THE SUPREME COURT OF APPEAL OF SOUTH AFRICA

JUDGMENT

Case No: 174/09

In the matter between:

D N BAYLY	**1ST Appellant**
SOUTH AFRICAN ELECTRONIC TRACKING SYSTEMS LTD	**2ND Appellant**
F T MARTIN	**3RD Appellant**
ELECTRONIC TRACKING SYSTEMS AS	**4TH Appellant**
A C STIPANOV	**5TH Appellant**
G H VAN LAUN	**6TH Appellant**
M JOHNSON	**7TH Appellant**
M S JUUHL	**8TH Appellant**
and	
A L KNOWLES	**Respondent**

Neutral citation: *Bayly v Knowles* (174/09) [2010] ZASCA 18 (18 March 2010)

Coram: HARMS DP, NUGENT, HEHER, LEACH JJA AND SERITI AJA

Heard: 2 March 2010

Delivered: 18 March 2010

Updated:

Summary: Company – Shareholders – oppression – shareholder in majority bloc making fair offer for minority's shares before litigation – effect on application under s 252 of the Companies Act 61 of 1973 – offer by minority to purchase a majority shareholding – interests of company and remaining shareholders to be considered.

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ORDER

On appeal from: South Gauteng High Court (Johannesburg) (Horn J sitting as court of first instance).

1. The appeal is upheld with costs including the costs of two counsel.

2. The order of the court *a quo* is set aside and replaced with the following:

‘(a) The application is dismissed.

(b) The applicant is to pay the costs of the first to fifth respondents including the costs of two counsel.’

JUDGMENT

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HEHER JA (Harms DP, Nugent, Leach JJA and Seriti AJA concurring):

[1] This is an appeal with leave of the South Gauteng High Court (Horn J) against an order made in favour of the respondent under s 252(3) of the Companies Act 61 of 1973 directing and regulating the disposal of shares in a small proprietary company.

[2] During April 2004 Mr Knowles (the respondent) was invited by the Norwegian holder of the rights to a vehicle-tracking system, Electronic Tracking Systems AS (‘ETS’, the fourth appellant), to acquire 50 per cent of the shares in South African Electronic Tracking Systems Ltd (the second appellant, hereafter referred to as ‘the company’) which had been set up to market the system, for R2 million.

[3] Unable to afford the whole price, Knowles introduced Bayly (the first appellant) to ETS as his co-investor. According to Knowles, the two of them reached a private agreement which the managing director of ETS, one Siqueland, afterwards confirmed, to offer to buy 51 per cent of the shares, to borrow the funds required for the purchase from certain brothers (one of whom, Fred Martin, is the third appellant in these proceedings) on the understanding that Bayly would be employed by the company as its managing director

and Knowles as its sales and marketing director ‘until we might decide otherwise’.

[4] On 20 December 2004 the negotiations were finalised. Bayly, Knowles and ETS signed a shareholders’ agreement and an agreement for the purchase and sale of shares.

[5] The relevant terms of the shareholders’ agreement, in summary, were as follows:

(a) The company would operate a business for the development, supply, sale and support of products and solutions designed and manufactured by and for ETS.

(b) The provisions of the agreement were to prevail in the event of a conflict between its terms and those of the memorandum and articles of the company. (The company statutes were not produced or relied on in the proceedings. As will appear, other shareholders apparently bought into the company. One does not know whether they bound themselves to the terms of the agreement.)

(c) The authorised and issued share capital of the company was R4000 divided into 4000 ordinary shares of R1 each.

(d) ETS was to own 49 per cent of the shares and Bayly and Knowles 25.5 per cent each.

(e) The shareholders would be entitled to appoint a maximum of four directors between them, ETS two non-executive directors and Bayly and Knowles two executive directors of whom one would be the managing director. The executive directors would be responsible for the day to day management of the company. Each director was to have an equal vote. The shareholders were entitled to remove and replace any director at any time.

(f) The day to day affairs and activities of the company would be managed by Bayly in his capacity as managing director of the company.

(g) No shareholder could alienate any shares unless first offered to the other shareholders in proportion to their holdings existing at the date of the offer.

(h) A deemed offer to the remaining shareholders would arise upon cessation of employment of any shareholder unless otherwise agreed in writing.

(i) The parties entered into the agreement on the basis of trust and they recorded an intention to observe good faith in contracting and dealing with each other.

[6] The sale agreement provided that ETS sold 2040 shares (51%) to Bayly and Knowles in equal proportions for R2 million.

[7] There can be no doubt that Bayly and Knowles entered into this relationship on the

understanding that both would participate equally in the management of the company.

[8] The company appears to have prospered. But the first seeds of dissension between Bayly and Knowles were sown by early in 2006 when Bayly, in the face of resistance by Knowles, employed Fred Martin as a consultant. Although Knowles yielded the point, the matter continued to rankle with him. According to his founding affidavit this event initiated a marked change in the relationship between himself and Bayly which gradually intensified. The deterioration was manifested in a strategy allegedly adopted by Bayly to undermine communications between Knowles and the techinical division, and in a reluctance to discuss the business, as well as the exclusion of Knowles from decision-making in the company.

[9] Bayly, in his answering affidavit, admitted that an alienation developed but blamed other causes: a lack of attention to the interests of the company on the part of Knowles, and an inclination to develop and favour other business interests.

[10] Although these competing explanations were extensively canvassed in evidence the court *a quo* did not find it necessary to resolve the differences and neither do I for reasons which will appear.

[11] Whatever may have been simmering under the surface of their relationship, nothing which disclosed a problem occurred until 22 October 2007, when Bayly caused the cancellation of the petrol cards and credit card issued to Knowles for use in his employment, without prior discussion or notice.

[12] On 1 November Bayly informed Knowles that he intended to make an offer for the purchase of the latter's entire interest in the company. On 9 November he submitted a draft offer in the form of a proposed Amending Shareholders' Agreement (which purported to reflect both ETS and the company as parties to it). [1]

[1] The question of whether ETS knew and approved of the proposal was not canvassed in the subsequent correspondence or affidavits. All that we know is that ETS, after initial equivocation, sided with Bayly in the litigation.

[13] The proposal provided for the resignation of Knowles as a director with effect from 1 November 2007, the sale of his shares (now 6333 in number) to Bayly for a price of R2 million, and further

'[To] the extent that the third shareholder [ie Knowles] is an employee of the company in any capacity, such employment relationship is by mutual consent terminated, against signature of this agreement.'

It contemplated Knowles's retention by the company as a distributor on a retainer of R40 000 per month for six months and thereafter on the basis of commissions and an annuity income. The proposal also included an undertaking by Knowles in restraint of trade in favour of the company.

[14] At the end of November the company withheld payment of the salary and medical aid contributions due to Knowles. By this time, according to his subsequent founding affidavit, the mutual trust and confidence between Bayly and himself had been destroyed beyond the possibility of restoration.

[15] On 12 December Mr Cyril Ziman, the attorney representing Knowles, sent a letter to Bayly setting out a counter proposal, involving a procedure which included an independent enquiry and valuation of Bayly's shareholding by an accountant, a first option to purchase in favour of Knowles, and, on failure to exercise that right, an option to purchase in favour of Bayly, and, failing exercise by both, a right in either party to apply for a winding up of the company. The counter offer was to remain open until 14 December, after which, Knowles would seek a winding up of the company.[2]

[16] The counter-offer was said in the attorney's letter to be 'a fair proposal to resolve the impasse'. Bayly then and thereafter disputed that. He made it clear that he had no intention of disposing of his shares. From this time threats and demands took over. Settlement negotiations failed. On 18 December 2007 Knowles called at the company's place of business in order, so he said, to attend to his duties, only to find that his office was

[2] The counter-proposal was taken up by Horn J and included verbatim in his order in the application. Counsel for the appellant justly described it as 'elaborate, unwieldy and expensive'. An order designed to regulate the disposal of interests in a company pursuant to s 252 should, as far as practically possible, achieve an expeditious, straightforward and inexpensive termination in the relationship and exclude the potential for further disputes.

locked and his books, records and personal belongings had been boxed and removed.

[17] During January 2008 Knowles telephoned Siqueland, who declined to take sides. He said he had no objection to Knowles purchasing Bayly's shares or remaining a director of the company. The third appellant, Martin, had by this time acquired shares in the company and had, according to Knowles, aligned himself with Bayly. Together they held a majority in the equity.[3]

[18] On 25 January 2008 Knowles applied to the Johannesburg High Court for interim orders for the reinstatement of his company benefits, payment of salary and medical aid contributions, access to the financial records of the company and restoration of access to its business premises.[4] He gave notice of an application to seek orders for the sale to him of Bayly's shares in the company (with the alternatives previously included in the counter-proposal, including an order winding up the company). The legal foundation of the application was s 252 of the Act.[5] Bayly, Martin, ETS and Stipanov opposed. They made common cause.

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[3] The realignment of shares between 2004 and 2008 was not explained by anyone in the application. The parties seem to have accepted that by the time proceedings commenced the respective holdings in the company were as follows:

Knowles	6333	31.67%
Bayly	6333	31.67%
Martin	5833	29.17%
Stipanov	500	2.50%
ETS	500	2.50%
Van Laun	250	1.25%
Johnson	250	1.25%
Juuhl	1	0.01%

Van Laun (sixth appellant) and Juuhl (eighth appellant) were the non-executive directors appointed by ETS. Johnson (seventh appellant) resided in the United Kingdom; the origin of his holding seems to precede the involvement of the present antagonists in the company. Stipanov (fifth appellant) is said by Knowles to have been in a relationship with Bayly.

[4] Knowles did not pursue the claim for interim relief.

[5] Section 252 provides (in so far as relevant):

'(1) Any member of a company who complains that any particular act or omission of a company is unfairly prejudicial, unjust or inequitable, or that the affairs of the company are being conducted in a manner unfairly prejudicial, unjust of inequitable to him or to some part of the members of the company, may, subject to the provisions of subsection (2), make an application to the Court for an order under this section.

. . .

(3) If on any such application it appears to the Court that the particular act or omission is unfairly prejudicial, unjust or inequitable, or that the company's affairs are being conducted as aforesaid and if the Court considers it just and equitable, the Court may, with a view to bringing to an end the matters complained of, make such order as it thinks fit, whether for regulating the future conduct of the company's affairs or for the purchase of the shares of any members of the company by other members thereof or by the company and, in the case of a purchase by the company, for the reduction accordingly of the company's capital, or otherwise.'

[19] Horn J, before whom the application was argued, could find no justification for winding up the company. He said in his judgment:

'The way the court can achieve the objects of section 252 without taking the drastic step of liquidation is to order that the majority shareholders purchase the shares of the minority shareholder or for the minority shareholder to purchase the shares of the majority.

. . .

According to the uncontested facts in the present matter the applicant has already rejected the offer by the first respondent to purchase his shares because the offer by the first respondent was far below the true value of the shares. The applicant has put forward a counter offer wherein the value of the shares is more realistically stated. However, the first respondent has failed to respond to the applicant's proposal. This means that the applicant can do nothing at this juncture to protect his investment and in effect has no remedy to redeem his investment with the second respondent. I have studied the relief set out in the notice of motion and I find the proposals contained therein eminently fair and a realistic way to deal with the matter.

. . .

It is a matter of fact that the applicant has been excluded from participation in any business activities of the second respondent. All financial and management information which the applicant has been entitled to has been withheld from him. He has lost all perks and benefits, including salary due to him by virtue of his employment with the second respondent. He has been effectively prevented from having any say in the affairs of the second respondent.'

[20] Counsel for the appellants submitted that the learned judge misdirected himself in the quoted passages. I agree. I find it necessary to refer to only two instances which, in my view, are sufficient to dispose of the appeal.

[21] As a matter of fact, there was no averment or admission in the affidavits (or in the correspondence that preceded them) that Knowles had rejected Bayly's draft offer because the price offered was 'far below the true value of the shares' (or was otherwise unreasonable in its terms). On the contrary, both in correspondence and under oath Knowles confined himself to the assertion that the offer was 'unacceptable' to him, without, as one might have expected, offering reasons for his refusal to take it up. (In fact, his reasons do not require the exercise of imagination since his attitude as manifested in the counter-proposal and in the argument before us was simply a refusal to dispose of his

shares to Bayly, thereby leaving him in control of the company. As Knowles viewed the matter, not without justification, it was he who had brought Bayly into the company, built up its business by his efforts and sales acumen and then been unfairly shut out.

[22] As might be anticipated, Bayly described his offer as 'under the circumstances . . . more than fair to [Knowles]'. Ordinarily such an averment would call for closer examination.[6] But, in this instance, far from provoking a denial from Knowles, it elicited only the following response:

'I state that a fair and equitable proposal was made by me to [Bayly] in annexure "AK" [ie the letter from his attorney].'

Having eschewed the opportunity of meeting the express averment of fairness it was not open to Knowles to contend otherwise. Horn J should therefore have approached the application upon the basis that Bayly had made a fair offer for Knowles's shares.

[23] I am bound to say that certain remarks of Hoffman J, as he then was, in *Re a company (No 006834 of 1988), ex parte Cremer* [1989] BCLC 365 (Ch D) at 368 apply four-square to the allegations made by Knowles in this case:

'Taken at their face value, these allegations amount at most to high-handed conduct in certain matters. There is nothing in them which can carry a serious imputation of dishonesty. This is an ordinary case of breakdown of confidence between the parties. In such circumstances, fairness requires that the minority shareholder should not have to maintain his investment in a company managed by the majority with whom he has fallen out. But the unfairness disappears if the minority shareholder is offered a fair price for his shares. In such a case, s 459 was not intended to enable the court to preside over a protracted and expensive contest of virtue between the shareholders and award the company to the winner.'

After his elevation to the House of Lords the learned judge found cause to address the issue again in *O'Neill v Phillips*, at 1106H-1107C:

'In the present case, Mr Phillips fought the petition to the end and your Lordships have decided that he was justified in doing so. But I think that parties ought to be encouraged, where at all possible, to avoid the expense of money and spirit inevitably involved in such litigation by making an offer to

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[6] Cf *O'Neill v Phillips;* In *re A Company (No 00709 of 1992)* [1999] UKHL 24; [1999] 1 WLR 1092 (HL) at 1107C-1108B; [1999] 2 All ER 961.

purchase at an early stage. This was a somewhat unusual case in that Mr Phillips, despite his revised views about Mr O'Neill's competence, was willing to go on working with him. This is a position which the majority shareholder is entitled to take, even if only because he may consider it less unattractive than having to raise the capital to buy out the minority. Usually, however, the majority shareholder will want to put an end to the association. In such a case, it will almost always be unfair for the minority shareholder to be excluded without an offer to buy his shares or make some other fair arrangement. The Law Commission (*Shareholder Remedies* paras 3.26 to 3.56) has recommended that in a private company limited by shares in which substantially all the members are directors, there should be a statutory presumption that the removal of a shareholder as a director, or from substantially all his functions as a director, is unfairly prejudicial conduct. This does not seem to me very different in practice from the present law. But the unfairness does not lie in the exclusion alone but in exclusion without a reasonable offer. If the respondent to a petition has plainly made a reasonable offer, then the exclusion as such will not be unfairly prejudicial and he will be entitled to have the petition struck out.'

[24] The failure to accept Bayly's offer has important consequences for Knowles. In English law the making of a reasonable offer for the shares of an oppressed minority is enough to counter reliance by the complainer on s 459 of the Companies Act (the equivalent of s 252). Pursuit of the complaint in the face of such an offer is evidence of abuse of the process sufficient to strike out such reliance *in limine.* The principle of encouraging affected parties to use the procedures provided in the articles (or in a shareholders' agreement) to avoid 'the expense of money and spirit' is laudable. In the context of s 252 the failure of a minority shareholder to accept a reasonable offer for his shares and leave the company in the hands of the majority is, at least, strong evidence of a willingness to endure treatment which is prima facie inequitable despite the choice of a viable alternative. If that is so it would not ordinarily behove him to continue to complain about oppression. The rule, however, cannot be absolute. In *Re Data Online Transactions (UK) Ltd* [2003] BCC 510, for example, it was held reasonable for a petitioner to refuse an otherwise acceptable offer where there was not a reasonable prospect that the offeror would be able to meet the financial commitment involved. One can conceive of cases where the offer, although reasonable, may be so tainted by bad faith or ulterior motive as to excuse non-acceptance. In the context of the present appeal, however, the absence of reasoned opposition to the acceptance of the offer defeated reliance on the inequity inherent in the deliberate alienation of Knowles from his right to participate in the

management of the company. Knowles had the power both to protect and redeem his investment in the company before he approached the court but, because he was insistent upon his right to retain his shares, he elected not to do so. Thereby he abrogated his right to rely on the inequity inherent in the conduct of the company.

[25] A second serious flaw in the reasoning of the learned judge relates to his finding that the facts of the case justified an order compelling Bayly to sell his shares to Knowles. In any exercise of a discretion under s 252(3) the court is bound to consider not only the interests of the warring shareholders but also those of shareholders who have stood apart and the best interests of the company itself. There is no indication that the court did so. A re-appraisal of the question drives one to the opposite conclusion.

[26] Although Bayly was not a majority shareholder by reason of his own shareholding alone, the order sought by Knowles would have changed the whole balance of the shareholding and rendered him the majority shareholder while transforming the interests of the other remaining shareholders from a *de facto* majority into a minority. To all intents and purposes the matter required to be approached on the basis that Bayly indeed commanded a majority.

[27] As Hoffman J remarked in *Re a company, ex parte Cremer*, above, at 367h

'I think it must be very unusual for the court to order a majority shareholder actively concerned in the management of the company to sell his shares to a minority shareholder when he is willing and able to buy out the minority shareholder at a fair price.'

The wide discretion afforded the court by s 252(3) does not however exclude that possibility in appropriate circumstances. But here there were no such circumstances. The company was viable and successful. It had become so under the direction of Bayly over more than three years. The sympathy factor arising from Knowles's propulsion of Bayly to the position of chief executive was no more than an historical curiosity. Knowles had striven hard for the success of the company and had participated to some (uncertain and undisclosed degree) in its management, as was his contractual right and his duty as a director, but it was Bayly who held the helm, hired and fired, and had the confidence of the staff (some twenty in number at the time of the application). He also maintained the essential level of co-operation and goodwill between the company and its supplier ETS.

When a choice between Knowles and Bayly needed to be made, ETS showed where its confidence lay. Knowles mostly worked away from the company's premises selling the product. By the time of the judgment he had ceased employment and not participated in management for more than a year. The effect of forcing Bayly out and placing Knowles in a position of control would have had effects on the company which can only be guessed at. (The change would be even more extreme now that more than two years have elapsed since his last involvement.)

[28] It follows from all these considerations that the only practicable order that could have been made in the circumstances was one which directed Bayly to acquire Knowles's shares. But Knowles did not seek an order having that effect.

[29] Counsel for Knowles, perhaps appreciating the weakness of his client's case for the purchase of Bayly's shares, concentrated on the relief of liquidation on the just and equitable ground. But Horn J had not made such an order and Knowles had not noted a conditional cross-appeal against his failure to do so. Strictly-speaking that excludes consideration of the matter. It needs to be pointed out, however, that in urging this aspect of his case, counsel fell into a double trap: liquidation would destroy a perfectly viable company, as all agreed; but, in doing so, it would provide no redress to Knowles for such oppression as he may have suffered. The first consequence is one that a court will avoid except in the most extraordinary circumstances; the second would favour revenge above reason – financially Knowles might even be prejudiced by a sale in liquidation. Nothing more need be said on this aspect.

[30] The following order is made:

1. The appeal is upheld with costs including the costs of two counsel.
2. The order of the court *a quo* is set aside and replaced with the following:

'(a) The application is dismissed.

(b) The applicant is to pay the costs of the first to fifth respondents including the costs

of two counsel.’

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J A HEHER
JUDGE OF APPEAL

APPEARANCES:

APPELLANTS: S F Burger SC and J W Steyn

Instructed by Le Roux Mathews & Du Plessis, Johannesburg;

Symington & De Kok, Bloemfontein

RESPONDENT: J Blou SC

Instructed by Cyril Ziman & Associates Inc, Johannesburg

Naudes Inc, Bloemfontein