THE SUPREME COURT OF APPEAL OF SOUTH AFRICA

JUDGMENT

SCA Case No: 12/2012

Reportable

In the matter between:

COMMUNICARE	**FIRST APPELLANT**
COMMUNICARE CONSTRUCTION	**SECOND APPELLANT**
HERMANUS JOHANNES FOURIE	**THIRD APPELLANT**

and

BLUMERUS LODEWYK EZRA KHAN	**FIRST RESPONDENT**
BARRY DEANE TILNEY	**SECOND RESPONDENT**

Neutral citation: *Communicare v Khan* (12/2012) [2012] ZASCA 180 (29 November 2012)

Coram: Cloete, Cachalia, Malan and Shongwe JJA and Swain AJA

Heard: 14 November 2012

Delivered: 29 November 2012

Summary*:* **Rights of members of company to enforce articles of association against company challenged – rights of respondents to vote at annual general meetings of first and second appellants, in respect of election of directors classified as personal rights, as opposed to corporate rights and consequently not susceptible to control by majority of members – rights enforceable against first and second appellants.**

ORDER

On appeal from: Western Cape High Court, Cape Town (Binns-Ward J sitting as court of first instance):

The following order is made:
The appeal is dismissed with costs, including the costs of two counsel where employed and the costs in the application for leave to appeal, on the same basis.

JUDGMENT

SWAIN AJA (CLOETE, CACHALIA, MALAN & SHONGWE JJA concurring):

[1] The two appellant companies, with the leave of the Western Cape High Court, Cape Town (Binns-Ward J) seek on appeal the rescission of an order, granted in favour of the respondents, in which it was declared that the election of the directors of the appellants, at their annual general meetings on 27 October 2009, was invalid and accordingly set aside.

[2] The election of four directors was necessitated by a provision in the articles of association of the first and second appellants, (quoted in para 22 below), that a third of the members of their respective boards was obliged to retire by rotation each year. The articles in addition provided that directors were also members of the first and second appellants for the duration of their office. The retiring directors were however excluded from voting in the election of successors, at the annual general meetings, on the basis that their retirement had to have occurred before a vacancy could be declared and the election for a successor could take place. As a consequence, before the election took place,

the retiring directors were deprived of their status as members and were ineligible to vote.

[3] Two of the grounds upon which the appellants (respondents in the high court) opposed the relief sought by the respondents (applicants in the high court) and which form the basis of this appeal, were that the resolutions were validly passed and in any event, that the respondents lacked the necessary locus standi to challenge their validity. I shall deal with these questions in reverse order.

[4] The locus standi of the respondents was challenged on the basis that, in accordance with the decision in *Foss v Harbottle* (1843) 67 ER 189, where a majority of members at a general meeting are lawfully entitled to correct, condone or ratify irregular conduct by the company in the management of its internal affairs, a court will not intervene at the behest of a member to compel the company to rectify such conduct.

[5] The challenge raised by the appellants based upon this decision, was that individual members have no right to enforce corporate rights, except when the irregularity complained of could not be remedied by the company, or the member concerned's individual membership rights had been affected adversely. It was submitted that on the facts of the present case, the right of the respondents to vote at the annual general meetings of the appellants, was a corporate right, not an individual member's right; and that any irregularity in this regard (which was denied) was capable of being rectified by majority vote, at any reconvened annual general meeting. The respondents contend however that the right is one which belongs to individual members of the appellants and as such, was not susceptible to majority control, at an annual general meeting of the appellants.

[6] As pointed out by the high court, the dichotomous categorisation of members rights as individual or personal membership rights, as opposed to corporate membership rights, is well established. Professor Pennington states that a court will incline to treat a provision as conferring a right on a member

'only if he has a special interest in its observance distinct from the general interest which every member has in the company adhering to the terms of its constitution'.[1]

[7] Professor Blackman[2] refers to the rules in the memorandum and articles which confer powers on the company and categorises the conditions which must be fulfilled for the exercise of these powers, as 'constitutional powers'.[3] He states that such rules place duties and obligations on the company, without necessarily conferring corresponding rights on the shareholders.[4] It may be a matter of some difficulty in a particular case to draw such a distinction.

[8] The issue for determination accordingly is whether the respondents have the power to approach a court to enforce, against the appellants, their rights to effectively exercise their votes on the election of directors at the annual general meetings of the appellants. It should be noted that the respondents were not denied the right to vote[5] but contended that their votes were adversely effected by the exclusion of the rights of the four retiring directors to vote.

[9] The principle in *Foss* as applied in *MacDougall v Gardiner* (1875) 1 Ch D 13, accordingly formed the basis for the argument advanced by the appellants, whereas the decision in *Pender v Lushington* (1877) 6 Ch D 70, fulfilled a similar role in the argument of the respondents. These are the leading cases in two lines of apparently conflicting authority, dealing with the broader

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[1] Professor R R Pennington *Company Law* 6 ed (1990) at 651 in Blackman infra fn2 at footnote 23.

[2] Michael Blackman 'Members' rights against the company and matters of internal management' (1993) 110 *SALJ* 473 at 477.

[3] Such powers it seems would be synonymous with 'corporate rights'.

[4] Supra fn2 at 477.

[5] The second respondent however, alleged that the proxy he had given to one of his fellow members, who voted at the meeting, had been irregularly obtained and exercised.

issue of when a member can compel a company to observe the provisions contained in its articles of association.

[10] Before examining these cases it is necessary to note two general principles of company law. As stated by Trollip JA in *Sammel & others v President Brand Gold Mining Co Ltd* 1969 (3) SA 629 (A) at 678G-H:

'By becoming a shareholder in a company a person undertakes by his contract to be bound by the decisions of the prescribed majority of shareholders, if those decisions on the affairs of the company are arrived at in accordance with the law, even where they adversely affect his own rights as a shareholder. That principle of the supremacy of the majority is essential to the proper functioning of companies.'

It is this principle which informs the reluctance of courts to intervene in matters concerning the internal management of a company.

[11] In terms of s 65(2) of the Companies Act 61 of 1973 (the Act), a member possesses a right against the company to complain of an irregularity, by virtue of the fact that, as decided in *Gohlke and Schneider & another v Westies Minerale (Edms) Bpk & another* 1970 (2) SA 685 (A) at 692F-G:

'The articles, therefore, merely have the same force as a contract between the company and each and every member as such to observe their provisions.'

[12] It is in the context of a reconciliation of the right of a member to enforce the articles against the company and complain of an irregularity committed by the company in respect of the articles, and the right of the majority to correct, condone or ratify the irregularity, that problems arise, which lie at the heart of the controversy.

[13] At the outset it must be noted that *Foss* was not concerned with the rights of members to enforce the provisions of the articles against the company. It was concerned rather with the inability of individual members to seek to enforce the rights of the company 'where the alleged wrong is a transaction

which might be made binding on the company or association and on all its members by a simple majority of its members'. (Per Jenkins LJ in *Edwards v Halliwell* [1950] 2 All ER 1064 (CA) at 1066.)

[14] In others words, the enquiry was directed at wrongs allegedly done to the company, in which the company itself should take action to remedy the wrongdoing, and the ability of a majority of its members to correct, condone or ratify the wrongdoing. If the requisite majority of members competently resolve to correct, condone or ratify the wrongdoing against the company, a court would not intervene as the will of the majority would demand recognition.

[15] Professor Blackman[6] accordingly questions how the rule in *Foss* is able to defeat members' rights against the company where a power which the company has to ratify a wrong against it, is used for an entirely different purpose, namely to defeat a member's rights against the company. As applied in *MacDougall*, according to Professor Blackman, the result is that where a member cannot enforce a provision in the articles against the directors (because it is a provision the breach of which may be corrected, condoned or ratified by the majority) the member is precluded from enforcing that provision against the company, by way of a personal action. He concludes that the application of the rule in *Foss* to matters for which it was not intended, with the object of curtailing intracorporate litigation, 'rides roughshod over the members' rights under the company contract by allowing de facto departures from the constitution'. [7]

[16] The desire to curtail intracorporate litigation was founded, according to Mellish LJ in *MacDougall* (at 25), upon the need to prevent litigation concerning irregularities, which are likely to occur in the conduct of meetings of companies.

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[6] Blackman supra at 478-479.

[7] Above at 479.

[17] By contrast, in *Pender*, Jessel MR distinguished the decision in *Foss*, and the cases that followed it, on the basis that the right which the member wished to assert against the company was 'an individual right in respect of which he has a right to sue' (at 80-81). In the very nature of the right being personal to the individual member, a failure by the company to recognise such a right, is beyond the power of the majority at the general meeting.

[18] It is unnecessary on the facts of this case to attempt to reconcile these apparently conflicting lines of authority, because Mr Hodes SC, who together with Mr Brusser SC, appeared for the appellants, quite correctly conceded in argument that the right of members of the appellants to vote on the election of directors, was a personal and not a corporate right. Consequently, as in *Pender*, the *MacDougall* line of cases are distinguishable, by virtue of the nature of the right possessed by the respondents.

[19] I agree with the view of the high court and the concession by Mr Hodes that a member's right to vote at a general meeting and have his or her vote counted, would ordinarily fall within the category of personal membership rights. Each member has a special interest in the observance of this right, distinct from the general interest which the members have in the observance by the company of its articles.

[20] For the sake of clarity, it should be noted that the provisions of the Act are applicable in the present case, as the conduct complained of occurred on 27 October 2009. In terms of s 165(1) of the Companies Act 71 of 2008, it appears that a personal action by a member at common law, to enforce rights which vest in a member in the articles, has not been abolished.[8]

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[8] F H I Cassim, M F Cassim, R Cassim, R Jooste, J Shev and J Yeats *Contemporary Company Law* 2 ed (2012) at 821.

[21] The respondents accordingly possessed the necessary locus standi to challenge the resolutions in question.

[22] I turn to consider the issue whether the resolutions appointing the directors taken at the annual general meetings, were in fact valid. What has to be determined, on a proper interpretation of article 15 of the Articles of Association of both appellants (which are in identical terms), is whether directors who retire at an annual general meeting are entitled to vote in respect of the election of individuals to fill such vacancies. The article reads as follows:

'ROTATION OF DIRECTORS

15. At the first annual general meeting of the company all the directors shall retire from office, and at the annual general meeting in every subsequent year one-third of the directors for the time being, or if their number is not three or a multiple of three, the number nearest to one-third, shall retire from office, provided that the director appointed by the Regional Government, shall not retire from office by reason of effluxion of time.

15.1 The directors to retire in every year shall be those who have been longest in office since their last election, but as between persons who became directors on the same day, those to retire shall, unless they otherwise agree among themselves, be determined by lot.

15.2 A retiring director shall be eligible for re-election.

15.3 The company at the annual general meeting at which a director retires in manner (*sic*) aforesaid or at any general meeting may fill the vacancy office by electing a person thereto.

15.4 If at any meeting at which an election of directors ought to take place the offices of the retiring directors are not filled, unless it is expressly resolved not to fill such vacancies, the meeting shall stand adjourned and the provisions of articles 7.7 and 7.8 shall apply *mutatis mutandis* to such adjournment, and if at such adjourned meeting the vacancies are not filled, the retiring directors or such of them as have not had their offices filled shall be deemed to have been re-elected at such adjournment meeting

unless a resolution for the re-election of any such director shall have been put to the meeting and negatived.

15.5 The company may from time to time in general meeting increase or reduce the number of directors, and may also determine in what rotation such increased or reduced number is to retire from office.

15.6 Unless the members otherwise determine in general meeting any casual vacancy occurring on the board of directors may be filled up by the directors, but the director so appointed shall be subject to retirement at the same time as if he had become a director on the day on which the director in whose stead he is appointed, was last elected a director.

15.7 The directors shall have the power at any time, and from time to time, to appoint a person as an additional director who shall retire from office at the next following ordinary general meeting, but shall be eligible for election by the company at that meeting as an additional director.'

[23] In terms of the Articles of Association of the appellants and the facts which are common cause, the only members of the appellants who were entitled to vote on the appointment of directors at a general meeting, were the directors of the company who were members because they were directors. It is therefore apparent that the eligibility of retiring directors to vote as members, in respect of the election of directors to fill vacancies in their number, was dependent upon their status as directors remaining as such, until the election took place.

[24] At the annual general meeting, the retiring directors were excluded from voting on the election of directors, on the basis of legal advice which had been obtained by the company secretary, at the request of one of the directors. If their exclusion was contrary to the articles, then the election of the directors was irregular, and falls to be set aside.

[25] The judgment of the high court referred to the rule that the articles are to be interpreted in the same manner as a contract or statute, and must be

taken to be a complete memorial, and the interpretation must be approached with sensible regard to the business or practical result, which the parties apparently sought to achieve by its production, or adoption.

[26] Central to the reasoning of the high court was that a proper construction of the articles envisaged ‘a seamless transition of directorships, whether by re-election, deemed re-election or replacement’ in respect of the scheme of rotational retirement.

[27] The cornerstone in the reasoning of the high court was that article 11 provided for a minimum number of directors, namely eight and article 7.5, provided for a quorum of members namely five personally present. Accordingly, in the event there was no seamless transition of directors, a hiatus may occur when the company were to be deprived of the one-third of the directors, who were obliged to retire. By virtue of the fact that directors were also obliged to function as members, a quorate meeting might be rendered non-quorate midway through its business, when the retiring directors were deprived of this status, and the election of directors was reached on the agenda, requiring their exit from the meeting. The high court also pointed to the fact that if all the vacancies were not filled there might be a period when the company would have to function without the requisite number of directors, until the situation could be remedied at a resumption of the annual general meeting in terms of article 15.4.

[28] Mr Hodes criticized the reasoning of the high court on the basis that the number of directors has nothing to do with the issue of whether an annual general meeting, or other general meeting, has the necessary quorum which is determined by the number of members present. However, the number of members present is directly determined by the number of directors present, who by virtue of their status as directors are also members. Mr Janisch, who appeared for the respondents, submitted that no such disruption would occur if the respondents’ interpretation prevailed.

[29] Mr Hodes also pointed to the fact that on the evidence, the absence of the retiring directors, did not have as a consequence that the meeting was rendered non-quorate. Mr Janisch's answer was that the enquiry was directed at establishing the potential consequences of the appellants' construction, not with what had actually occurred at the meeting.

[30] Mr Hodes, in addition, submitted that the danger of such a hiatus and its effect upon the workings of a general meeting, could be avoided by conducting all of the business on the agenda, before the election of directors was held. As pointed out by Mr Janisch, this solution does not deal with the problem which arises if the vacancies are not filled at the meeting, with the result that the appellants might have to function with less than the requisite number of directors, until the resumed annual general meeting.

[31] In interpreting article 15, the language used must be considered in the light of the ordinary rules of grammar and syntax, the context in which the provision appears, the apparent purpose to which it is directed, and the material known to those responsible for its production. The process is objective, not subjective. A sensible meaning is to be preferred to one that leads to insensible or unbusinesslike results, or undermines the apparent purpose of the document. (*Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 (4) SA 593 (SCA) para 18.)

[32] An interpretation which does not exclude the possibility of a hiatus occurring between the retirement of a director and the election of a replacement would ascribe to article 15 a meaning with an unbusinesslike result and would undermine the apparent purpose of this article.

[33] The arguments advanced were directed at illustrating from the point of view of the opposing protagonists that phrases such as 'shall retire from office', 'the annual general meeting at which a director retires', 'a retiring director shall be eligible for re-election', and 'the retiring directors' meant either that a process of retiring was intended, or that retirement as a *fait accompli* was intended. However, where article 15 can legitimately be interpreted to avoid a hiatus and

thereby produce a businesslike result, it is that interpretation that should in my view be adopted, and the court a quo was correct in doing so. In reaching this conclusion, I do not overlook the argument advanced by Mr Hodes that article 15.3 provides that at an annual general meeting 'at which a director retires' the company 'may fill the vacancy office by electing a person thereto', and that the use of the word 'vacancy' can only refer to a *fait accompli*, namely a director's post which is already vacant, because he or she has retired. I agree with the submission of Mr Janisch that the high court dealt with this argument comprehensively, concluding correctly that the fact that a retiring director will leave a vacancy that may be filled by an election, does not mean that the vacancy must already have existed at the time of the election. The elected or re-elected director moves seamlessly into the vacancy that follows the election. If the incumbent is not re-elected, he is bound to vacate (retire) as soon as the result is known. If his vacancy is not filled for any reason, he remains in office until the resumed annual general meeting, at which he either vacates, or is re-elected.

[34] I conclude that on a proper interpretation of article 15 the directors who retire at an annual general meeting are entitled to vote as members in respect of the election of individuals to fill such vacancies. The exclusion of the retiring directors from voting was accordingly unjustified and the resolutions appointing replacement directors were correctly declared invalid by the high court and set aside.

[35] The concession that a member's right to vote at a general meeting and have his or her vote counted, constituted a personal right of a member, the denial of which was not susceptible to correction, condonation or ratification by the majority at the general meeting, disposes of the appellants' argument that the high court failed to consider whether the irregularity could have been corrected in this manner.

[36] A further argument advanced by Mr Hodes was that the right of the respondents to vote, was not adversely affected by virtue of the exclusion of the

rights of the four retiring directors to vote, because at least the first respondent, did vote at the meeting. In other words, the respondents on the evidence lack locus standi to challenge the validity of the resolution.

[37] The high court dismissed this argument relying upon the decision in *Spiliopoulos & another v The Hellenic Community of Johannesburg & others* 1938 WLD 160 at 166 where Greenberg JP held that:

'I think that in the present case it is sufficient for the applicants to show that their rights as shareholders have been violated by a diminution of the effect of their votes through the voting of a substantial number of persons who were not entitled to vote…'

[38] In the present case the opposite scenario is true, ie fewer members voted than were entitled to and I understood Mr Hodes to argue that as a consequence, the votes of the respondents were not diminished, but were in fact enhanced. The inherent fallacy in this argument, is that its validity depends upon the assumption that the votes of the excluded members, would have been cast in opposition to those of the respondents. If those votes would have supported the votes cast by the respondents, then it could not be concluded that their mere exclusion enhanced the votes of the respondents. The high court correctly summarised the argument as follows:

'The right to exercise a vote as a member goes limping if the effect of the vote is that it is not properly counted in the context of all the other votes that might be validly cast on the issue in question. In other words if the voting procedure admits votes that could not validly be cast, the vote that the member entitled to vote casts is devalued by a diminution of its effect as a proportion of the total; likewise, if the votes of members entitled to vote are invalidly excluded, the effect of the vote of the member allowed to cast a vote is adversely effected if the votes of the excluded members might have weighed with the members vote in determining the result.'

[39] In addition, having found that the exclusion of the right of the retiring directors to vote in respect of the election of directors, was contrary to article 15, and that the relevant resolutions were invalid and correctly set aside, the

respondents' voting rights were adversely effected by this conclusion, because the votes they cast were without cause or effect.

[40] As regards the issue of costs, Mr Janisch asked for the costs of two counsel where employed, for the reason that his erstwhile leader, Mr Duminy SC, was indisposed. No argument to the contrary was advanced by Mr Hodes. The costs of the application for leave to appeal were reserved for the decision of this court.

[41] In the result it is ordered that:

The appeal is dismissed with costs, including the costs of two counsel where employed and the costs in the application for leave to appeal, on the same basis.

K G B SWAIN
ACTING JUDGE OF APPEAL

APPEARANCES:

FOR FIRST AND	P HODES SC (WITH HIM R BRUSSER SC)
SECOND APPELLANTS:	Instructed by CLIFFE DEKKER HOFMEYR INC
	CLAUDE REID INC, Bloemfontein
FOR FIRST AND	M JANISCH
SECOND RESPONDENTS:	Instructed by KRITZINGER ATTORNEYS INC
	MATSEPES INC, Bloemfontein