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The Just and Equitable Principle of Winding Up Solvent Companies

Introduction

This circular will examine the principles relating to the winding up of a solvent company on the basis of what is referred to as the just and equitable principle and in particular reference to a recent decision in the Supreme Court of Appeal in the case of _Thunder Cats Investments 92 (Pty) Limited and Another vs Nkonjane Economic Prospecting and Investment (Pty) Limited and Others [2014] 1 All SA 474 (SCA)_ (hereinafter referred to as the Thunder Cats Case).

Companies Act of 1973 vs Companies Act of 2008

The winding up of solvent companies is dealt with in section 79 to 81 of the Companies Act 71 of 2008.   The de-registration of such companies is dealt with in sections 82 and 83.   Under the old Companies Act of 1973, section 344 (h) provided that one of the circumstances under which a company could be wound up is if it appeared to the Court that it was "just and equitable" that the company be wound up. Generally such a decision was based, not on a discretion by the Court, but a judgment on the facts found by the Court to be relevant.   Amongst these could be a deadlock between the directors or shareholders, fraud committed within the company or the oppression of minority shareholders. It was not restricted to deadlock at either director or shareholder level. The Court could base its decision on any number or factors which were relevant and which could go far beyond a simple deadlock of board members or shareholders.

Under the new Act, sections 81 (1)(d)(i) and (ii) provide that a company, or one or more directors, or one or more shareholders, can apply to Court for an order to wind up the company on the grounds that the directors are deadlocked in the management of the company and the shareholders are unable to break the deadlock, and that there will be irreparable injury to the company as a result of

the deadlock or the company's business cannot be conducted to the advantage of shareholders generally as a result of the deadlock. Section 81(d)(ii) provides that the company can also be wound up on the basis that the shareholders are deadlocked in voting power and have failed for a period that includes at least two consecutive annual general meeting dates to elect successors to directors whose terms have expired.

Section 81(d)(iii) then provides that this can also happen when "it is otherwise just and equitable for the company to be wound up".   The question is whether sections 81(1)(d)(i) and (ii) affect the meaning of the words "just and equitable" in section 81(d)(iii) so as to limit the section to only deadlock situations as described in the former sections.   There has been conflicting case law with regards to the interpretation of this section with some cases stating that the just and equitable principle in question under section 81 has to be narrowly construed and cannot include the wider considerations which applied under the old Act.   Other cases have however accepted that the legal basis for liquidation under section 344 (h) of the old Act is the same as under section 81(1)(d)(iii) of the new Act.

The Thunder Cats Case

Thunder Cats had been placed into liquidation on the basis that it was just and equitable to do so as provided for by section 81 (1)(d)(iii) of the Companies Act 71 of 2008.   It was found that there had been a breakdown of the relationship between shareholders. There were only four shareholders, each of whom had the right to appoint a director and so there was a direct correlation between the shareholders and the board of directors. Shareholders had a right to participate in the management of the company. In a sense, it was a partnership disguised as a company. The respondents wished to leave the company and sell their shares, but they were being precluded from doing so by the appellants. There was also, in the shareholder's agreement, a prohibition on the sale of shares by any shareholder without the consent of other shareholders.   These are common clauses in shareholders agreements and in the Memorandum of Incorporation of companies.

The appellants who opposed the application for winding up argued that the application was based upon the deadlock between the parties of both shareholder and director level.   They argued,

however, that deadlock as a ground for liquidation was excluded by clause 8.2 of the shareholders agreement pertaining to the company. The question was whether the wording in section 81(1)(d)(i) and (ii) restricted the meaning of this section to exclude other forms of deadlock under section 81(d)(iii). In other words it was argued that the just and equitable provision under sub paragraph (iii) could not be used to get around the provisions of the shareholders agreement and was not a catch-all provision to provide the Court with a wider discretion to make a decision in circumstances such as these.

The Appeal Court found that the just and equitable ground contemplated in section 81(1)(d)(iii) is not to be interpreted so as to relate only to matters similar to the other grounds which are provided in section 81(1). The examples of deadlock in section 81 (1)(d)(i) and (ii), that is where either the Board or shareholders are deadlocked, are examples only and are not exhaustive and do not limit the just and equitable principles which the Court applied under the old Act. Accordingly the confusion that reigned regarding this issue has now been definitively pronounced on by the Supreme Court of Appeal. The grounds to wind up a solvent company on just and equitable principles still remain wide and such decisions will be based on all facts placed before the Court.

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Further Advice

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