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CONTRACT

Agreement not to sue is not contrary to Public Policy: Coral Lagoon Investments v Capitec Bank

In 2006 Coral Lagoon Investments 194 (Pty) Ltd ("Coral") and its holding company, Ash Brook Investments 15 (Pty) Ltd ("Ash Brook") (together "the appellants") and Capitec Bank Holdings Limited ("Capitec") concluded a subscription of shares and shareholders agreement in terms of which Coral subscribed for ten million ordinary shares in Capitec for a total subscription price of R300 million.

An important element of the subscription agreement were three sets of selling restrictions aimed at keeping the shares in black shareholders' hands. From about 2014 there was ongoing dissatisfaction about the selling restrictions by Ash Brook and its shareholders. In 2016 Coral and Ash Brook instituted action against Capitec, in which they challenged the validity of certain provisions of the subscription agreement. The action was removed from the court roll for settlement negotiations.

In 2017 the parties then concluded a transaction for the transfer of the shares. One of the agreements constituting the 2017 transaction was a consent agreement entered into between Capitec and the appellants, which contained a *pactum de non petendo* (agreement not to sue). Later in 2019, when Coral sought to sell some of its shares, Capitec refused to grant consent. Coral and Ash Brook instituted another action against Capitec, claiming that Capitec's prevention of the sale of the shares by Coral led to a loss of R 1,225 billion. Capitec asserted that the action should be withdrawn because the appellants had agreed in a consent agreement between the parties, not to institute legal proceedings against Capitec.

The High Court enforced the *pactum* and the appellants appealed to the Supreme Court of Appeal ("SCA") claiming the *pactum* was against public policy. In the SCA, the court held the clauses in the consent agreement make clear that the institution of future legal proceedings by Coral and Ash Brook and its related entities against Capitec are not permitted where they sought to use or rely on the 2017 Transaction as was the case here.

The court held, that a *pactum de non petendo in anticipando* forms part of our law. It is a contractual undertaking not to institute an action. The court referred to the case of Beadica 231 CC and others in which the Constitutional Court held that public policy is the basis on which courts may decline to enforce contractual terms where the term itself or its enforcement would be contrary to public policy. Public policy requires in general that parties should comply with contractual obligations that have been freely and voluntarily undertaken.

In determining what public policy requires, courts must conduct a careful balancing exercise in which it has to "employ [the Constitutional] values to achieve a balance that strikes down the unacceptable excesses of "freedom of contract", while seeking to permit individuals the dignity and autonomy of regulating their own lives". This includes a consideration of various factors, including, but not limited to, whether the parties negotiated with equal bargaining power and whether they understood what they were agreeing to. Courts should use the power to invalidate a contract or not to enforce it sparingly and only in the clearest of cases.

The SCA found the *pactum* was not against public policy. It held the following factors were instructive in its reasoning:

- The appellants were free to secure independent legal and other professional advice on the consent agreement.
- They were all experienced businesspeople who engaged in detailed and complex negotiations over a period of time and the parties had equal bargaining power.
- There were no special rules that were to apply where a BEE transaction was involved.
- The pactum was concluded in a particular context for a specific legitimate reason, that is, to proceed with the 2017 sale of shares transaction and to protect Capitec's interests from further litigation instituted by the appellants in respect of the 2017 transaction, who from 2016 already had matters pending against Capitec.

- Lastly the *pactum* did not prevent the appellants from suing Capitec on matters unrelated to the 2017 transaction.

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The pitfall of failing to register as a credit provider

In the recent Western Cape, High Court case of *Blacher v Josephson* the High Court looked at the enforceability of a credit agreement where the credit provider, in contravention of the National Credit Act, 34 of 2005 ("NCA"), failed to register as a credit provider.

The parties in this matter were previously close friends who entered into an oral loan agreement during 2015. In terms of the loan agreement the respondent lent R2,500,000 to the appellant and advanced such monies to the appellant by way of five unequal instalments.

The parties did not enter into a written loan agreement at any point, but they did enter into a written acknowledgement of debt ("AOD") after the second instalment was advanced to the appellant which covered an amount of R1,200,000. Upon the payment of the fifth and final instalment the parties entered into a second AOD which covered the whole amount of the loan.

The two AOD's provided for an effective annual compound interest rate of 30% and, subject to a 45-day notice period, the loans were repayable upon demand.

Over the next four years the appellant made repayments to the respondent totalling R2,121,500, however, by May of 2019 the appellant was in default under the loan agreement and was put on terms by the respondent's attorneys. The appellant was called upon to repay all outstanding amounts under the loan agreement which totalled R3,861,500.

In response, the appellant raised concerns about the respondent not having been a registered credit provider and failing to perform a credit assessment at the time the loan was granted.

In an attempt to regularise the loan agreements, the respondent requested that a third AOD be executed, which the parties entered into during August 2019. In terms of this AOD the appellant was required to pay R2,500 000 to the respondent by the end of September 2019.

The appellant thereafter made one further payment of R965,000, meaning that the appellant repaid a total of R3,086,500 on the original capital amount of R2,500,000. The R586,500 paid in interest constituted a 23.46% return for the respondent over a four-year period.

After the appellant failed to make any further payments, the respondent declared a dispute in terms of the third AOD and referred said dispute to arbitration. The arbitrator made an award in favour of the respondent, the validity of which was later confirmed by the Western Cape High Court.

However, upon review to a full bench of the Western Cape High Court the original credit agreement, subsequent AOD's and the arbitration awards were declared to be unlawful and therefore unenforceable.

The original credit agreement had been concluded in 2015, at which time the NCA stated that a credit provider may not enter into a credit agreement with a value of over R500,000 unless the credit provider is registered. As the credit agreement in this matter exceeded the threshold in place at the time the respondent was required to register as a credit provider. The credit provider's failure to register as a credit provider rendered the original credit agreement unlawful and unenforceable.

It is important to note that, in 2016, the R500,000 threshold was reduced to R0 (nil). This means that, if the NCA applies to a credit agreement, the provider must be registered as a credit provider in terms of the NCA at the time that the agreement is concluded – no matter the value of the agreement − failing which the agreement is unlawful and unenforceable. If the provider was not registered as a credit provider at the relevant time and is out of pocket, they may have a claim against the other party under the common law of unjust enrichment.

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TAX

SARS can't have the 'money and the box'

Money or the Box is a game where a contestant must choose between the money or an undisclosed prize in a box. In *Lance Dickson Construction CC v CSARS* a full bench of the Western Cape High Court said, in the context of understatement penalties, SARS is not entitled to ask for both the money and the box.

The taxpayer was appealing against a 25% understatement penalty imposed by the tax court for failing to account for capital gains tax. Where there is an understatement of tax a three-phase process is contemplated. First SARS must decide whether the 'understatement' meets the requirements of the definition in section 221 of the Tax Administration Act (TAA). If it meets these requirements SARS must consider whether the understatement results from a "*bona fide* inadvertent error." If the understatement was a result of a *bona fide* error no penalty may be levied. If there is no error SARS must identify the appropriate behavioural category in section 223 of the TAA under which the taxpayer's conduct falls.

In the present case SARS chose the category "reasonable care not taken in completing a return" which carries a 25% penalty. SARS has the onus of proving the facts to justify the imposition of such a penalty. However, the evidence of the SARS witness was that the behavioural category "no reasonable grounds for tax position taken", which carries a 50% penalty, was a more appropriate behavioural category.

The court held that once SARS elected to impose the 25% penalty it was required to prove the factual basis for such penalty. It was common cause that it did not do so, SARS witness stating that a 50% penalty should have been payable. Having chosen in its assessment to impose a 25% penalty SARS could not seek to advance a factual basis for a 50% penalty without revising its assessment. The reason for this is that the taxpayer must be given an opportunity to reconsider its position before embarking on its tax appeal. SARS cannot ask the Court for the money and the box.

There is no strict liability when it comes to understatement penalties, the mere establishment of a tax understatement does not give SARS a right to impose a penalty, SARS must still comply with the TAA. Once SARS failed to discharge its onus in proving the 25% penalty that was the end of its case. Therefore, the taxpayer succeeded with its appeal against the 25% penalty.

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COMPLIANCE

Are you a new "accountable institution" under FICA?

As part of a slew of legislative amendments made in an effort to avoid the greylisting of South Africa, several changes have been made to the Financial Intelligence Centre Act, 2001 ("FICA"). One such change involves amendments to the list of "accountable institutions" listed in Schedule 1 of FICA. Under FICA, accountable institutions have onerous obligations and contraventions of the Act could result in massive fines and even jail time.

Although several amendments have been made to Schedule 1 of FICA, in this article we will highlight three new categories of accountable institutions: −

1. **A person who carries on the business of a credit provider as defined in the National Credit Act, 2005 ("NCA")** [Schedule 1, item 11(a) of FICA].

Do you carry on the business of a credit provider under the NCA? If so, then you are an accountable institution in terms of FICA.

2. **A person who carries on the business of providing credit in terms of any credit agreement that is excluded from the application of the NCA by virtue of section 4(1)(a) or (b) of that Act** [Schedule 1, item 11(b) of FICA].

If you carry on the business of providing credit, but the NCA does not apply to you due to any of the following reasons, you are nevertheless an accountable institution under FICA:

Reason 1: Your credit agreement is with a consumer which is:

(i) a juristic person whose asset value or annual turnover, together with the combined asset value or annual turnover of all related juristic persons, at the time the agreement was made, equals or exceeds R1-million; or

(ii) the state; or an organ of state [Section 4(1)(a) of the NCA].

Reason 2: Your credit agreement is a "large agreement" (in other words, an agreement where the principal debt falls at or above R250,000) and the consumer is a juristic person whose asset value or annual turnover is, at the time the agreement was made, below R1-million [Section 4(1)(b) of the NCA].

3. **A person who carries on the business of dealing in high-value goods in respect of any transaction where such a business receives payment in any form to the value of R100,000 or more, whether the payment is made in a single operation or in more than one operation that appear to be linked, where "high-value goods" means any item that is valued in that business at R100,000 or more** [Schedule 1, item 20 of FICA].

Do you carry on the business of dealing in goods valued at R100,000 or more? If so, you are an accountable institution under FICA.

Those who fall into the above categories must register as an accountable institution with the Financial Intelligence Centre by **19 March 2023**.

It is essential for new accountable institutions to become familiar with their obligations under FICA, which are numerous. The potential sanctions and penalties for transgressions of the Act are high. We understand that the Financial Intelligence Centre will seek to assist the new sectors in order to procure their full and proper compliance.

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Widening the Beneficial Ownership of Trusts

On 29 December 2022, the General Laws (Anti Money Laundering and Combating Terrorism Financing) Amendment Act was assented to by the President. The legislation was rushed through Parliament at the end of 2022 as part of South African efforts to avoid greylisting. Included in this legislation are amendments to the Trust Property Control Act and the introduction of a new definition of a 'Beneficial Owner' of a trust.

The new definition creates five broad classes of beneficial owners of a trust, namely:

- a natural person who directly or indirectly ultimately owns the relevant trust property;
- a natural person who exercises effective control of the administration of the trust arrangements that are established pursuant to a trust instrument;
- each founder of the trust;
- each trustee of the trust; and

- each named beneficiary in the trust deed.

The purpose of creating classes of beneficial owners is to place an obligation on the Trust and the Master to keep records of the individuals who fall within these classes which record will be useful to combat money laundering and terrorism. Although it may have been unintended by the legislature, deeming every founder, trustee and named beneficiary to be a beneficial owner of a trust will have legal and tax consequences.

Beneficial ownership has a particular meaning. Beneficial ownership of the trust assets is different from "legal ownership" of trust assets which vests in the trustees responsible for administering the trust. A trustee or founder cannot be said to be beneficial owners as they have no rights of use or enjoyment of the trust assets. Central to the concept of a trust is a separation between ownership or control and benefit. A founder has no claim to the assets of a trust even if they once belonged to him. Neither do trustees who are responsible for administering the assets. Furthermore, not all beneficiaries have a vested right to trust assets; for example, discretionary beneficiaries only have a contingent right to the assets.

The taxation of a trust beneficiary is triggered by that beneficiary acquiring a vested right to an amount or asset held by a trust. At the point of vesting the beneficiary has use and enjoyment of the trust asset or amount and can be said to be a beneficial owner. Given that all parties to a trust (including the founder, trustees and discretionary beneficiaries) are to be deemed as beneficial owners there is likely to be some legal confusion on these parties' rights and obligations. The change to the Trust Property Control Act will only take effect upon proclamation by the President and therefore can still be amended.

Beneficial ownership of companies: new record-keeping and reporting requirements

On 1 April 2023, several changes to the Companies Act, 2008 will come into force. They arise from the General Laws (Anti-Money Laundering and Combating Terrorism Financing) Amendment Act, 2022 – one of the Acts which were enacted in an effort to avoid the greylisting of South Africa. The goal is to establish and maintain official records of the natural persons who beneficially own or control companies, for purposes of assisting authorities to detect crime and corruption.

A distinction is made between "affected companies" (regulated companies and the private companies controlled by them) and companies which fall outside that definition. In this article, I will focus on the record-keeping and reporting requirements on companies which fall outside the definition of "affected companies":

A company must record in its securities register prescribed information regarding the natural persons who are the beneficial owners of the company. The precise information, the form in which it must be kept, and the time period within which it must be updated after any change, will be prescribed by Regulation.

The company must file a record with the Companies and Intellectual Property Commission (CIPC) regarding the individuals who are the beneficial owners of the company. CIPC will maintain a register of this information. The precise information, the form in which it must be reported, and the time period within which it must be updated after any change, will be prescribed by Regulation.

In its annual return, the company must include a copy of its securities register. CIPC will make the annual returns available electronically to any person as will be prescribed by Regulation.

Regulated companies and private companies controlled by them ("affected companies") have new record-keeping and reporting requirements in addition to the existing rules regarding reporting to the Takeover Regulation Panel. The company must, among other things, keep a register of the persons who hold beneficial interests in 5% or more of the total number of securities of that class issued by the company and the extent of those beneficial interests. This information will be published in its audited annual financial statements and included in its annual return. Beneficial owners must notify the company when their beneficial interest crosses thresholds (multiples of 5%) and, in turn, the company must notify CIPC for its records.

On 10 March 2023, proposed Companies Amendment Regulations were published in the Government Gazette and the public has been given until 24 March 2023 to submit their written comments thereon.

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COMPANY

Protection of minority shareholders and directors

A shareholder is defined as the holder of shares issued by a company and who is entered as such in the certificated or uncertificated securities register. A director is a member of the board of a company, as contemplated in section 66 of the Companies Act 71 of 2008 (“Act”). It is trite that by becoming a shareholder, a person undertakes to be bound by the decisions of the majority, even where these decisions may adversely affect their rights or interests. The question that arises from the above is, what remedies are available to shareholders and directors who are victims of oppressive and unfairly prejudicial conduct?

The answer can be found in section 163 of the Act which provides *inter alia*:

- A shareholder or a director of a company may apply to a court for relief if any act or omission of the company or a related person, has had a result that is oppressive or unfairly prejudicial to, or that unfairly disregards the interests of, the applicant.
- If the business of the company, or a related person, is being or has been carried on or conducted in a manner that is oppressive or unfairly prejudicial to, or that unfairly disregards the interests of, the applicant.

The Court in *Grancy Property Limited v Manala and Others* considered the concept of oppressive conduct. With reference to a decision of the House of Lords it is stated that “the *concept of “oppressive” denotes conduct that is burdensome, harsh and wrongful and such conduct would include a lack of probity or good faith and fair dealing in the affairs of a company to the prejudice of some portion of its members.”*

The test for unfair prejudice is objective and it seeks to determine whether a reasonable bystander observing the consequences of the conduct would regard it as having a prejudicial effect. The minority shareholder must establish that the particular act or omission complained of is oppressive or unfairly prejudicial.

In conclusion, once a court is satisfied that the conduct complained of meets the requirements of the Act, it may make any interim or final order it considers fit including an order restraining the conduct complained of, an order regulating the company’s affairs, directing a company to amend its memorandum or to create or amend a shareholder’s agreement. The court may even appoint replacement or additional directors or declare any person delinquent or under probation.

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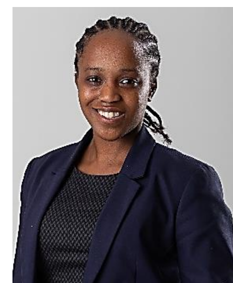

EMPLOYMENT

Don’t fake it even when you make it!

It is established law that an employee can be dismissed for misrepresenting his or her qualifications to the employer. But what happens to the remuneration paid to the employee during the time he was employed? This question was raised in the recent High Court judgment of *Umgeni Water v Naidoo.*

Umgeni Water (the employer) ran a graduate employment programme that it had implemented to recruit graduates in order to train, and hopefully retain once they successfully completed the programme. Applicants were required to hold, at minimum, a bachelor’s degree in engineering.

Naidoo (the employee) applied to join the programme and submitted a BSc degree certificate in Engineering, together with his academic record from the University of KwaZulu-Natal. After completing the programme, he was appointed and worked for the employer for eight years until he resigned.

When the employee was initially appointed, it was not common practice for the employer to verify qualifications. However, several years later it hired a private company to do so and when the employee applied for another position within the company the verification report stated that he did not have a degree.

The employer initially felt that there was some error and gave the employee several opportunities to show that he had a qualification, but he failed to do so.

In addition to instituting disciplinary proceedings against the employee for misrepresentation of his qualifications, the employer instituted civil action on the basis that the employee's conduct had been fraudulent and sought repayment of the remuneration paid to the employee, being R2,203,565. The employer argued that had it not been for the employee's misrepresentation and fraudulent conduct it would not have employed him.

After hearing evidence, the court concluded that the degree and academic records produced by the employee as evidence were forged and found accordingly that the employee had failed to prove that he had the required degree. The court further found that the employee misrepresented the true state of his qualifications to secure employment, which was fraudulent. The court thus held that because the fraud was proven, the employer became entitled to be repaid the amount paid to the employee.

Punitive costs were awarded on an attorney and client scale (being a higher scale) against the employee as the court, in exercising its discretion, considered that the employee was guilty of reprehensible conduct and showed no remorse. The employer was also allowed to execute the judgment amount against the employee's provident fund benefits.

This case demonstrates that an employee who misrepresents their qualifications can not only find himself being fired but also repaying the employer the remuneration that they received while employed.

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