing of an ordinary resolution.¹¹ The articles may prescribe longer but not shorter periods of notice¹² but a majority of shareholders holding not less than 95

1 *Leveson 79; Gundelfinger v African Textile Manufacturers Ltd & Others 1939 AD 314.*
2 *Hahlo 290.*
3 *S 180.*
4 *Table A art 34, Table B art 33.*
5 *S 180(2).*
6 *S 181.*
7 *S 181(3), (4).*
8 *S 182.*
9 *S 183.*
10 *S 187.*
11 *S 186.*
12 *S 186(1)(b).*

per cent of all the total voting rights may agree to have a meeting called on shorter notice.¹³ Failure to give notice as required to all registered shareholders renders the meeting and any resolutions passed at it invalid, provided that notice need only be given to shareholders within reasonable reach,¹⁴ and a defect in giving notice can be cured by the consent of all the shareholders of the company.¹⁵

Every shareholder is entitled to attend, speak, vote and propose amendments.¹⁶ Unless the articles provide for a greater number of shareholders to constitute a quorum, the quorum for general meetings shall be, in the case of a public company, three shareholders entitled to vote, personally present, and in the case of a private company having more than one shareholder, two shareholders entitled to vote, present in person or by proxy, and in the case of a wholly owned subsidiary company, the representative of the holding company.¹⁷ Where a private company has only one shareholder, such person present in person or by proxy, constitutes the meeting.¹⁸

Ordinary resolutions are passed by a simple majority of the shareholders present and entitled to vote at a meeting, and take effect as from the date on which they are passed.¹⁹

There are four requirements for the passing of a valid special resolution.²⁰ Firstly, not less than 21 clear days notice must be given to the shareholders specifying the intention to propose the resolution as a special resolution and what the terms and effect of the resolution and the reasons for it are.²¹ A resolution may, with the written consent of all the shareholders, be passed as a special resolution at a meeting of which the 21 days notice has not been given.²² Secondly, a general meeting of shareholders must be held.²³

13 S 186(2).

14 Majola Investments (Pty) Ltd v Uitzigt Properties (Pty) Ltd 1961 (4) SA 705 (T).

15 *Hahlo 290 and the authorities cited.*

16 *Hahlo 295 and the authorities cited.*

17 S 190; *Hahlo 295.*

18 S 184.

19 S 203(2); *Hahlo 296.*

20 S 199 read with s 200; *Hahlo 352, and 295 - 308; Swerdlow v Cohen* 1977 (3) SA 1050 (T) at 1053.

21 S 199(1); see also s 199(3).

22 S 199(3A).

23 S 199(1); *Hahlo 127 and 322 - 326.*

Thirdly, at the meeting, not all the shareholders need be present. Only shareholders holding in the aggregate not less than one-fourth of the total votes of all the shareholders entitled to vote thereat, must be present in person or by proxy at the meeting.²⁴ Therefore shareholders holding three-fourths of the total votes of all the shareholders entitled to vote may be absent! The shareholders who are present must pass a resolution on a show of hands or by poll. If the special resolution is passed on a show of hands, the applicable principle is "one hand one vote",²⁵ and it must be passed by not less than three-fourths of the number of shareholders who are entitled to vote on a show of hands at the meeting who are present in person or by proxy. Where a poll has been demanded,²⁶ the resolution must be passed by not less than three-fourths of the total votes to which the shareholders present in person or by proxy are entitled on a vote by poll. In order to pass a special resolution in a company by poll, therefore, only three-sixteenths of the total votes are required. This "required majority" will increase depending upon the number of shareholders attending general meetings. Fourthly, the special resolution must be lodged with the Registrar within one month after it was passed and registered before it has legal effect.²⁷

Although it is accepted that intra vires acts which can be authorised by the company in general meeting by ordinary resolution can also be authorised by the informal unanimous assent of all the shareholders,²⁸ the position as regards special resolutions is not equally clear.

It is submitted that the Registrar can only register a special resolution if the company lodges with him a copy of the resolution,²⁹ together with either a copy of the notice convening the meeting concerned, or a copy of the consent to waive such notice.³⁰ The Registrar cannot register a special resolution if the shareholders did not hold a meeting to pass the resolution

24 S 199(1)(a).

25 S 197(1).

26 S 198.

27 S 200.

28 *Hahlo 322 and the authorities cited; Gohlke and Schneider v Westies Minerale (Edms) Bpk 1970 (2) SA 685 (A).*

29 Form CM26.

30 S 199(3A); form CM25A.

and, it is submitted, that fact is brought to his attention.³¹ It is submitted that the shareholders cannot act as an organ of the company by informal unanimous assent of the shareholders, or even in terms of a written shareholders agreement where all the shareholders are a party thereto, where the Act requires a special resolution.³²

2.3 The shareholders' right to vote

A shareholder has an interest in the company entitling him, *inter alia* and subject to the memorandum and articles, to a share in the share capital of a company,¹ to a share in the profits of the company, and to attend and vote at meetings of the company.²

Usually the articles authorise the creation of different classes of shares, such as ordinary, preference or deferred shares.³ The division between the various classes of shares is primarily based on the nature of the rights afforded by them in regard to dividends and participation in the distribution of capital on liquidation.⁴ A discussion of the nature of shareholders' rights to dividends and capital falls outside the scope of this work, which concentrates on the shareholders' right to vote.

Every issued share must entitle the holder thereof to attend, speak and to vote in general meeting.⁵ The shareholder, as beneficial owner of the share, is entitled to vote in general meeting. In the event that the shareholder is not the registered member, the company will disregard his vote should he attend and vote in general meeting, and have regard only for the vote of the registered member.⁶ In these circumstances, if the shareholder wishes to exercise his right to vote, he can demand registration of the transfer of the

31 *Fourie JSA "Eenparige Toestemming en Spesiale Besuite" (1959) 52 THRHR 569; Hahlo 96 and 326 and the authorities cited; Xuereb 54.*

32 *Hahlo 465 and s 200.*

1 *S 1 sv "share"; Hahlo 186; Eastaway & Booth 15 - 7; Borland's Trustee v Steel Brothers & Company Ltd [1901] 1 Ch 279 at 288; Liquidators, Union Share Agency v Hatton 1927 AD 240 at 250-1; Standard Bank of SA Ltd v Ocean Commodities Inc 1983 (1) SA 276 (A) at 288.*

2 *Hahlo 221; Cilliers & Benade 88 - 89.*

3 *Eastaway & Booth 3 - 7; Cilliers & Benade 89 - 90.*

4 *Hahlo 193.*

5 *S 193; Hahlo 194.*

6 *See 2.2.2 above.*

shares to him and registration as a member,⁷ or he can appoint the registered member in respect of the shares he owns as his agent or proxy.

A shareholder's right to vote has been described as a right of property⁸ which he may exercise as he pleases according to his own wishes and private interests.⁹

A shareholder may therefore divide his votes and cast them in different ways, or he may abstain from voting. Often a minority group of shareholders is able to exercise effective voting control in a company because the majority shareholders either abstain from voting or, due to apathy, fail to vote.¹⁰

A shareholder may also cast his vote as he wishes in respect of any resolution even where he has a particular interest in its subject-matter.¹¹ A shareholder, unlike a director, owes no fiduciary duty to the company.¹² Even a director, as shareholder, may attend and vote in general meeting in his own interests like any other shareholder who is not a director.¹³ Where a director, as shareholder, casts his vote in general meeting for his own selfish purpose, and against the "interests of the company", it is submitted that he cannot be held to be in breach of his fiduciary duty which he, as director, owes to the company. It is only where he casts his vote as director in board meetings contrary to the interests of the company that he may be in breach of his fiduciary duty to the company.¹⁴

7 See also s 115.

8 *Hahlo* 308 and the authorities cited; *Henochnberg* 308; *Xuereb* 16; *Pender v Lushington* (1877) 6 Ch D at 75.

9 *Hahlo* 297; but cf Peter G Xuereb "Voting Rights : A Comparative Review" (1987) 8 *The Company Lawyer* at 16 where the author expresses the view, correctly it is submitted, that the concept that a shareholder's right to vote is a "right of property" which a shareholder may exercise in his own interests, even where those conflict with those of the company, is an obstacle to the idea that priority should be given to the interests of a "company as a whole".

10 J S McLennan "The case of the missing shareholders" (1980) 9 *Businessman's Law* 151 for a discussion of the problem of absentee shareholders; see also 3.2 below.

11 *Pickering* 250 footnote 10 and the authorities cited; *Hahlo* 308; *Sammel v President Brand Gold Mining Company Ltd* (1969) (3) SA 629 (A) at 680.

12 *Hahlo* 308 and the authorities cited; see also 3.2.4 footnote 3 below.

13 *Hahlo* 308; *Gundelfinger v African Textile Manufacturers Ltd* 1939 AD 314.

14 *Cilliers & Benade* 234; *Hahlo* 377 and the authorities cited.

The company can in certain circumstances¹⁵ acquire an interest in a contract made by a director on his own behalf. In this event the director cannot, as a shareholder, use his voting power to prevent the company from claiming the benefits of the contract.¹⁶

A shareholder's freedom to vote in his own interests is not affected by the fact that he may control the majority of votes. Unlike directors, a controlling shareholder of a company owes no fiduciary duty to the company,¹⁷ and neither directors nor shareholders owe any fiduciary duty to the shareholders of a company.¹⁸ It follows that shareholders can bind themselves by voting agreements to exercise their vote in any way they please, but directors cannot.¹⁹

2.4 The concept of corporate control

The legal consequences of the shareholders' right to attend, vote and pass ordinary and special resolutions in general meeting, is crucial to the notion of corporate control.¹ In Daimler Company Ltd v Continental Tyre and Rubber Company (Great Britain) Ltd², Lord Parker of Waddington, when dealing with the question of piercing the corporate veil on the ground of the "enemy character" of a company, had the following to say³:

"... I think that the analogy is to be found in control, an idea which, if not very familiar in law, is of capital importance and is very well understood in commerce and finance. The acts of a company's organs, its directors, manager, secretary, and so forth, functioning within the scope of their authority, are the company's acts and may invest it definitely with enemy character. It seems to me that similarly the character of those who can make and unmake those officers, dictate their conduct mediately or immediately, prescribe their duties and call them to account, may also

15 *S 234 read with s 235; and see Henochsberg 373 - 381 for a discussion on ss 234 - 240.*
 16 *Henochsberg 375; Cook v Deeks [1916] 1 AC 554 (PC) at 564 - 565; Clemens v Clemens Bros Ltd [1976] 2 AL ER 268 (Ch); and Stewart v Schwab 1956(4) SA 791(T); but cf E B M Company Ltd v Dominium Bank [1937] 3 ALL ER 555.*
 17 *cf Xuereb 63; and see 3.3.4 footnote 3 below and footnote 12 above.*
 18 *Pickering 250 footnote 11; Gower 573; Hahlo 393; Percival v Wright [1902] 2 Ch 421.*
 19 *Hahlo 297; Leveson 79; Greenwell v Porter [1902] 1Ch 530 at 535; Flegg v McCarthy & Flegg 1942 CPD 109; and see 3.3.1 below.*

1 *See 2.2, 2.3 and 2.4 above.*

2 *[1916] 2 AC.*

3 *At 340.*

be material in a question of the enemy character of the company. ... For certain purposes a court must look behind the artificial persona - the corporation - and take account of and be guided by the personalities of the natural persons, the corporators ...".⁴

The controlling shareholders, or the persons who control the controlling shareholders, may wield sufficient voting power in general meetings to pass resolutions and thereby theoretically have the power to "make and unmake" the directors who control the day-to-day administration of a company.⁵ This is the very essence of corporate control. Corporate control essentially denotes the relationship which exists when an individual or group of individuals, who are clearly identifiable in some respects and who may themselves be incorporated, exercise powers of direction and dominium over the affairs of a company.⁶

2.5 The definition of a "parent undertaking" in English Company Law

The discussion of corporate control and the various legal¹ and de facto² forms of control should be viewed against the background of the English definition of corporate control. The English Companies Act 1989 has introduced a definition³ of "parent undertaking" and "subsidiary undertaking" which is much wider than the South African definition of "holding", "subsidiary", "controlling" and "controlled" companies. The English formulation now includes forms of de facto control,⁴ thus offering a more realistic formal recognition of the exercise of control by one undertaking over another.⁵

4 My underlining.

5 See *Farrar* at 311 where he says: "... the extent to which the shareholders can realistically be regarded as electing the directors, given the board's control of the proxy machinery, must always be open to question. In fact boards often become self-perpetuating".

6 *Pickering* 248.

1 See 3 below.

2 See 4 below.

3 See s 21 of the *Companies Act, 1989*.

4 See ss 258(2)(c) and 258(4) of the *Companies Act, 1985*.

5 An "undertaking" is not only a "company", cf 3.4.1 below and the South African definition of "holding company" and "subsidiary company".

Section 21 of the Companies Act, 1989 replaces section 285 of the Companies Act, 1985 and reads as follows:

"258(1) The expressions 'parent undertaking' and 'subsidiary undertaking' in this Part shall be construed as follows; and a 'parent company' means a parent undertaking which is a company.

258(2) An undertaking is a parent undertaking, in relation to another undertaking, a subsidiary undertaking, if -

- (a) it holds a majority of the voting rights in the undertaking, or
- (b) it is a member of the undertaking and has the right to appoint or remove a majority of its board of directors, or;
- (c) it has the right to exercise a dominant influence over the undertaking -
 - (i) by virtue of provisions contained in the undertakings memorandum or articles, or
 - (ii) by virtue of a control contract, or
- (d) it is a member of the undertaking and controls alone, pursuant to an agreement with other shareholders or members, a majority of the voting rights in the undertaking.

258(3) For the purpose of subsection (2) an undertaking shall be treated as a member of another undertaking -

- (a) if any of its subsidiary undertakings is a member of that undertaking, or
- (b) if any shares in that other undertaking are held by a person acting on behalf of the undertaking or any of its subsidiary undertakings.

258(4) An undertaking is also a parent undertaking in relation to another undertaking, a subsidiary undertaking, if it has a participating interest⁶ in the undertaking and -

- (a) it actually exercises a dominant influence over it, or
- (b) it and the subsidiary undertaking are managed on a unified basis."

The English definition of "parent undertaking" includes legal and de facto forms of control exercised by a company, a partnership, a close corporation, or an unincorporated association carrying on a trade or business with or without a view to profit, such as a trust, over another company.⁷

6 A "participating interest" means an interest held by an undertaking in the shares of another undertaking which it holds on a long term basis for the purpose of securing a contribution to its activities by the exercise of control or influence arising from or related to that interest - see s 260(1) of the Companies Act, 1985 inserted by s 22 of the Companies Act, 1989. There is a rebuttable presumption that a holding of 20 per cent or more of the shares of an undertaking shall be a "participating interest" - see s 260(2) of the Companies Act, 1985, inserted by s 22 of the Companies Act, 1989.

7 S 260(1) of the Companies Act, 1985 inserted by s 22 of the Companies Act, 1989.

Chapter 3 - Legal forms of control

Any form of control which is based on rights and duties enforceable in a court of law, may be termed a "legal" form of control.¹ A shareholder's statutory right to vote,² conferred by the articles upon the shareholder, is proprietary in nature and is enforceable.³ A shareholder may supplement the articles by agreement and transfer his right to vote to a third party, while retaining for himself only his rights to capital and dividends. The third party's right to vote thus arises ex contractu and not from the articles.⁴

There are a number of advantages to containing the right to vote in an agreement supplementary to the articles.⁵ Firstly, the right to vote is one of the bundle of rights constituting the share which is normally transferred with the share in the hands of successive owners. A contractual right to vote, however, exists only for as long as the person is a party to the contract. Secondly, the articles are alterable by special resolution, and the rights therein contained may be modified or destroyed by the controlling shareholders.⁶ A contract, on the other hand, can only be altered or cancelled by the consent of all the parties to the contract. Thirdly, any right contained in the articles to be valid must be within the scope of the legislative authority given by the Act to a company over its shareholders, whereas a contract is subject merely to the general provisions of the law of contract. A shareholder may therefore take upon himself by contract with the company many obligations which could not be imposed upon him by the company in the articles.⁷

There are three ways in which voting control in a company may be achieved,⁸ namely, by:

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- 1 *Pickering 249.*
 - 2 *S 193.*
 - 3 *Xuereb 16; Pender v Lushington (1877) 6 Ch D 70.*
 - 4 *See 3.3 below.*
 - 5 *Farrar 122 - 129; Hahlo 127 and the authorities cited; Shalfoon v Cheddar Valley Co-Operative Dairy Co Ltd [1924] NZLR 561.*
 - 6 *See 2.2 above and s 62.*
 - 7 *Hahlo 127 - 128 and the authorities cited.*
 - 8 *Pickering 249; see, for example, 3.3.2 below.*

1. acquiring ownership of, or control over, the shares with the required majority of voting rights;
2. restricting the voting rights of some of the shareholders, thereby concentrating the voting rights among others; or
3. aggregating the required majority of existing voting rights of the shareholders under the control of one group or person.

The various legal forms of shareholders' voting control may be grouped into five major categories,⁹ namely, proprietary control,¹⁰ control by constitutional means,¹¹ inter-shareholder control arrangements,¹² inter-company control arrangements¹³ and the management contract.¹⁴

3.1 **Proprietary control**

The most obvious method of acquiring control in a company is by acquiring ownership of the required majority¹ of voting rights of the shareholders of the company, either by acquiring the ownership of the shares, or by merely acquiring the rights to vote. Although the latter acquisition may be less expensive than the former, problems arise in connection with the exercise of the right to vote when the owner of that right is not the registered member as only the votes of registered members have legal effect.² Therefore the purchaser of the votes or of the shares must ensure that the sellers thereof either remain as registered members and vote in accordance with his instructions or that he be registered as a member.

⁹ *Pickering 249.*

¹⁰ *See 3.1 below.*

¹¹ *See 3.2 below.*

¹² *See 3.3 below.*

¹³ *See 3.4 below.*

¹⁴ *See 3.5 below.*

¹ *See 2.2 above.*

² *See 2.1.2 above; cf Farrar 311.*

A straightforward purchase of the shares is more easily achieved where there are few shareholders and where the register of members accurately reflects the addresses and names of the shareholders. Where the number of shareholders increase and the register of members reflects nominee members, it becomes increasingly difficult, if not impossible, to trace the shareholders in order to purchase their shares.³ In these circumstances, it would be advisable to adopt one of the other legal forms of control.

3.2 Control by constitutional means

Upon registration the company's memorandum and articles bind the company and its shareholders to the same extent as if they had respectively been signed by each shareholder, to observe all the provisions of the memorandum and of the articles.¹ The memorandum and articles constitute a contract between the company and its shareholders, qua shareholders, as well as between the shareholders inter se; a non-shareholder or a shareholder not registered as a member acquires no rights under the articles.²

The articles, being subordinate to the memorandum³ are its "by-laws".⁴ The controlling shareholders may prescribe in the articles capital structures in which their voting control is concentrated to a greater or lesser extent.

3 *Pickering* 251 footnote 12.

1 S 65(2).

2 *Hahlo* 113; *Henochsberg* 100 - 101; *Cilliers & Benade* 56 - 59; *Hickman v Kent or Romney Marsh Sheep-Breeders Association* [1915] 1 Ch 881 at 900; *Gohlke and Schneider v Westies Minerale (Edms) Bpk* 1970 (2) SA 685 (A); *De Villiers v Jacobsdal Salt Works (Michaelis and De Villiers) (Pty) Ltd* 1959 (3) SA 873 (O); *Rosslare (Pty) Ltd v Registrar of Companies* 1972 (2) SA 524 (D); but cf P J J Olivier "Die Grondslag van maatskappy- gebondenheid aan die akte van oprigting en die statute en in verband daarmee rektifikasie" (1989) *THRHR* 409 where the author discusses the curious nature of the "contract" between the company, a legal fiction, and its members.

3 *Quadrangle Investments (Pty) Ltd v Witind Holdings Ltd* 1975 (1) SA 572 (A) at 579.

4 *Hahlo* 92.

The controlling shareholders have almost complete freedom to establish classes of share capital conferring, restricting, or denying entirely, various rights in respect of dividends, capital and voting. The freedom of the controlling shareholders to amend the articles as they wish is tempered by the statutory safeguard created for the benefit of oppressed shareholders in section 252 and by the tenets of minority protection in terms of the common law.⁵

There are five ways of arranging the capital structure of a company in the articles which will have the effect of concentrating or dispersing the voting control of the shareholders. These five arrangements are termed capital gearing,⁶ vote gearing,⁷ loading votes,⁸ class powers of appointment of directors⁹ and class powers of general management.¹⁰

3.2.1 Capital gearing

Capital gearing is the arrangement of equity share capital¹ and loan capital² of a company in such a way that the contributors of loan capital do not participate in the management of the company. A company wishing to raise capital has a choice between issuing equity shares or issuing debentures.³

A company, if so authorised by its memorandum or by its articles, may create and issue debentures.⁴ A debenture is a formal acknowledgment

5 *Hahlo* 506 - 565 and especially at 530 for a general discussion on majority rule and minority protection; *Foss v Harbottle* (1843) 2 Hare 461 67 ER 189; *Prudential Assurance Company Ltd v Newman Industries Ltd (No2)* [1980] 2 ALL ER 841 (Ch); [1982] 1 Ch 204; [1982] 1 ALL ER 354 (CA).

6 See 3.2.1 below.

7 See 3.2.2 below.

8 See 3.2.3 below.

9 See 3.2.4 below.

10 See 3.2.5 below.

1 "Equity share capital" and "equity shares" in relation to a company, means its issued share capital and shares excluding any part thereof which, neither as respects dividends nor as respects capital, carries any right to participate beyond a specified amount in a distribution - s 1 sv "equity share capital" and "equity shares".

2 Ss 116 - 130; *Eastaway & Booth* 7.

3 *Farrar* 134; *Pickering* 251.

4 S 116.

of debt by a company to its creditor.⁵ The company will issue a debenture deed to the creditor.⁶ Debenture holders' names are recorded in the company's books.⁷ They have a personal right against the company for the return of their capital and interest, which rights are, like those of shareholders, of contractual effect and are usually set out in the debenture deed.⁸

The degree of control exercised by shareholders and debenture holders over management depends on the terms of the articles.⁹ The articles can provide that shareholders alone, or that shareholders and debenture holders, have the power to appoint directors. If the articles empower debenture holders to appoint directors, then the control of the shareholders over the management of the company would be less effective. Any nominee director appointed by a debenture holder may exercise his vote at board meetings to protect the assets securing the loan made by the debenture holder,¹⁰ or may prevent mismanagement of the other directors or at least report such mismanagement to the debenture holder who can then take appropriate action to protect his security.

Debenture holders are not shareholders and cannot vote at general meetings. They are therefore unable to exert any direct influence over the general meeting.¹¹ Although the debenture holders may be deprived of the opportunity of influencing the management of the company through the general meeting they can exert a dominant influence over the board of directors if they loan capital to the company on the condition that they be entitled to appoint directors or that they be entitled to call up the loan at any time. Usually only a debenture holder making a large loan to the company is in a powerful enough position to insist on these conditions being included in the terms of the loan agreement.

5 *Farrar 135; Hahlo 215; Coetzee v Rand Sporting Club 1918 WLD 74.*

6 *S 126; Farrar 135.*

7 *Ss 128 - 9.*

8 *S 126; Farrar 135; Hahlo 215-9; Gower 559-560.*

9 *See 2.1.3 above.*

10 *Cilliers & Benade 231 footnote 14.*

11 *Farrar 216.*

The normal contractual remedies of a creditor, for example, the contractual right of the debenture holder to call up his loan should the company default on repayment and place the company in liquidation if it is unable to pay its debts,¹² are always available to the debenture holder¹³ and may also influence directors and shareholders of a company when they exercise their respective rights to vote.

The only real difference between shareholders and debenture holders in relation to their ability to manage a company, is one of degree, namely, that of the relative effectiveness of the powers of participation or intervention in the company's management which the various classes of contributors have at their disposal. Often, though, the debenture holders do not participate in the management of the company because they do not, or cannot, insist on acquiring the power to appoint one or more directors to the board of directors. Therefore, by attracting capital in this manner, the company can concentrate the power to manage the company in the hands of shareholders only.

3.2.2 Vote gearing

Whereas capital gearing is used to exclude creditors from participating in the management of a company, vote gearing is used to restrict the voting power of one class of shareholder¹ in such a way that, as between various classes of shareholders, voting control is concentrated in only one class. The voting rights of shareholders of a particular class of shareholders are equal as between those shareholders,² but the voting rights between the different classes of shareholders may differ.³

¹² Ss 345-6.

¹³ *Farrar* 216.

¹ *Hahlo* 207; the term "class of shareholders" is defined in *Sovereign Life Assurance Company v Dodd* [1892] 2 QB 573 (CA) at 583: "The term 'class ...' must be confined to those persons whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest".

² S 193; *Hahlo* 194.

³ S 75; s 195.

It is submitted that the controlling shareholders of large companies with many shareholders may effectively use the method of issuing preference shares with limited voting rights in order to raise capital while at the same time retaining voting control. Vote gearing is a simple method of arranging the balance of voting power amongst different classes of shareholders. The memorandum, or more usually the articles, will authorise the creation of different classes of shares.⁴ The controlling shareholders may create a class of share, such as preference shares, with limited voting rights.⁵ Such voting rights become effective and the preference shareholders are only entitled to vote in general meeting in certain defined circumstances.⁶ However, preference shareholders may not vote for the appointment or removal of a director, or for any proposed variation of rights attached to another class of shares.⁷

If authorised by the articles, the controlling shareholders may by special resolution convert any class of shares into shares of another class.⁸ Thus, a class of ordinary shares with an unlimited right to vote may be converted into a class of preference shares, with a limited right to vote. The balance of voting control may thus be re-arranged amongst the various classes of shareholders. The new class of preference shareholders can therefore be excluded from voting control.⁹

The rights of shareholders, however, may be contained in the memorandum in which event those rights cannot be altered except in the manner prescribed in the memorandum,¹⁰ or by way of a compromise

4 *Hahlo 193; see 1.3 above.*

5 *S 194(1).*

6 *For example, where a proposed resolution directly affects the rights attached to the preference shares, or where it affects the interests of the preference shareholders, or where a resolution for the winding up of the company or for the reduction of its capital is proposed (S 194(1)(b)), or when payment of the stipulated preference dividend is in arrear (S 194(1)(a)).*

7 *Pickering 253 footnote 19; Utopia Vakansie-Oorde Bpk v Du Plessis 1974 (3) SA 148 (A) at 178.*

8 *S 75(1)(i); cf S 252(2)(c).*

9 *Hahlo 193; P A Delport Die Verkryging van Kapitaal in die Suid-Afrikaanse Maatskappyreg met spesifieke verwysing na die Aanbod van Aandele aan die Publiek unpublished LLD thesis, University of Pretoria (1987) 127 ff.*

10 *S 56(5).*

or arrangement.¹¹ Voting rights of shareholders contained in the articles may be altered by special resolution,¹² or alternatively, only with the consent of a specified proportion of the holders of the issued shares of a particular class of shareholder, or a resolution sanctioning the variation passed at a separate meeting of the holders of those shares.¹³

An issue of shares, or the creation and issue of a new class of shares, or a sub-division of existing shares¹⁴ does not constitute a variation of the voting rights of the existing shareholders merely because there is a re-arrangement of the balance of voting power between the shareholders.¹⁵ Any application by an aggrieved shareholder under section 252 in these circumstances will probably fail.

Both vote gearing and capital gearing either concentrate voting rights or disperse voting rights in the company. The former effect is more common.¹⁶

3.2.3 Loading votes

Whereas vote gearing limits the voting rights of a particular class of shareholders, such as preference shareholders, the method of loading votes concentrates voting rights on a particular class of shareholders.

11 S 311; *Hahlo* 207.

12 S 62.

13 Table A art 7; Table B art 9.

14 See 3.3.1 below for a discussion on the effect and meaning of a scheme of sub-division.

15 *Hahlo* 207; *White v Bristol Aeroplane Company Ltd* [1953] Ch 65; [1953] 1 ALL ER 40.

16 *Pickering* 253. For example, the capital of a company may be divided equally between debentures on the one hand and preference shares and ordinary shares on the other. The ratio of share capital to loan capital is therefore 1:1. The capital gearing will be 4:1 because one-fourth of the capital, namely the ordinary shares, controls capital four times its size. By gearing the votes so that the preference shareholders have limited voting rights, the ordinary shareholders control assets four times greater in value than the total nominal ordinary capital. If, however, the preference shares were also to have unconditional voting rights, then the balance of voting power between the two classes of shareholders would be equal.

Every issued share must include a right to vote.¹ "Non-voting" shares are not permitted. Furthermore, voting rights of each share of a class of shares must be equal.² A private company may, however, load voting rights onto a particular class of shares, which will result in the other classes of shares effectively becoming "non-voting shares".³

The controlling shareholders may provide in the articles that the votes to which any new shareholder or new class of shareholders is entitled above a stated number increase, not in direct proportion to the number of shares held, but in either a lower or higher proportion.⁴ If the votes increase in a lower proportion, the articles may further provide that no shareholder shall be entitled to more than a specified number of votes.⁵ Any shareholder holding more than the specified number of shares will have no vote in respect of those shares. In other words, he will own "voteless shares".⁶ The voteless shares will regain the vote if they are transferred to a person who, even with those shares, does not hold more than the limit.⁷

The use of loading votes to readjust the balance of voting control is particularly useful in company acquisitions⁸ and the controlling

1 S 193.

2 S 193; *Hahlo 194*; but see s 196, in terms of which s 193(1) does not apply to shares issued prior to 1 January 1974 which have no voting rights or unequal voting rights.

3 S 195(2) read with s 193(1); *Swerdlow v Cohen 1977 (3) SA 1050 (T)* at 1053. For example, a private company may issue class "A" ordinary shares with 1 vote each and class "B" ordinary shares with, say, 10 votes each. 10 class "A" ordinary shares will be required to neutralise 1 class "B" ordinary share. Clearly, the class "B" shareholders will exercise voting control in the company if an equal amount of shares in each class are issued.

4 S 195(4)(b); For example, the articles may provide that the first 30 class "B" ordinary shares issued or allotted by the company to any particular person will have, say, 10 votes per share, and thereafter, only 1 vote per share.

5 S 195(4)(b); *Henochsberg 306*.

6 *Hahlo 195*.

7 *Hahlo 195*; *B Venniker "Disenfranchising a Shareholder? A comment on Sections 193 and 195 of the Companies Act" (1977) SALJ* at 94.

8 For example, company A acquires the shares in company B and issues to the shareholders of company B, in consideration for the loss of their shares in company B, shares in company A. The voting rights of the shares in company A may be loaded in such a way that control is conferred on the existing class of shareholders of company A. The voting control in the companies may thus be conveniently readjusted after the acquisition of company B's shares.

shareholders of a private company with only a few shareholders can use the method of loading votes on their existing issued shares in order to retain control for themselves when issuing new shares to raise capital.¹⁰

3.2.4 Class powers of appointment of directors

The right to appoint directors to the board may be conferred in terms of the articles upon a particular class or particular classes of shareholders or upon a third party.¹ Where the articles expressly so provide this may be a valid right enforceable by the courts.²

Directors traditionally owe a fiduciary duty only to the company and not to any person who may appoint them in terms of the articles.³ While the directors do not owe any duties to shareholders as such, the shareholders may appoint them specifically as their agents in any matter, in which case the directors will owe them the ordinary fiduciary duties arising from that agency relationship.⁴ In order to remain in office, therefore, nominee directors will when carrying out their duties bear in mind the interests of the shareholders who appointed them.⁵

The right to appoint directors conferred on a class of shareholders in terms of the articles may be transferred by that class, or the controlling majority of that class, to a third party including a director. The third party can then appoint nominee directors to the board who will follow his instructions. In this manner the third party can acquire control of the board. In these circumstances the third party may be regarded as a "shadow" director.⁶

10 *Pickering* 253.

1 *See 2.1.1 above.*

2 *British Murac Syndicate v Alperton Rubber Company Limited* [1915] 2 Ch 186.

3 *Percival v Wright* [1902] 2 Ch 421; but cf *Hahlo* 376 and *Farrar* 325 - 9 and the authorities cited for the recent developments in Anglo-American law which indicate a trend towards imposing a fiduciary duty not only to the company, but also to shareholders, individually or as a group, to the general body of creditors when a company is insolvent or nearly insolvent, and even to employees in certain circumstances.

4 *Farrar* 325 footnote 15.

5 *S* 220; cf *Farrar* 311.

6 *See 2.1.1 footnote 11 above.*

If the articles confer the right to appoint directors upon a class of shareholders, then the board of directors cannot exercise that right or transfer that right to a third party.⁷ If, on the other hand, the articles confer the right to appoint directors upon the board of directors, the board can transfer this right to a third party under a power of attorney.

It is submitted that a company may become unmanageable in circumstances where the articles provide that the management of the company is the responsibility of the directors only, and that different classes of shareholders can appoint directors to the board. In these circumstances the board of directors will be responsible for the management of the company to the exclusion of the general meeting.⁸ Each nominee director will represent the interests of the class of shareholders who appointed him. The final forum for deciding matters affecting the management of the company is transferred, in terms of the articles, from the general meeting to the board, which now represents sectional interests. Thus the company may become unmanageable. The fiduciary duty of each nominee director to act in the best interests of the company as a whole might conflict with the personal interest, or contractual obligation, of the individual nominee directors to act in the interests of the class of shareholders who appointed them.⁹

3.2.5 Class powers of general management

A provision in the articles which could make the company even less manageable than one providing that different classes of shareholders can appoint nominee directors, it is submitted, would be one providing

⁷ *Pickering* 254 footnote 26; *James v Eve* (1873) LR 6HL 335.

⁸ See 2.1.3 above.

⁹ *Pickering* 255, where he states that these circumstances would form the only exception to the general principle that in English company law the majority in general meeting have the ultimate powers of control; *Hahlo* 333; in *Sage Holdings Ltd v The Unisec Group Ltd* 1982 (1) SA 337 (W) at 354 Goldstone J, in an *obiter dictum*, stated that directors appointed in this manner amounts to a "stratagem" which is "foreign to the basic concepts of our law and [is] subversive of the proper exercise of their fiduciary duties by [the] directors"; *James North (Zimbabwe) (Pvt) Ltd v Mattinson* 1990 (2) SA 277 (ZHC).

that different classes of shareholders are empowered to manage different aspects of the company's business. In order to co-ordinate the management of a company properly on an unified basis, the articles usually provide that the board of directors are solely responsible for the management of the company. It is unlikely to find in practice articles providing for general management powers to be divided among different classes of shareholders. One class of shareholder would then, for example, allocate the company's profits for each year either to the reserve fund or to the payment of dividends, while another class would manage some specific asset or part of the total enterprise.

Such a division of management powers, if in fact it existed in a company, would be of specific interest to a third party wishing to acquire control of the company in question. The third party need only consider what aspect of the company he wished to control, which class of shares he would require for that purpose, and acquire only those shares. The day-to-day management of a company would be disrupted by any failure of the different classes of shareholders to co-operate with each other. For this reason, such a division of management powers between classes of shareholders is inadvisable.

3.3 Inter-shareholder control arrangements

In order to become part of the group of controlling shareholders, it is necessary for shareholders to group together and, by agreement, set up voting control arrangements between themselves or between themselves and a third party, or between themselves and the company. Unlike the control arrangements established in the articles,¹ these inter-shareholder control arrangements bind neither the company nor shareholders who are not a party to them, are not public documents and can therefore be concealed from the public eye,² and can be amended only by the consensus of all parties to them, thus affording greater protection to the shareholders against oppression than the articles.³

¹ Discussed in 3.2 above.

² Except perhaps the voting trust; see 3.3.2 below.

³ S 252; Farrar 122.

There are three main forms of arrangement set up by shareholders to supplement the articles,⁴ namely the voting agreement,⁵ the voting trust⁶ and the irrevocable proxy.⁷

3.3.1 Voting agreements

A shareholder's right to vote is a proprietary legal right which is severable from the other incidents of share ownership.¹ Shareholders may therefore enter into a "voting agreement" with any person in respect of their right to vote and may, in particular, agree to vote in support of any person, whether a shareholder or not.²

It is submitted that before entering into a voting agreement with any person it is essential to ascertain whether that person is the shareholder or merely a nominee in respect of the shares he purports to hold. Where the registered member of a company is merely a nominee the third party should enter the voting agreement with the shareholder, not the nominee.³ Furthermore, the shareholder should be required to warrant that his nominee will cast the relevant vote in the manner prescribed in the agreement.

Entering into a voting agreement with the controlling shareholders is an ideal way for a third party to effectively acquire voting control in a company and to retain his anonymity. Thus, a director, in his capacity as a director, may enter into a voting agreement with the shareholders whereby the shareholders undertake to vote in accordance with that

4 *Farrar 123; Pickering 248; Xuereb Peter G "Voting Rights : A Comparative Review" (1987) 8 Company Lawyer 16.*

5 *See 3.3.1 below.*

6 *See 3.3.2 below.*

7 *See 3.3.3 below.*

1 *See 2.3 and 3.1 above.*

2 *Farrar 123 - 6.*

3 *See 2.2 above.*

director's instructions, or he may enter the agreement in his capacity as a shareholder and bind himself to vote in accordance with the terms of a voting agreement.⁴ In this way a director can acquire control of the general meeting, effectively entrenching himself as a director.

Where the terms of the voting agreement otherwise conflict with the terms of the articles, the articles are not thereby amended, though to comply with the articles necessarily entails breach of the agreement.⁵

Where a shareholder votes contrary to his undertaking in the voting agreement the other parties to the voting agreement may enforce compliance in a court of law specifically, or may claim damages against the party in breach.⁶ Furthermore, the company cannot be required to disregard the vote of the intransigent shareholder.⁷ The resolution passed at the particular general meeting will be valid and cannot, if submitted, be set aside.

Therefore, where a purchaser of shares is obliged in terms of the transaction to vote for, and not to oppose, the re-election of directors appointed by the seller of the shares, the courts may enforce such a provision specifically⁸ but have a discretion not to do so,⁹ or it

4 *Greenwell v Porter* [1902] 1 Ch 530 at 535.

5 *Scotmotors (Plant Hire) Ltd v Dundee Petrosea Ltd* [1982] SLT 445; whether or not the shareholders *inter se* can contract against the alteration of the articles, for example, unless there is unanimous consent, is an open question (Farrar 120). It has been suggested (Farrar 120 footnote 4) that such a provision in the article does not deprive a company of its statutory power to alter the articles (S 62) but rather purports to contrive majorities for or against a resolution when the statutory power is being exercised.

6 *Hahlo* 364 - 5 and the authorities cited; *Stewart v Schwab* 1956 (4) SA 791 (T) at 793.

7 *Henochsberg* 169; *IRC v J Bibby & Sons Ltd* [1945] 1 ALL ER 667 (HL) at 671; *IRC v Silverts Ltd* [1951] 1 ALL ER 703 (CA) at 708 - 709; and *S Berendsen Ltd v IRC* [1957] 2 ALL ER 612 (CA) at 621.

8 *Henochsberg* 308 and the authorities cited.

9 *Esterhuizen v East Rand Crushers (Pty) Ltd* 1968 (4) SA 281 (T).

may grant an interdict prohibiting the purchaser from voting in a manner contrary to his undertaking.¹⁰ Thus, where the shareholders are also directors, the court may refuse specific performance where to perform it would constitute interference with the bona fide exercise of their powers as directors.¹¹

The voting agreement is not binding on persons not a party to it.¹² Therefore the voting agreement cannot be enforced against a third party or a shareholder contracting with the board of directors or contracting with a general manager of the company, where the third party, the shareholder, the board and the general manager are not a party to it.¹³

A voting agreement, like any other agreement, is governed by the general law of contract and the parties to it will be bound only by the express terms of their agreement.¹⁴ The courts will not generally enforce an implied term as a term of the voting agreement, such as an implied term that the parties to it would not put an end to the existing state of affairs.¹⁵ Herein lies the real danger inherent in any voting agreement for the contracting parties must expressly provide for every conceivable eventuality and contingency, lest a cunning shareholder escapes his obligations and thwarts the purpose of the agreement. The question whether a provision is express or implied is always one of construction.

There are obvious ways a party may escape his obligations under a voting agreement. Firstly, if the voting agreement imposes an obligation on a shareholder to vote only in respect of whatever shares he owns from time to time then, in order to escape this obligation and end the

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- 10 *Pickering* 257; *Stewart v Schwab* 1956 (4) SA 791 (T); *Greenwell v Porter* [1902] 1 Ch 530; *Puddephatt v Leith* [1916] 1 Ch 200.
- 11 *Cilliers & Benade* at 231 footnote 12; *Coronation Syndicate Ltd v Lilienfield and the New Fortune Company Ltd* 1903 TS 489 at 496 - 7; see 2.1.3 above.
- 12 *Gower* 569; *Greenhalgh v Mallard* [1943] 2 ALL ER 234 (CA).
- 13 *Hahlo* 465; Peter G Xuereb "Voting Rights: A Comparative Review" (1987) 8 *Company Lawyer* 16; *Scotmotors (Plant Hire) Ltd v Dundee Petrosea Ltd* [1982] SLT 445.
- 14 *Hahlo* 311; *Greenwell v Porter* [1902] 1 Ch 530 at 535.
- 15 *Greenhalgh v Mallard* [1943] 2 ALL ER 234 (CA) at 240.

contract, the shareholder may dispose of all or most of his shares. The obligation of the parties to a voting agreement to vote in terms of the agreement will endure only in respect of whatever shares they might from time to time possess. By selling his shares, the shareholder is not in breach of the terms of the voting agreement, nor are the purchasers of the shares bound by the terms of the voting agreement¹⁶ unless the voting agreement includes an express provision to the effect that the parties to it are obliged to own a specified minimum number of shares with a specified minimum number of votes, or that the shares may only be transferred subject to the condition that the transferee, upon transfer of the shares to him, undertakes to vote in accordance with the provisions of the voting agreement. The express undertaking of the purchaser of the shares to restrict his right to vote and to vote in accordance with the terms of the voting agreement effectively restricts the transfer of shares to persons interested not in control of the management of the company, but only in a return on their investment in the form of dividends.¹⁷

Secondly, there is nothing to prevent any person, whether a party to the voting agreement or not, from altering the voting strength of a particular class of shareholders or from interfering with the voting control which such agreement confers, unless the voting agreement contains an express provision precluding parties to it from doing so.¹⁸

For example, a class of shares may be sub-divided.¹⁹ The number of shares held by each shareholder of that class of shares which is sub-divided will increase, causing the voting power of that class of shareholders to be effectively increased. In this way, the controlling shareholders can increase the voting power of any particular class of shareholder not a party to the voting agreement, thus diluting the voting

¹⁶ *Pickering 256; Hahlo 267; Greenhalgh v Mallard [1943] 2 ALL ER 234 (CA) at 239 and 237.*

¹⁷ *Consolidated Crusher Holdings (Pty) Ltd v Plen 1968 (1) PH A2 (T).*

¹⁸ *Pickering 256; Greenhalgh v Arderne Cinemas Limited [1946] 1 All ER 512.*

¹⁹ *S 75(1)(e).*

power of the shareholders who are party to the voting agreement. Only an express prohibiting provision in the voting agreement will prevent the shareholders implementing such a scheme of sub-division.

A voting agreement will thus not be effective unless the parties to it can between them exercise sufficient voting rights to prevent the shareholders of the company from passing a special resolution in favour of a scheme which will weaken their collective voting strength.²⁰ Thus, if the parties to a voting agreement do not stipulate for some permanence of control their position will be highly precarious and easily undermined. It is, however, not always possible to achieve certainty and effectiveness by providing expressly for all foreseeable eventualities and contingencies in a voting agreement. Although much care may be taken in drafting such an agreement in order to contend with as many eventualities as possible, a cunning protagonist will usually be able to find a way of undermining its collective voting strength.

3.3.2 Voting trusts

A voting trust involves the voting rights of all or some of the shares in a company being settled on trust.¹ There are two types of trust, namely a "discretionary trust", where property is donated to and vests in the trustees to administer in terms of the trust deed, and a "vested trust", where property vests in the trust beneficiaries but is administered by the trustees in terms of the trust deed on behalf of the trust beneficiaries.² A trust is not a separate legal entity.³ Only the discretionary trust, which is the more common form of trust in practice, will be dealt with below.

20 *Pickering* 256 - 7.

1 *Farrar* 126; *Pickering* 257.

2 *S 1 sv "trust" of the Trust Property Control Act, 57 of 1988.*

3 *Cilliers & Benade* 3; *Magnum Financial Holdings v Summerly* 1984 (1) SA 160 (W) at 163.

A shareholder may transfer his shares⁴ to a trustee, who will acquire title to the shares and will be a registered member of the company, to be administered by the trustee in terms of a trust deed. The shareholder divests himself of his title to the shares and retains for himself only rights arising from the trust deed in respect of dividends and capital. Therefore, upon transfer of the shares to the trustee, the shareholder surrenders his rights as shareholder and becomes a trust beneficiary.⁵ The trustee acquires such rights and consequently the company has regard only for the trustee as the registered member.

Any dividend paid by the company to the trustee, as the registered member, will constitute income in the trust estate in terms of the trust deed. The trust income, subject only to any special provision to the contrary contained in the trust deed, vests in the trustees in their capacity as such.⁶ The trust beneficiaries will have a personal right to their portion of the trust income only once the trustees have exercised their discretion, in terms of the trust deed, to apportion and distribute the income to them.⁷ The company is not obliged to take any notice of the fact, even if it is aware of it, that the registered member holds the shares as trustee or as nominee⁸ on behalf of another.⁹ There is, therefore, no duty on the company to ensure that the trustee is paying the trust beneficiaries dividends received by him in terms of the trust deed.¹⁰

4 See *Farrar* 126 where it is stated: "The shares are usually transferred as there is doubt as to whether votes can be separated from ownership of the shares." It is submitted that there is no reason why the right to vote, which is a proprietary legal right, cannot be separated from the ownership of shares.

5 *Pickering* 258 footnote 43, where it is stated: "It is clear, however, that where a company's shares are held on trust the rights of the beneficiaries are derived from the terms of the trust itself, and not from the provisions of the company's regulations: *Butt v Kelson* [1952] Ch 197".

6 S 12 of the Trust Property Control Act, 57 of 1988.

7 *Henochnberg* 170 and the authorities cited.

8 It is not certain whether the person who holds shares as a trustee is a nominee. See *Sammel v President Brand Gold Mining Company Ltd* 1969 (3) SA 629 (A) at 667. It is submitted that the answer must lie in the proper construction of the trust deed and the terms upon which the shareholders transfer their shares to the trustee.

9 S 104; *Hahlo* 223; *Henochnberg* 169 and the authorities cited.

10 *Henochnberg* 170 and the authorities cited.

More importantly, the trustees can exercise the votes in respect of shares transferred to the trust in accordance with their authority to do so in terms of the trust deed. A trust deed is a flexible instrument and may confer on the trustees an absolute and unfettered discretion to exercise the votes as they wish, subject only to the fiduciary duty of the trustees to act in the best interests of the trust beneficiaries, or it may restrict their authority to vote. The voting trust, in effect, confers upon the trustees a joint irrevocable proxy with general or restricted powers.¹¹ Furthermore, the trust objects, which must be lawful, may be either general or may be confined to certain specific matters.

The trust deed, unlike the voting agreement, must be lodged with and registered by the Master of the Supreme Court¹² and is, therefore, not a private document. Any person who in the opinion of the Master has sufficient interest in the trust deed so registered with him, may inspect and make copies of the trust deed.¹³ Therefore, in order to conceal the identity of the real controllers of the trust, the trustees can enter a private voting agreement with the real controllers, whereby the trustees undertake to vote in accordance with their instructions. The trust beneficiaries could possibly attack this agreement, or interdict the trustees from performing their obligations in terms of this voting agreement, if they ever became aware of it, on the ground that if the trustees fetter their discretion they will be in breach of their duty to act in accordance with the terms of the trust deed.¹⁴

The voting trust has many uses other than concentrating voting power.¹⁵ For example, where there is a close association of shareholders and directors with comparable status within the company the existence of independent trustees with powers to appoint and

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- 11 *Hahlo 311; Farrar 126; Pickering 257; Burns v Siemens Brothers Dynamo Works Ltd [1919] 1 Ch 225; Munro v Ekerold 1949 (1) SA 584 (SWA); cf Table A art 47, Table B art 48; see 3.3.3 below.*
12 *Hereafter referred to as "the Master; s 4 of the Trust Property Control Act, 57 of 1988.*
13 *S 18 of the Trust Property Control Act, 57 of 1988.*
14 *Tony Honore The South African Law of Trusts 3rd ed (1985) ("Honore") 278.*
15 *Farrar 127.*

remove directors will go some way towards preventing undesirable strife between such shareholders and directors. Furthermore, where the founders of a company wish to perpetuate a policy or belief they can entrench this in the trust objects, simultaneously restricting the authority of the trustees to vote only in the furtherance of this policy or belief. In this way, the policy or belief can be perpetuated for as long as the trust deed is in existence. Finally, the trust deed itself can be amended only by consensus in terms of an amendment clause contained in it. Therefore it is easier for the trustees to safeguard the interests of the trust beneficiaries in a trust deed, than for the shareholders to safeguard their interests individually in terms of the articles.¹⁶

The voting trust is also a potential vehicle for abuse because under it shareholders may surrender more of their legal rights and remedies to the trustees than under almost any other means of concentrating control¹⁷ and not be able to control the trustees.¹⁸ If sufficient shares carrying the required majority of votes¹⁹ are transferred to the voting trust, the trustees can acquire sufficient votes to pass resolutions in general meeting, thereby becoming the controllers, or at least a dominating influence, in the company. If directors of a company controlled the board of trustees of the voting trust, or were themselves trustees, they would, in terms of the powers conferred upon them by the trust deed, determine such issues as inter alia the terms of appointment and remuneration of directors.²⁰ Such a situation would be untenable if abused.

Furthermore, the trustees often have little interest or personal stake in the success of the company resulting in them taking less responsible short term decisions in relation to the management of the company. Unlike directors, trustees, as registered members of a company, owe no fiduciary duty to the company.²¹ Instead, they have a duty to the trust

16 *Pickering 258.*

17 *Pickering 259.*

18 *Farrar 127.*

19 *See 2.2 above.*

20 *Pickering 258 - 9 footnote 45.*

21 *See 2.1.2 above.*

beneficiaries to act within the powers conferred upon them by the trust deed.²² The trust beneficiaries' remedy against the trustees in the event of a breach of that duty would be to claim their right to receive a dividend or a share in the surplus capital upon distribution thereof.²³ Whether or not the trust beneficiaries can prevent the trustees from voting in any particular way, especially if the trustees enjoy a wide unfettered discretion to do so in terms of the trust deed, is doubtful.

It is therefore in the interests of shareholders, before relinquishing their shares to the trust, to ensure that the trust deed contains a provision effectively empowering them to appoint the trustees of their choice, and to remove any trustee who proposes to use the voting power conferred by the trust for his own selfish purpose or for some other corporation's purpose or for hostile purposes.²⁴

A voting trust, controlled by the directors of the company, is an indirect method of circumventing the company law principle that a company cannot purchase its own shares and be a member of itself, except in certain defined circumstances.²⁵ Although this principle is primarily aimed at maintaining the capital of the company and thus protecting shareholders' investments,²⁶ it also prevents further abuse by the

22 *Honore* 278.

23 See generally *Honore* 278 - 291.

24 *Pickering* 269 footnote 47; *Warren v Pim* 66 NJ Eq 353 at 375; 59 Atl 773 at 781 (1904); H W Ballantine "Voting Trusts, Their Abuses and Regulations" (1942) 21 *Texas Law Review* 139 at 151 - 152.

25 S 38; *Trevor v Whitworth* (1887) 12 App Cas 409; but cf *Hahlo* 172 where the author states that in the United Kingdom, where it originated, this principle no longer applies, though it still applies in South Africa. In England it was held in *in re Castiglione's Will Trusts* [1958] Ch 549, that a company can hold its own shares on trust for itself. This position has been entrenched by statute in South Africa only in relation to employment participation schemes - see s 38(2)(b). In terms of ss 159 - 181 of the Companies Act, 1985, both public and private companies are now permitted, provided their articles authorise it, to redeem and purchase their own shares and to be members of themselves; see also *Farrar* 163 - 176.

26 *Hahlo* 170-171 and the authorities cited.

directors. The directors could, if they were not prohibited from doing so,²⁷ use the company to purchase its own shares and be a member of itself. The directors of that company, it is submitted, could then exercise control over those shares themselves, effectively acquiring voting control in that company, and preventing the remainder of the shareholders of the company from being able to pass an ordinary resolution removing them from office. The directors, in effect, would be increasing their own powers of control at the expense of the company.

3.3.3 Irrevocable proxies

In order to acquire voting control in the general meeting a third party¹ may approach the registered members of a company, and for a consideration, become their "proxy". Unless the articles otherwise provide, a proxy shall not be entitled to appoint more than one proxy.² Acquiring control by canvassing for proxies is not easily achieved for a number of reasons:

- 3.3.3.1 A "proxy" is merely an authorisation given by a shareholder to another person to exercise his right to attend, speak and vote in his stead at any meeting of the company.³ A proxy is therefore merely the agent of the shareholder who appointed him⁴ and has no title or other rights to the shares beyond the authority given him by his appointment.⁵ The authority so given, however, may be wide or it may be limited. In order to be effective as a means of acquiring

27 S 38.

1 *Proxies may, but need not be, members of the company; s 189(1); Hahlo 297; Henochsberg 292, M J Oosthuizen "Die Uitbring van Volmagstemme by die Neem van Spesiale Besluite" (1975) 38 THRHR 160.*

2 *S 189(1) proviso.*

3 *S 189(1); Pickering 261.*

4 *Henochsberg 292; Cousins v International Brick Co Ltd [1931] 2 Ch 90 at 94.*

5 *Farrar 127; Pickering 262; Gower 538 - 541.*

control in a company, the proxy should be authorised to vote in whatever way he deems appropriate, and the authority of the proxy must be expressed to be irrevocable, either over a period of time, or for stipulated meetings or resolutions only.⁶

3.3.3.2 A shareholder may normally cancel the proxy either expressly or by personal attendance and voting.⁷ On ordinary agency principles, it is clear that as between the shareholder and his proxy, a revocation is always effective if notified to the proxy before he has voted, and if he disregards it he usurps an authority and is liable to his principal.⁸

3.3.3.3 Voting at general meetings takes place on a show of hands or by a poll.⁹ A proxy may attend, speak and vote on a poll but may not, unless the articles otherwise provide, vote on a show of hands.¹⁰ On a show of hands a proxy who is entitled to vote in terms of the articles has only one vote, irrespective of the number of shares he holds or represents.¹¹ The registered members and proxies may demand a vote by poll¹² and therefore it is not necessary to appoint a different person as proxy for each registered member in order to acquire control by proxy.

3.3.3.4 The danger always exists that a proxy will vote contrary to the authorisation as evidenced on the proxy form.¹³ In these circumstances it is uncertain whether the company may disregard his vote.¹⁴ Furthermore, it is not certain whether proxy holders can

6 *Farrar 127; Pickering 262 footnote 58; see 3.3.3.2 below.*

7 *Gower 540 footnote 96.*

8 *Gower 540.*

9 *S 197 and s 198.*

10 *S 189(1); Henochsberg 292 - 293; 308.*

11 *S 197(1); Hahlo 297.*

12 *S 198(2).*

13 *S 189(5)(b) and (6)(b).*

14 *Henochsberg 293; Gower 541 footnote 2; Hahlo 319; Cousin v International Brick Ltd [1931] 2 Ch 90 at 95, 100 and 102.*

be compelled to attend company meetings, and apparently only if they are present and if there is a binding contract compelling them to do so, may they be compelled to exercise the authority conferred upon them.¹⁵

3.3.3.6 There is nothing to prevent another shareholder from attacking the validity of the appointment of a proxy. Unless the articles provide otherwise, it is for the chairman of the general meeting to determine the validity of an appointment of a proxy and as to whether a proxy's vote is or is not to be rejected on that basis.¹⁶

3.3.3.7 The person wishing to acquire control of the company by proxy must be prepared to expend time, money and effort canvassing for votes especially where the members are geographically widely dispersed.

The proxy making machinery is ideally suited for the directors to acquire control of the general meeting. The shareholders may be invited by the directors to complete a proxy form consenting to the nomination of one of the directors as proxy.¹⁸ Shareholders who are too apathetic to attend, or due to circumstances are unable to attend, a general meeting, may confirm the director's appointment as proxy. In this manner the directors can utilise the votes of the absentee shareholders.

Where consideration has been given for an authority to vote, whether that authority is express or implied, then in effect a voting agreement has been created which is identical in its nature with the voting agreement

15 *Farrar 127; Pickering 263 footnote 66; Gower 540 - 541; Second Consolidated Trust Ltd v Ceylon Amalgamated Tea and Rubber Estates Ltd [1943] 2 ALL ER 567.*

16 *Henochsberg 294; Hahlo 318; In re Indian Zoedone Company. (1884) 26 Ch 70 (CA) at 77.*

17 *S 189(5).*

discussed above.¹⁸ No realistic distinction between voting agreements and irrevocable proxies can be founded upon the fact that the latter are usually, but not necessarily, entered into between the shareholders of a company whereas the former relationship are more often created between shareholders and non-shareholders.¹⁹

3.4 Inter-company control arrangements

A company may be a shareholder of another company.¹ A "group" of companies may thus be created in which the shares of the various companies in the group are held by other companies in the group in such a way that the voting control is concentrated in one or more of the companies. A "group" of companies is not a separate legal persona but is comprised of a number of companies, each company being a separate legal persona.² It is therefore possible for one company in a group to trade, another company to retain ownership of all assets, and yet another company to manage the business.

A group of companies may comprise a holding company and its subsidiaries,³ or it may comprise a network of interlinking companies without this formal control arrangement. The basic characteristic of a group of companies is that the management of the companies comprising it may be

¹⁸ See 3.3.1 above.

¹⁹ Pickering 263.

¹ Cilliers & Benade 115; Hahlo 220; Henochsberg 168.

² Salomon v Salomon & Company Ltd [1897] AC 22 (HC); Dadoo Ltd v Krugersdorp Municipal Council 1920 AD 530; Gower 112 and 251; D H Botha "Recognition of the group concept in the Company Law" 1982 De Jure 107 ("Botha") at 110; K Hofsetter "Parent responsibility for subsidiary corporations: Evaluating European Trends" (1990) 39 International Company Law Quarterly 576; C Schmitthoff "Salomon in the Shadow" 1976 Journal of Business Law 305 at 311.

³ See 3.4.1 below.

co-ordinated in such a way that they are managed on a central and unified basis in the interests of the group as a whole.⁴ The control implicit in the "holding-subsiary" company relationship which a holding company exercises over its subsidiaries makes it possible for the group to be managed in this way.⁵

The statutory recognition of the group of companies is limited to disclosure of the group's annual financial statements,⁶ and to the abuse of control provisions.⁷ By carefully avoiding the ambit of the holding-subsiary company definition, it is possible to create group structures which circumvent the statutory disclosure provision and prohibitions reserved for holding companies and their subsidiaries.

There are basically three "group" structures which may be used to concentrate voting control in one company, namely, the holding company-subsiary company relationship,⁸ cross-holdings,⁹ and circular holdings.¹⁰

3.4.1 Holding company - subsidiary company relationship

The method of defining a subsidiary company only in terms of share ownership and control, or presumptions of control, based on the degree of integration or dependency between the companies permits a wide variety of group structures to be created.

Essentially there are two definitions of a subsidiary company. The first definition contains two elements. A company is deemed to be a subsidiary of another company if that other company either is a member

4 Gower 251.
5 Botha 108; Hahlo 69 - 73; see 3.4.1 below.
6 S 288.
7 S 37, s 38, s 39, s 226 and s 227.
8 See 3.4.1 below.
9 See 3.4.2 below.
10 See 3.4.3 below.

of it and controls the composition of its board of directors,¹¹ or if it holds more than one-half of its equity share capital or if it is a subsidiary of any company which is a subsidiary of that other company,¹³ or if subsidiaries of that other company, or if that other company and one or more of its subsidiaries, together hold more than one-half of its equity share capital.¹⁴

The meaning of "control" is extended so that the composition of a company's board of directors shall be deemed to be controlled by another company if that other company may, by the exercise of some power,¹⁵ without the consent or concurrence of any other person, appoint or remove the majority of the directors.¹⁶ Furthermore, a company shall be deemed to have power to appoint a director where a person cannot be so appointed without its consent or concurrence, or a person's appointment as director follows necessarily from his appointment as director of it.¹⁷

For the purposes of working out whether a company "holds" more than one-half of the equity share capital of another, shares held¹⁸ or power exercisable by that other company in a fiduciary capacity are excluded,¹⁹ but shares held by a nominee, subject to a few exceptions, are included.²⁰ The Act does not state how the equity share capital is to

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- 11 *S 1(3)(a)(i)(aa); Henochsberg 12; Sage Holdings Ltd v The Unisec Group Ltd 1982 (1) SA 337 (W) at 350 - 352.*
- 12 *S 1(3)(a)(i)(bb); See 2.3 above for the definition of "equity share capital"; for a general discussion on the main consequences of the holding-subsidary relationship, see Hahlo 52 - 53.*
- 13 *S 1(3)(a)(ii).*
- 14 *S 1(3)(a)(ii) and (iv).*
- 15 *This includes a potential power - see in this regard Henochsberg 12; Sage Holdings Ltd v The Unisec Group Ltd 1982 (1) SA 337 (W).*
- 16 *S 1(3)(b).*
- 17 *S 1(3)(b)(i) and (ii).*
- 18 *Henochsberg submits, correctly it is submitted, at 12 that by the word "holds" the legislature means "is the beneficial owner of" and that the intention is that the provisions of the Act designed to prevent abuse of the holding company/subsidiary relationship are not to be evaded by the device of having nominee holdings.*
- 19 *S 1(3)(c)(i).*
- 20 *S 1(3)(c)(ii).*

to be valued or counted. In the case of par value shares, one has regard exclusively to their nominal value and, in the case of no par value shares, one has regard exclusively to the value according to the stated capital account.²¹

The definition of the "controlling-controlled" companies relationship includes, but is wider than, that of the "holding-subsidary" companies relationship.²² Without prejudice to the generality of the term "controlling company", a company is deemed to control another if it holds more than fifty per cent of the equity share capital of that other company, or is entitled to exercise more than half of the voting rights in respect of the issued shares of that company, or is entitled, or has the power to determine the composition of the majority of the board of directors.²³

The definition of holding-subsidary companies does not extend to control exercised by an entity which is not a company, or by a non-member, or by virtue of a power contained in debentures, or in a fiduciary capacity, or by a minority, or by means of cross-holdings of less than fifty per cent, interlocking directorships or any other form of de facto control.²⁴

A holding company, with a relatively small capital base, may therefore be a member of and control subsidiary companies with capital many times greater than the holding company.²⁵ In this manner, it is possible to obtain control over many companies in which there may be, in aggregate, very substantial minority interests. The holding-subsidary company relationship is a very powerful instrument for the concentration of control in the holding company.

21 *Henochsberg 12; Sage Holdings Ltd v The Unisec Group Ltd 1982 (1) SA 337 (W) at 353.*
22 *Hahlo 54.*
23 *S 1(1) "controlled company" and "controlling company".*
24 *Farrar 490; see 3 below.*
25 *Pickering 264.*

3.4.2 Cross-holdings

One of the most important consequences of shareholders' majority voting control in a company, is the power to appoint and remove the majority of the board of directors.¹ It is submitted that where a company is the shareholder or registered member of another company, the board of directors will exercise the voting rights attached to those shares in terms of their authority conferred by the articles. Therefore, the board of directors of the holding company effectively exercise the power to appoint or remove the majority of the board of directors of such subsidiary.

Similarly, if the subsidiary company were allowed to be a member of its holding company then the board of directors of the subsidiary company would effectively be able to appoint or remove the majority of the board of directors of the holding company. The directors of both companies could maintain themselves in office indefinitely against the wishes of other shareholders.

In order to prevent directors of holding and subsidiary companies maintaining themselves in power in this manner, a subsidiary company is prohibited from being a member of its holding company.² A company may be a member of another company, therefore, only if it is not a subsidiary of that other company.

In order to circumvent the prohibition contained in section 39 it is necessary to ensure that the companies in the group structure do not fall within the ambit of the definition of holding-subsidiary company. This is not difficult to achieve under existing South African law.³ Firstly, the companies must not hold, directly or indirectly, more than fifty per cent of

¹ Cf 2.1.2 and 2.1.3 above.

² S 39.

³ But cf 2.5 above and the new definition in England of parent-subsidiary undertaking in the Companies Act, 1989.

the equity share capital in each other.⁴ Secondly, they must not be members of each other, and they must not "control" the composition of the board of directors of the other companies within the meaning of that expression in the definition of holding-subsiary company.⁵

The cross-holdings structure will fall outside the holding company-subsiary company relationship if the various companies in the group formation, reciprocally, hold less than fifty per cent of the equity share capital in each other, are not registered members of each other but merely "hold" the shares through their appointed nominees,⁶ and do not control the composition of each others' boards of directors. Where there is a common directorship sitting on each company's board, or an agreement between the directors of each company, a unified co-ordinated group structure can be formed.⁷

3.4.3

Circular holdings

The circular holdings structure is merely a variation of the cross-holding device. Circular holdings differ from cross-holdings in that shares in one company are normally only held by one other company. The suggested structure is that each company in the group holds shares, each less than a majority, in the form of a circle or chain of interests.¹

If the directors of all the inter-connected companies are the same persons, or agree to act in concert, they can in practice generally maintain themselves in office indefinitely, and against the wishes of other members.

The circular ownership device differs from the cross-holding device in that there is no reciprocal joint majority direct and indirect interest in

4 *S 1(3)(a)(i)(bb).*

5 *S 1(3)(a)(i)(aa); Sage Holdings Ltd v The Unisec Group Ltd 1982 (1) SA 337 (W) at 350 - 352.*

6 *But cf Henochsberg 12 and 3.4.1 footnote 18 above.*

7 *Pickering 265 - 6; Farrar 128.*

1 *Pickering 267; Farrar 128.*

each of the companies held by other inter-connected company or companies in the circle. Therefore the directors of any of the companies may be removed by the remaining shareholders acting together unless the directors acquire for themselves sufficient shares to make up a majority interest. Otherwise, the directors must merely accept the risk of holding only de facto minority control.²

3.5 Management contracts

The management of a company is usually delegated by the general meeting to an autonomous board of directors whose appointment is based on election by the shareholders in general meeting.¹ The terms of appointment of the directors may, however, be set forth in the articles, in a service contract entirely independent of the articles, or in a service contract which, expressly or by implication, embodies the relevant provisions of the articles.² Third parties may therefore be "imported" by a company to perform specific functions or tasks on its behalf either as agents or as independent contractors. The general meeting may even delegate the whole or practically the whole of its powers of general management to a third party, or a member, under an express management contract.³

Provision may be made in the articles for the directors to further delegate any or all of the powers, authorities and discretions conferred upon them by the company's regulations.⁴ The delegation of powers may authorise further sub-delegation, for example, by the board of directors to a managing

2 *Pickering 267.*

1 *See 2.1.1 above; cf Farrar 311.*

2 *Hahlo 344 and 352.*

3 *Farrar 127; Pickering 267; Cilliers & Benade 209; Gower 154-156.*

4 *Table A art 80, Table B art 79; Hahlo 454.*

director, to whom they entrust to or confer upon such of their powers as they think fit.⁵ A delegation to a third party of managerial powers in excess of that authorised by the articles cannot be enforced by that third party against the company.⁶

The management contract between the company and the managing director is obviously capable of abuse in that the board of directors may be able to divest themselves of most of their duties and responsibilities. However, if the managing director in fact controls the company, he could fall within the definition of "director".⁷

In order to manage a company professionally the board, it is submitted, should be entitled to delegate management powers to qualified and competent third parties. The main difficulty is probably that of distinguishing and defining "legitimate" delegations of power to a managing agency, which are unlikely to be wrongfully used, from those which might be. Professional and technical matters generally ought to come within the former category, while contracts delegating to management any substantial part of the business should come within the latter. The definition of a "substantial part of any business of a company" may, if adopted, require judicial elaboration particularly if the management contract becomes more commonly used.⁸ Where directors have a material interest in a management contract this must be made known, both at the company's registry and to members.⁹

5 *Hahlo* 454 and 463; *Pickering* 267 footnote 79; *Table A* arts 61 - 62, *Table B* arts 62 - 63; *In re Newspaper Proprietary Syndicate Ltd* [1900] 2 Ch 349 at 350; *Nelson v James Nelson & Sons Ltd* [1914] 2 KB 770 (CA) at 779; *Moresby White v Rangeland Ltd* 1952 (4) SA 285. (SR) at 286; *Harold Holdsworth & Co. (Wakefield) Ltd v Caddies* [1955] 1 WLR 352; [1955] 1 ALL ER 725 (HL) at 728-730; and *Anderson v James Sutherland (Peterheads) Ltd* 1941 SC 203 at 217.

6 *Woodlands Limited v Logan* [1948] NZLR 230.

7 *Pickering* 268 footnote 82; cf *Henochsberg* 9 who requires a valid appointment as a director before recognition of director status is granted; and cf *S v Vandenberg* 1979 (1) SA 208 (D); *Hahlo* 329; see 2.1.1 above.

8 *Pickering* 268-9.

9 S 234 - s 241.

Chapter 4 - De facto means of acquiring control in a company

Legal forms of control may not always be practically effective where the shareholders of a large company are geographically widely dispersed. In such a case, no one individual shareholder or definable grouping of shareholders may possess legal rights to exercise a majority of votes in general meeting. Usually, however, in most companies, some grouping or individual shareholder will emerge with de facto powers of control, which are virtually as real in most respects as those conferred by legal majority voting rights.¹

While precise definition is impossible in legal terms, three general forms of de facto control may be distinguished, namely, the informal agreement,² minority control³ and personal influence.⁴

4.1 Informal agreements

Two or more shareholders may, on an informal basis, undertake informally to vote together. This informal undertaking may not be intended by the parties to have any legal effect and will therefore be unenforceable at law. Sometimes the understanding to vote together may amount to little more than a general tacit community of interest, particularly when it is between members of a family. The understanding to vote together may also take the form that one or more shareholders will take no active interest in the management of the company, but will instead acquiesce in these functions being carried out by others.⁵

Informal agreements of this nature are often elusive and transitory in nature and may be readily dissolved, whether informally or by conflict of interest between the parties, or by changes in share ownership. Nevertheless, while they are in existence, they can be extremely effective as a means of concentrating voting control in a company, particularly in a private company with few shareholders.

1 Pickering 269.

2 See 4.1 below.

3 See 4.2 below.

4 See 4.3 below.

5 Pickering 270 footnote 88.

4.2 Minority control

Where there is no majority bloc or grouping of shareholders within the company a voting bloc of less than 50 per cent may for most purposes be adequate to give "working control".⁶ A concentration of only a few votes may be adequate where there is a large membership, provided that the remaining votes are well divided and cast in a random manner. A small coherent group can in these circumstances achieve its objects and, most importantly, with as few as 10 per cent of the votes can appoint their own nominees as directors. The effectiveness of the minority grouping to exercise voting control depends largely upon the indifference of the majority of members and the absence of any other concentration of votes.⁷

The indifference or inability of other shareholders to attend general meetings or to maintain an active interest in the affairs of the company, can create ideal conditions permitting an active minority to take over its administration, and in particular to maintain themselves or their representatives in office as its directors.

The exact proportion of minority votes which will be sufficient to give de facto control of a company varies widely from company to company.⁸ Minority control in the case of smaller companies is much more difficult to acquire and an increasingly large bloc of votes is required as the number of shareholders diminishes.⁹

The danger always exists that in companies with a large membership and in which no individual or group of shareholders have legal control, minority control may pass into the hands of the directors. By virtue of their position

⁶ *In fact, only three-sixteenths of the total number of votes is sufficient to pass a special resolution; see 2.2 above.*

⁷ *Pickering 270 footnote 91.*

⁸ *See Pickering 271 footnote 93 where it is stated: "Among larger companies the test sometimes employed is that if the single largest shareholder holds 20% of the votes or more, or if the largest 20 shareholders together hold 30% of the votes or more, minority bloc voting control may exist."; and see 2.5 above for the definition of "participating interest" in the new s 260(1) of the Companies Act, 1985 inserted by s 22 of the Companies Act, 1989.*

⁹ *Pickering 271 footnote 94.*

and knowledge of the affairs of the company and control of its proxy-voting machinery, the directors have a potential unchecked power.¹⁰ Certain checks have been developed such as those of requirements for disclosure by the directors of their interest in contracts with the company,¹¹ of their dealings in the shares of the company,¹² and of payments for loss of office,¹³ and the conferment upon the shareholders of the right to vote by proxy.¹⁴

Minority control, by definition, may always be displaced should a larger group of shareholders emerge, but the practical difficulties of achieving this, against a united board of directors in particular, may be very nearly insuperable.¹⁵

4.3 Personal influence

One of the most important human attributes which is impossible to measure or define is that of force of personality. This, combined perhaps with a certain talent, business acumen, skill, and power of persuasion, may accord to some people an influence far greater in the company's affairs than that proportionate to their stake in its capital. By its nature, such personal influence is incapable of assessment or measurement in any objective sense.

10 *Farrar 311.*

11 *S 234.*

12 *S 230.*

13 *S 227.*

14 *S 197.*

15 *Pickering 271 footnote 99; Gower 443 - 444 and 456 - 457.*

Chapter 5 - Conclusion

There are various methods of acquiring control in a company,¹ namely by acquiring:

1. almost complete ownership of all the shares in a company;
2. the required majority of voting rights in general meeting through legal devices with or without majority ownership, for example, through holding company relationships and the use of capital and vote gearing, loading votes, voting trusts and voting agreements;
3. minority control; or
4. control of the management of a company.

The scope of this dissertation was limited to acquiring control in a company through the exercise of the shareholders' rights to vote which, it is submitted, are severable from the other incidents of share ownership.

A distinction may be drawn between forms of control founded on legally enforceable rights and obligations and forms of control without this basis.² Forms of control which are legally enforceable, such as categories 1 and 2 above, are based on rights and obligations arising from the articles or from a contract.³ "De facto" forms of control, such as categories 3 and 4 above, cannot be clearly defined in legal terms. De facto forms of control do not originate from either the articles or a contract, but may instead arise from an informal agreement between shareholders, or from minority control exercised by a group of shareholders or from the exercise of personal influence by one or more shareholders, or by a third party over the shareholders, or from a combination of these forms.⁴

1 *Farrar 9.*
2 *Pickering 249.*
3 *See 3 above.*
4 *See 4 above.*
5 *Pickering 249.*

Both legal and de facto forms of control may be effective as a means of controlling a company, but, it is submitted, de facto control will become ineffective if a legal form of control emerges or may be ignored when a stronger personal influence or minority grouping forms.⁵ Legal control, on the other hand, cannot be overcome in any of these ways, is always enforceable in a court of law, and is, therefore, a more satisfactory form of control. There is often an overlap between legal forms of control, and between legal and de facto forms of control.

Although it would appear that the objective of any person who wishes to acquire control in a company would be to acquire legal control in one of its many forms, the trend appears to be in favour of acquiring de facto control in a company or control over the management of the company. This is so largely because of the number of and the geographic dispersion of shareholders in a large company.⁶ The owners of the company, the shareholders, tend in these circumstances to confer control in the company to the management of the company in terms of the articles. With this divergence of ownership and control comes a divergence of interest: the shareholder is interested more in income and capital appreciation of his investment rather than the company as an enterprise whereas management is interested in the enterprise for a diversity of motives ranging from self interest to professional pride.⁷

It is submitted that the identity of interest between ownership and management will vary depending on the number and geographic dispersion of the shareholders of the company. In a small company with few shareholders, there will be a greater identity of interest between ownership and management which, it is submitted, usually ensures that minority shareholders do not suffer discrimination. The position is not the same in large companies with many shareholders where the owners of the company usually have little or nothing to do with the control of the company. The position of the minority shareholders in these circumstances is safeguarded to a large extent by the requirements of the Act for special resolutions and the provision of entrenched minority rights, the right of action for relief against oppression conferred under section 252, and the action at common law for fraud on a minority.

6 *Farrar 8 - 9.*
7 *Farrar 9.*

It is submitted that the acquisition of control in a company requires firstly an analysis of the articles of a company. The articles usually provide for, inter alia, the rights of the various classes of shareholders, the procedures to be followed in general meeting and the division of powers between the shareholders in general meeting and the board of directors. These factors are important before a decision is made by a third party whether to acquire ownership of the company or to acquire control of the management of the company. In large companies with many shareholders, it is submitted, it would be more advisable and economic to acquire control of the management of the company. As the number of shareholders diminish, consideration may be given to acquiring ownership of the company through the acquisition of its shares or through one or more of the devices set out in the articles⁸ or through control of the required majority of shares in terms of an agreement separate from the articles.⁹

Inter-company control arrangements have been increasingly brought under the regulation of the law, both by statute¹⁰ and by the courts. Inter-shareholder agreements, it is submitted, tend to become increasingly impracticable and, in consequence, of diminishing importance as companies expand in size. Finally, the degree of capital gearing is always limited by the powerful curbs of market acceptability.

It is submitted that the use of devices supplementary to the articles will be a more appropriate method of acquiring control in a "small" company.¹¹ Firstly, the voting arrangement is set out in a private document which is not accessible to the public.¹² Secondly, unlike the articles which are alterable by special resolution,¹³ a contract is only alterable by agreement of all the parties to it. It is therefore submitted that the voting agreement, insofar as shareholders are concerned, is the most flexible form of aggregating voting power in a company and the shareholders

8 See 3 above.

9 See 4 above.

10 See 2.5 and 3.4.1 above.

11 See 3.3 above.

12 Except the voting trust deed - see s 18 of the Trust Property Control Act, 57 of 1988. But see 3.3.2 for the other advantages of the voting trust.

13 See 2.2 and 3.3 above

retain title to their shares.¹⁴ Shareholders surrender more of their rights under a voting trust than under any other form of control because they transfer their shares to the trustees and relinquish their title thereto.¹⁵ It is submitted that the voting trust is a useful device where a third party wishes to acquire control in a company because the third party can acquire title to the shares and exercise the votes in terms of a wide discretion conferred by the trust deed.

Any form of control, such as class powers of appointment of directors and class powers of general management, should, it is submitted, be avoided because they may result in the company becoming unmanageable.¹⁶

The other constitutional forms of control, namely capital and vote gearing and loading votes, are all useful methods which may always be utilised in appropriate circumstances, such as when the existing shareholders wish to retain control in the company but need to raise capital by the issue of new shares.¹⁷

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- 14 See 3.3.1 above.*
15 See 3.3.2 above.
16 See 3.2.4 and 3.2.5 above.
17 See 3.2.1, 3.2.2 and 3.2.3 above.

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- 3.2 Brown v Nanco (Pty) Ltd 1976 (3) SA 832 (W), 1977 (3) SA 761 (W)
- 3.3 Coetzee v Rand Sporting Club 1918 WLD 74
- 3.4 Consolidated Crusher Holdings (Pty) Ltd v Plen 1968 (1) PH A2 (T)
- 3.5 Dadoo Ltd v Krugersdorp Municipal Council 1920 AD 530
- 3.6 Davis v Buffelsfontein Gold Mining Company Limited 1967 (4) SA 631 (W)
- 3.7 De Villiers v Jacobsdal Salt Works (Michaelis and De Villiers) (Pty) Ltd 1959 (3) SA 873 (O)
- 3.8 Esterhuizen v East Rand Crushers (Pty) Ltd 1968 (4) SA 281 (T)
- 3.9 Fisheries Development Corporation of SA Ltd v Jorgenson 1980 (4) SA 156 (W)
- 3.10 Flegg v McCarthy & Flegg 1942 CPD 109
- 3.11 Gohlke and Schnelder v Westies Minerale (Edms) Bpk 1970 (2) SA 685 (A)
- 3.12 Gundelfinger v African Textile Manufacturers Ltd & Others 1939 AD 314
- 3.13 Inland Property Development Corporation (Pty) Ltd v Cilliers 1973 (3) SA 245 (A)
- 3.14 James North (Zimbabwe) (Pvt) Ltd v Mattinson 1990 (2) SA 277 (ZHC)
- 3.15 Jeffery v Pollak and Freemantle 1938 AD 1
- 3.16 Labuschagne v Denny 1963 (3) SA 538 (A)
- 3.17 Liquidators, Union Share Agency v Hatton 1927 AD 240
- 3.18 Magnum Financial Holdings v Summerly 1984 (1) SA 160 (W)
- 3.19 Moosa v Laloo 1956 (2) SA 237 (D)
- 3.20 Moresby White v Rangeland Ltd 1952 (4) SA 285 (SR)
- 3.21 Munro v Ekerold 1949 (1) SA 584 (SWA)
- 3.22 Quadrangle Investments (Pty) Ltd v Witind Holdings Ltd 1975 (1) SA 572 (A)
- 3.23 R v Kritzinger 1971 (2) SA 57 (A)
- 3.24 Rosslare (Pty) Ltd v Registrar of Companies 1972 (2) SA 524 (D)
- 3.25 S v Shaban 1965 (4) SA 646 (W)
- 3.26 S v Vandenberg 1979 (1) SA 208 (D)
- 3.27 Sage Holdings Ltd v The Unisec Group Ltd 1982 (1) SA 337 (W)
- 3.28 Sammel v President Brand Gold Mining Company Limited 1969 (3) SA 629 (A)
- 3.29 Standard Bank of S A Ltd v Ocean Commodities Inc 1980 (2) SA 175 (T)
- 3.30 Standard Bank of S A Ltd v Ocean Commodities Inc 1983 (1) SA 276 (A)
- 3.31 Stewart v Schwab 1956 (4) SA 791 (T)
- 3.32 Swerdlow v Cohen 1977 (3) SA 1050 (T)
- 3.33 The Unisec Group Ltd v Sage Holdings Ltd 1986 (3) SA 259 (T)
- 3.34 Utopia Vakansie-Oorde Bpk v Du Plessis 1974 (3) SA 148 (A)
- 3.35 Waja v Orr 1929 TPD 865.