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CORPORATE & COMMERCIAL ALERT

IN THIS **ISSUE**

LET'S GET PERSONAL: THE TRANSFERABILITY OF SHAREHOLDER RIGHTS UNDER A COMPANY'S CONSTITUTIONAL DOCUMENTS.

It's a long-standing and well acknowledged principle in South African common law that parties to an agreement are generally free to cede and assign their contractual rights as they wish, except where there is a clause specifically prohibiting the transfer of those rights. As a result, where a contract is silent as to whether the rights of a party may be transferred to third parties, that party is generally free to cede and assign its rights freely, without the consent of the other parties.

CDH
CLIFFE DEKKER HOFMEYR

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As is most often the case, however, there are a few exceptions to this principle. One such exception, which recently rose its head again in the SCA judgment of *Propell Specialised Finance v Attorneys Insurance Indemnity Fund NPC*, is where the rights of a party are of a personal nature and not intended by the parties to be freely assignable to outsiders. Rights of a personal nature (or "*delectus personae*", as they're more formally known) may not, without a specific empowering contractual provision, be transferred to third parties.

The *Propell* case confirmed the established common law position. Propell Specialised Finance had attempted to enforce certain rights allegedly ceded to it by a law firm, BSL, under an insurance policy between BSL and the Attorneys Insurance Indemnity Fund. The SCA held that the nature of the rights that were purportedly ceded to Propell were of a personal nature to BSL (being a law firm which can benefit under the Attorneys Insurance Indemnity Fund). If the rights were ceded to Propell it would create a claim against the Attorneys Insurance Indemnity Fund in favour of a person who was never intended to benefit under the insurance policy. In short, these were rights that were personal in nature to BSL which could not be freely ceded even in the absence of a clause in the insurance policy expressly prohibiting the cession.

What if certain contractual rights bestowed upon a shareholder in a shareholders' agreement or a memorandum of incorporation are of such a nature that makes them personal to the particular shareholder?

Shareholders are often granted rights or entitlements specifically by name. For example, shareholders are often singled out and granted special rights to transfer their shares, appoint directors, approve or veto certain matters, to be offered corporate opportunities, be present at meetings to constitute a quorum and to exit the shareholding structure, to name a few. Since the Companies Act, No 71 of 2008 came into force in 2011, convention has preferred that, where confidentiality is not a concern, these rights be entrenched in a memorandum of incorporation to ensure that they prevail where there is a conflict with a shareholders' agreement.

Most shareholders' agreements feature "boilerplate" clauses regulating cession and assignment and rights and obligations (most often allowing it with counterparty consent).

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In the absence of a particular contractual regime relating to the cession of rights, can a shareholder transfer its rights to a third party purchaser?

The same is not true of MOIs, which are generally silent as to the cession and assignment of rights. This leaves the door open to the Propell question: in the absence of a particular contractual regime relating to the cession of rights, can a shareholder transfer its rights to a third party purchaser?

The answer: yes it can. But only to the extent that such rights are not intended to be personal or unique to it. It may be argued by the remaining shareholders that certain rights cannot be transferred to a third party purchaser without their consent.

Consider the following scenarios:

(i) an investment fund with a mandate to realise its investment after a certain period of time has negotiated an "exit event" clause in a company's MOI. An "exit event" is customarily included in a company's constitutional documents to allow a particular shareholder to dispose of its investment in a company or group. This is often achieved through an initial public offering of shares or some other corporate transaction whereby the shareholder is permitted to divest;

(ii) a strategic shareholder who contributes specific know-how to a company in a particular industry has an entrenched right to be offered specific corporate opportunities in that field of expertise; or

(iii) a founder of a company who holds shares alongside an institutional investor where the former contributes his/her intellectual property to the company and the latter contributes loan funding to the company, thereby exempting the founder from contributing cash loans.

In each circumstance, the rights in favour of the first shareholder may be considered personal to it. It is not a given that a third party purchaser of its shares will automatically inherit these rights. Shareholders should be careful not to open the door to this question. Instead, if they wish for personal rights to be transferable along with their shares they should expressly cater for this in the MOI or the shareholders' agreement.

Anita Moolman and Andrew Giliam

CDH
CLIFFE DEKKER HOFMEYR

OUR TEAM

For more information about our Corporate & Commercial practice and services, please contact:

Willem Jacobs
National Practice Head
Director
Corporate & Commercial
T +27 (0)11 562 1555
M +27 (0)83 326 8971
E willem.jacobs@cdhlegal.com

David Thompson
Regional Practice Head
Director
Corporate & Commercial
T +27 (0)21 481 6335
M +27 (0)82 882 5655
E david.thompson@cdhlegal.com

Mmatiki Aphiri
Director
T +27 (0)11 562 1087
M +27 (0)83 497 3718
E mmatiki.aphiri@cdhlegal.com

Roelof Bonnet
Director
T +27 (0)11 562 1226
M +27 (0)83 325 2185
E roelof.bonnet@cdhlegal.com

Tessa Brewis
Director
T +27 (0)21 481 6324
M +27 (0)83 717 9360
E tessa.brewis@cdhlegal.com

Etta Chang
Director
T +27 (0)11 562 1432
M +27 (0)72 879 1281
E etta.chang@cdhlegal.com

Clem Daniel
Director
T +27 (0)11 562 1073
M +27 (0)82 418 5924
E clem.daniel@cdhlegal.com

Jenni Darling
Director
T +27 (0)11 562 1878
M +27 (0)82 826 9055
E jenni.darling@cdhlegal.com

André de Lange
Director
T +27 (0)21 405 6165
M +27 (0)82 781 5858
E andre.delange@cdhlegal.com

Werner de Waal
Director
T +27 (0)21 481 6435
M +27 (0)82 466 4443
E werner.dewaal@cdhlegal.com

Lilia Franca
Director
T +27 (0)11 562 1148
M +27 (0)82 564 1407
E lilia.franca@cdhlegal.com

John Gillmer
Director
T +27 (0)21 405 6004
M +27 (0)82 330 4902
E john.gillmer@cdhlegal.com

Sandra Gore
Director
T +27 (0)11 562 1433
M +27 (0)71 678 9990
E sandra.gore@cdhlegal.com

Johan Green
Director
T +27 (0)21 405 6200
M +27 (0)73 304 6663
E johan.green@cdhlegal.com

Allan Hannie
Director
T +27 (0)21 405 6010
M +27 (0)82 373 2895
E allan.hannie@cdhlegal.com

Peter Hesseling
Director
T +27 (0)21 405 6009
M +27 (0)82 883 3131
E peter.hesseling@cdhlegal.com

Quintin Honey
Director
T +27 (0)11 562 1166
M +27 (0)83 652 0151
E quintin.honey@cdhlegal.com

Roelf Horn
Director
T +27 (0)21 405 6036
M +27 (0)82 458 3293
E roelf.horn@cdhlegal.com

Yaniv Kleitman
Director
T +27 (0)11 562 1219
M +27 (0)72 279 1260
E yaniv.kleitman@cdhlegal.com

Justine Krige
Director
T +27 (0)21 481 6379
M +27 (0)82 479 8552
E justine.krige@cdhlegal.com

Johan Latsky
Executive Consultant
T +27 (0)11 562 1149
M +27 (0)82 554 1003
E johan.latsky@cdhlegal.com

Giada Masina
Director
T +27 (0)11 562 1221
M +27 (0)72 573 1909
E giada.masina@cdhlegal.com

Nkcubeko Mbambisa
Director
T +27 (0)21 481 6352
M +27 (0)82 058 4268
E nkcubeko.mbambisa@cdhlegal.com

Nonhla Mchunu
Director
T +27 (0)11 562 1228
M +27 (0)82 314 4297
E nonhla.mchunu@cdhlegal.com

Ayanda Mhlongo
Director
T +27 (0)21 481 6436
M +27 (0)82 787 9543
E ayanda.mhlongo@cdhlegal.com

William Midgley
Director
T +27 (0)11 562 1390
M +27 (0)82 904 1772
E william.midgley@cdhlegal.com

Tessmerica Moodley
Director
T +27 (0)21 481 6397
M +27 (0)73 401 2488
E tessmerica.moodley@cdhlegal.com

Anita Moolman
Director
T +27 (0)11 562 1376
M +27 (0)72 252 1079
E anita.moolman@cdhlegal.com

Jo Neser
Director
T +27 (0)21 481 6329
M +27 (0)82 577 3199
E jo.neser@cdhlegal.com

Francis Newham
Director
T +27 (0)21 481 6326
M +27 (0)82 458 7728
E francis.newham@cdhlegal.com

Gasant Orrie
Cape Managing Partner
Director
T +27 (0)21 405 6044
M +27 (0)83 282 4550
E gasant.orrie@cdhlegal.com

Verushca Pillay
Director
T +27 (0)11 562 1800
M +27 (0)82 579 5678
E verushca.pillay@cdhlegal.com

David Pinnock
Director
T +27 (0)11 562 1400
M +27 (0)83 675 2110
E david.pinnock@cdhlegal.com

Allan Reid
Director
T +27 (0)11 562 1222
M +27 (0)82 854 9687
E allan.reid@cdhlegal.com

Ludwig Smith
Director
T +27 (0)11 562 1500
M +27 (0)79 877 2891
E ludwig.smith@cdhlegal.com

Ben Strauss
Director
T +27 (0)21 405 6063
M +27 (0)72 190 9071
E ben.strauss@cdhlegal.com

Tamarin Tosen
Director
T +27 (0)11 562 1310
M +27 (0)72 026 3806
E tamarin.tosen@cdhlegal.com

Roxanna Valayathum
Director
T +27 (0)11 562 1122
M +27 (0)72 464 0515
E roxanna.valayathum@cdhlegal.com

Deepa Vallabh
Head: Cross-border M&A,
Africa and Asia
Director
T +27 (0)11 562 1188
M +27 (0)82 571 0707
E deepa.vallabh@cdhlegal.com

Roux van der Merwe
Director
T +27 (0)11 562 1199
M +27 (0)82 559 6406
E roux.vandermerwe@cdhlegal.com

Charl Williams
Director
T +27 (0)21 405 6037
M +27 (0)82 829 4175
E charl.williams@cdhlegal.com

BBBEE STATUS: LEVEL TWO CONTRIBUTOR

JOHANNESBURG
1 Protea Place, Sandton, Johannesburg, 2196. Private Bag X40, Benmore, 2010, South Africa. Dx 154 Randburg and Dx 42 Johannesburg.
T +27 (0)11 562 1000 F +27 (0)11 562 1111 E jhb@cdhlegal.com

CAPE TOWN
11 Buitengracht Street, Cape Town, 8001. PO Box 695, Cape Town, 8000, South Africa. Dx 5 Cape Town.
T +27 (0)21 481 6300 F +27 (0)21 481 6388 E ctn@cdhlegal.com