Dispute Resolution and Finance & Banking

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Pasiya and Others v Lithemba Mining (Pty) Ltd and Others: An exercise in discretion

Pasiya and Others v Lithemba Mining (Pty) Ltd and Others [2024] 1 All SA 626 (SCA) was an appeal before the Supreme Court of Appeal (SCA) following the dismissal by the court *a quo* of the appellants' application for declaratory relief. The declaratory relief sought included an order (i) declaring as unlawful and setting aside a loan agreement concluded in 2009; (ii) declaring as unlawful and setting aside the changes to shareholding which occurred in January 2010 pursuant to the inability of the borrower to repay the loan; and (iii) directing that dividends be paid in terms of shareholding as it stood before the shareholding changes.

Background

In 2000, the second respondent founded Lithemba Investments (Pty) Limited (LI) and invited a group of black female entrepreneurs to participate in LI as a Black economic empowerment investment company intended to serve as an empowerment partner in the energy sector. In terms of its shareholders' agreement, if LI identified a project, but was unable to undertake the project, it would, in its capacity as the identifier of the opportunity, be entitled to a percentage of shareholding in the project. LI identified an opportunity to invest in a coal mine in Mpumalanga (the project). This opportunity was presented to the shareholders of LI but it was declined due to the cash contribution required, which LI was unable to provide. It was then resolved that certain shareholders of LI would be allowed to invest in the project through a new entity, on condition that LI would, at no cost and as the identifier of the investment, be entitled to 10% of the shareholding in the project, which was subsequently changed to 12% of the shareholding. The shareholders of LI who were willing to invest in the project acquired an existing company for this purpose and later renamed it to Lithemba Mining (Pty) Limited (LM).

LM participated in the project through various subsidiaries structured as follows:

- LM entered into a joint venture with Middle East South Africa Energy Investment Holdings (Pty) Limited (MESA) and established a new company, Lithemba Wonderfontein Coal (Pty) Ltd (LWC) for this purpose. LM held 80% of the shares in LWC and MESA held the remaining 20%;
- subsequently LWC entered into a joint venture with Umcebo Mining (Pty) Ltd (Umcebo) and established Mbokodo Mining (Pty) Ltd (Mbokodo) for this purpose; and
- Mbokodo held 100% of the shares in Umsimbithi Mining (Pty) Ltd (Umsimbithi), which owned the coal mine.

In terms of the shareholders' agreement concluded between LWC and Umcebo, if a shareholder was unable to heed a cash call in respect of the project, that would constitute a deemed offer for their shares. In March 2009, Umsimbithi issued a cash call to its shareholder Mbokodo for project costs. Mbokodo similarly issued a cash call to its shareholders LWC and Umcebo for the project costs. LWC issued a corresponding call to its shareholders for

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its portion of the cash call. Ultimately, LM as the majority shareholder of LWC was required to raise funding for this cash call. Various attempts were made to raise the required funding and, in the end, the board of LM resolved to approach LI for a loan.

The board of LM resolved (i) that the terms of a convertible short-term loan from LI to LM were approved; (ii) to increase the authorised shares from 10,000 ordinary shares to 40,000 ordinary shares; and (iii) in the event of default by LM on the loan, LI would be issued with the appropriate number of shares to perfect its security for the loan. Subsequently, the board issued a memorandum and notice for a shareholders' meeting. Ahead of the LM shareholders' meeting, a project report was distributed to the shareholders of LM by the third respondent, which report noted a funding shortfall in respect of the project and that the shareholders of LM were required to contribute proportionately towards the shortfall. In April 2009, the shareholders of LM unanimously resolved to (i) approve the conclusion of a convertible loan agreement between LM and LI, which loan would be secured by way of a share issue in the event of default by LM; (ii) increase the authorised shares as aforementioned; and (iii) authorise the chairperson of the company or its company secretary to attend to all necessities to implement the resolutions.

The loan agreement between LI and LM was concluded in July 2009, the proceeds of which were used to *inter alia* meet the project cash call. A key term of the loan was that as continuing covering security, LM pledged to issue such number of additional shares to LI that would result in (i) a discharge of the obligations of LM to LI under the loan, and (ii) an increase in LI's shareholding in LM such that it would hold 51% of the issued shares. In the same month, the chairperson of the board of LM circulated a memorandum to the shareholders of LM informing them of a capital call to subscribe for additional ordinary shares proportionately in order to repay the loan from LI. The LM capital call was extended a number of times, with the final call being 23 October 2009. Only some of LM's shareholders were able to subscribe for additional shares and the disproportionate acquisitions led to the dilution of the LM shareholders that failed to participate in the capital call. The proceeds of the capital call were insufficient to repay the LI loan and in November 2009, LI demanded repayment of its loan outstandings. Due to the non-payment of the loan outstandings by LM, LI perfected its security and its shareholding in LM increased from 12,5% to 38,11%, which resulted in a further dilution of the LM shareholders.

The shareholders, whose equity had been diluted, raised their dissatisfaction with the chain of events and took numerous steps, except approaching the courts, to air this dissatisfaction. However, only in 2020, 10 years after the central events, did the disgruntled shareholders seek relief from the High Court.

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The court *a quo*: In summary

In 2020, the appellants instituted proceedings in the High Court, claiming declaratory relief. They alleged *inter alia* that:

- they had been presented, as LM shareholders, with a commercially prejudicial loan which resulted in the dilution of their shareholding in LM and in the increase of LI's shareholding in LM; and
- the second respondent was not authorised by the LM shareholders to conclude the loan.

The court *a quo* found that the appellants had established an interest in an existing or contingent right as shareholders in LM. However, in the exercise of its discretion in weighing up the facts and because of the appellants' undue delay in instituting the proceedings, it refused to grant the declaratory relief sought and dismissed the application with costs.

The SCA

The appellants stated that the court *a quo* erred in its application of the test for declaratory relief, as it failed to deal with the first leg of the test. It dealt only with the delay, which was one factor from the second leg of the test, and decided the matter on that basis without considering the merits.

The appellants argued that the court *a quo* should have dealt with the merits and only then should it have considered the question of whether to exercise its discretion in favour of, or against, the granting of the order.

It was also submitted by the appellants that the court *a quo* erred by not dealing with the merits of their claims and all of the defences raised by the respondents.

Whether the test for declaratory relief was met

Section 21(1)(c) of the Superior Courts Act 10 of 2013, provides that a High Court may, in its discretion, and at the instance of any interested person, enquire into and determine any existing, future, or contingent right or obligation, notwithstanding that such person cannot claim any relief consequential upon the determination.

The question of declaratory relief should be examined in two stages, as per *Cordiant Trading CC v Daimler Chrysler Financial Services (Pty) Ltd* [2005] (6) SA 205 (SCA). First, the applicant must satisfy the court that they are a person interested in an "*existing, future or contingent right or obligation*". Then, if the applicant passes that leg satisfactorily, the second leg requires the court to decide whether the case is a proper one for the exercise of the discretion conferred on it.

The SCA had to decide if the court *a quo* erred in its application of this test. The SCA held that, notwithstanding the appellant's contentions, the court *a quo* did in fact apply the first leg of the test appropriately. The court *a quo* had found that the appellant had an interest in an existing or contingent right, as LM shareholders whose shareholding was diluted. This affected them in relation to the sharing of dividends and their voting rights.

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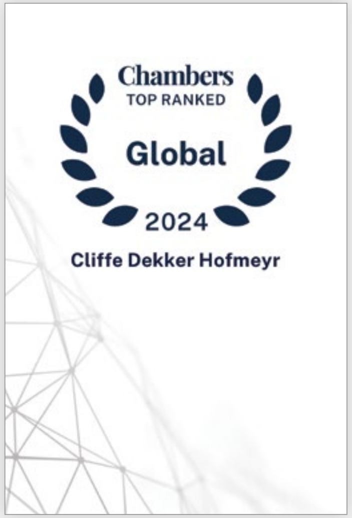

On the second leg of the test, the court *a quo* found that it ought not to exercise its discretion in favour of granting the declaratory order sought, as the appellants unduly delayed approaching the court for their relief. The appellants only sought the court's intervention in 2020 imploring it to "*turn the wheels back to the position prevailing in 2009*". The court *a quo* found that LM and the other shareholders would suffer great inconvenience and prejudice should the *status quo* be changed after so many years. Furthermore, the court *a quo* also held that if the declaratory order were made, the appellants would not be able to claim the restoration of the shares, as the claims had prescribed because the dilution of shareholding occurred in 2009.

The SCA held that appellants had not shown that the court *a quo* failed to exercise its discretion judicially, or that it was influenced by wrong principles or made a decision not reasonably open to it (which is what was required for an appeal per *Recycling and Economic Development Initiative of South Africa v Minister of Environmental Affairs; Kusaga Taka Consulting (Pty) Ltd v Minister of Environmental Affairs* [2019] (3) SA 251 (SCA) (REDISA)).

Whether the loan was unlawful

In attacking the authority that LM had to conclude the loan agreement in the first instance, the appellants sought to set aside the 18 April 2009 minutes and resolutions that gave effect to the loan agreement. The appellants argued that:

- the reasons given to the LM shareholders were different to those relied on by the LM board to change LM's authorised share capital;
- the authorised increase was for 10,000 shares and not 40,000 shares;
- the manner in which the loan was approved and concluded breached both the Companies Act 71 of 2008 (2008 Companies Act) and the Companies Act 61 of 1973 (1973 Companies Act); and
- the LM board did not act in good faith and in the best interests of LM when the authorised share capital was increased, in breach of section 76 of the 2008 Companies Act.

It must be noted that the conclusion of the loan agreement, the resolutions and minutes pertaining to it, the repayment, and the eventual dilution, all took place in 2009. The Companies Act of 2008 was only promulgated in 2011.

Therefore, the SCA was first required to decide if the 2008 Companies Act applied in the circumstances. It applied the general rule of interpretation that, in the absence of express provision to the contrary, statutes are not retroactive.

The appellants attempted to rely on section 224 of the 2008 Companies Act, which deals with transitional arrangements. The appellants referred to items 2, 4, 7 and 11 of Schedule 5 in support of their contention that the legislature intended the 2008 Companies Act to apply to the transactions under consideration as from 1 May 2011 when it came into operation.

The SCA took cognisance of the fact that the events giving rise to the dispute all occurred before the 2008 Companies Act came into operation in 2011. By 2011 all the relevant transactions, including LI's perfection of its security shares, were implemented, and rights had vested. The SCA also applied the principles set out in the Interpretation Act 33 of 1957 (Interpretation Act).

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The SCA held that, under the circumstances, the rights were accrued, and obligations were incurred under transactions implemented under the 1973 Companies Act only. The repeal of the 1973 Companies Act did not affect the rights which any person acquired before the repeal and did not extinguish any obligations any person incurred before the repeal, as per section 12(2) of the Interpretation Act.

The SCA therefore disagreed with the appellants that the transitional arrangements in Schedule 5 of the 2008 Companies Act were relevant to the facts before it. It found further that the transitional provisions related to matters that were pending finalisation at the date the 2008 Companies Act was made effective (1 May 2011).

LM resolutions (board and shareholders)

The SCA held that the facts showed that the loan was lawfully authorised, concluded and repaid; the changes to the shareholding were lawfully and properly authorised and effected; and dividends were declared and paid in accordance with the changed shareholding. The loan, the board, and the shareholder authorisations approving its conclusion and repayment accordingly complied with the 1973 Companies Act.

Validity of the share issuance

In terms of section 221 of the 1973 Companies Act, the directors of a company did not have the power to issue shares of a company without the prior approval of the company in a general meeting. The SCA concluded the issuance of shares to LI was approved by LM shareholders at the general meeting on 18 April 2018.

Of specific interest is the SCA's application of section 92 of the 1973 Companies Act, which provided that a company could not issue shares unless the full issue price of, or other consideration for, such shares had been paid to, and received by, the company. The SCA held that the shares issued to LI were issued in terms of the LI loan by way of set-off against the portion of the loan amount that remained outstanding, and this was permitted under the relevant legislation.

The appellants also argued that the LM board did not act in good faith and in the interests of LM when they resolved to increase its authorised share capital, as shareholders were not provided with sufficient information regarding the reason for the increase of the LM share capital, relying on *Trinity Asset Management (Pty) Limited and Others v Investec Bank Limited and Other* [2009] (4) SA 89 (SCA) and *CDH Invest NV v Petrotank South Africa (Pty) Ltd and Others* [2019] (4) SA 436 (SCA).

The SCA held that the appellants' reliance on Trinity was incorrect, as that case involved shareholders' rights to receive accurate information and to seek an interdict to stop a shareholders' meeting **until** correct information has been furnished. The case did not support the proposition that a shareholder can claim that the failure to receive accurate information entitles them to a declaration that the resolutions adopted, and the acts subsequently taken by the company, were unlawful.

CDH Invest SCA was also found not to apply by the SCA as LM's board exercised its powers *bona fide* in the interest of the company, as the loan ensured LM could meet the

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capital call, which resulted in the shareholders of both LM and LI benefitting greatly over the years from the dividends from LWC. In CDH Invest SCA, the directors had acted with egregious conduct and knew that the resolution voted thereon was contrary to the proclaimed purpose.

Prescription

Further, the SCA held the transactions which gave rise to the dilution of the appellants' shareholding were concluded in 2009 and implemented in 2010 when the share register was updated to reflect an increase of LI shareholding in LM. The SCA held this did not constitute a continuous wrong (as highlighted in *Barnett v Minister of Land Affairs* [2007] ZASCA 95, and therefore the claim for the delivery of shares therefore prescribed in 2013.

Reflections

This case raises interesting questions regarding secured loans and convertible loans, and brings to the forefront the importance of using the correct terminology in describing the terms of loans to ensure that there are not questions regarding the security obtained in lieu of the loan. It is important that legal advice be sought before concluding such an agreement, especially if parties are not familiar with the terminology or certain that their rights are properly secured as envisaged and agreed during negotiations.

Conclusion

This matter had many facets, including:

- parties waiting too long before seeking the court's assistance, and therefore letting any potential claim they had prescribe;
- the principles underlying the application of legislation retrospectively;
- how the courts are to apply the two-pronged test when declaratory relief is sought, and what parties need to prove when launching declaratory proceedings;
- the requirement for board members to inform shareholders of all the facts when seeking shareholder approval; and
- shareholders' obligations to ensure they understand and implement their rights when further information may be required.

This list is not exhaustive, as this case had many nuances. However, an important takeaway is that waiting too long to seek relief from the courts to resolve a dispute is detrimental to the case of a person seeking the court's help.

The court's findings indicate that even if the appellants had sought relief from the courts early on, they would have been unsuccessful, as the SCA found that all the transactions and steps taken to conclude the loan agreement and effect of the dilution of shareholding had been validly concluded and implemented. It would appear that the appellants had made their journey that much harder by leaving it so late before approaching the courts.

Belinda Scriba, Kuda Chimedza, Loyiso Bavuma and Sophie Muzamhindo

OUR TEAM

For more information about our Dispute Resolution practice and services in South Africa and Kenya, please contact:

Rishaban Moodley
Practice Head & Director:
Dispute Resolution
Sector Head:
Gambling & Regulatory Compliance
T +27 (0)11 562 1666
E rishaban.moodley@cdhlegal.com

Tim Fletcher
Chairperson
Director: Dispute Resolution
T +27 (0)11 562 1061
E tim.fletcher@cdhlegal.com

Imraan Abdullah
Director:
Dispute Resolution
T +27 (0)11 562 1177
E imraan.abdullah@cdhlegal.com

Timothy Baker
Director:
Dispute Resolution
T +27 (0)21 481 6308
E timothy.baker@cdhlegal.com

Eugene Bester
Director:
Dispute Resolution
T +27 (0)11 562 1173
E eugene.bester@cdhlegal.com

Neha Dhana
Director:
Dispute Resolution
T +27 (0)11 562 1267
E neha.dhana@cdhlegal.com

Denise Durand
Director:
Dispute Resolution
T +27 (0)11 562 1835
E denise.durand@cdhlegal.com

Claudette Dutilleux
Director:
Dispute Resolution
T +27 (0)11 562 1073
E claudette.dutilleux@cdhlegal.com

Jackwell Feris
Sector Head:
Industrials, Manufacturing & Trade
Director: Dispute Resolution
T +27 (0)11 562 1825
E jackwell.feris@cdhlegal.com

Tiffany Gray
Director:
Dispute Resolution
T +27 (0)11 562 1388
E tiffany.gray@cdhlegal.com

Nastascha Harduth
Sector Head: Business Rescue,
Restructuring & Insolvency
Director: Dispute Resolution
T +27 (0)11 562 1453
E n.harduth@cdhlegal.com

Anja Hofmeyr
Director:
Dispute Resolution
T +27 (0)11 562 1129
E anja.hofmeyr@cdhlegal.com

Tendai Jangara
Director:
Dispute Resolution
T +27 (0)11 562 1136
E tendai.jangara@cdhlegal.com

Corné Lewis
Director:
Dispute Resolution
T +27 (0)11 562 1042
E corne.lewis@cdhlegal.com

Nomlayo Mabhena-Milo
Director:
Dispute Resolution
T +27 (0)11 562 1743
E nomlayo.mabhena@cdhlegal.com

Sentebale Makara
Director:
Dispute Resolution
T +27 (0)11 562 1181
E sentebale.makara@cdhlegal.com

Vincent Manko
Director:
Dispute Resolution
T +27 (0)11 562 1660
E vincent.manko@cdhlegal.com

Khaya Mantengu
Director:
Dispute Resolution
T +27 (0)11 562 1312
E khaya.mantengu@cdhlegal.com

Richard Marcus
Director:
Dispute Resolution
T +27 (0)21 481 6396
E richard.marcus@cdhlegal.com

Burton Meyer
Director:
Dispute Resolution
T +27 (0)11 562 1056
E burton.meyer@cdhlegal.com

Desmond Odhiambo
Partner | Kenya
T +254 731 086 649
+254 204 409 918
+254 710 560 114
E desmond.odhiambo@cdhlegal.com

Lucinde Rhoodie
Director:
Dispute Resolution
T +27 (0)21 405 6080
E lucinde.rhoodie@cdhlegal.com

Clive Rumsey
Sector Head: Construction & Engineering
Director: Dispute Resolution
T +27 (0)11 562 1924
E clive.rumsey@cdhlegal.com

Belinda Scriba
Director:
Dispute Resolution
T +27 (0)21 405 6139
E belinda.scriba@cdhlegal.com

Tim Smit
Sector Head:
Consumer Goods, Services & Retail
Director: Dispute Resolution
T +27 (0)11 562 1085
E tim.smit@cdhlegal.com

Marelise van der Westhuizen
Director:
Dispute Resolution
T +27 (0)11 562 1208
E marelise.vanderwesthuizen@cdhlegal.com

Joe Whittle
Director:
Dispute Resolution
T +27 (0)11 562 1138
E joe.whittle@cdhlegal.com

Roy Barendse
Executive Consultant:
Dispute Resolution
T +27 (0)21 405 6177
E roy.barendse@cdhlegal.com

OUR TEAM

For more information about our Finance & Banking practice and services in South Africa and Kenya, please contact:

Mashudu Mphafudi
Practice Head & Director:
Finance & Banking
T +27 (0)11 562 1093
E mashudu.mphafudi@cdhlegal.com

Johan de Lange
Deputy Practice Head:
Finance & Banking
Director: Projects & Infrastructure
T +27 (0)21 481 6468
E johan.delange@cdhlegal.com

Sammy Ndolo
Managing Partner | Kenya
T +254 731 086 649
+254 204 409 918
+254 710 560 114
E sammy.ndolo@cdhlegal.com

Dr Adnaan Kariem
Director:
Finance & Banking
T +27 (0)21 405 6102
E adnaan.kariem@cdhlegal.com

Mbali Khumalo
Director:
Finance & Banking
T +27 (0)11 562 1765
E mbali.khumalo@cdhlegal.com

Jacqueline King
Director:
Finance & Banking
T +27 (0)11 562 1554
E jacqueline.king@cdhlegal.com

Stella Situma
Partner | Kenya
T +254 731 086 649
+254 204 409 918
+254 710 560 114
E stella.situma@cdhlegal.com

Andrew van Niekerk
Director:
Finance & Banking
T +27 (0)21 481 6491
E andrew.vanniekerk@cdhlegal.com

Deon Wilken
Director:
Finance & Banking
T +27 (0)11 562 1096
E deon.wilken@cdhlegal.com

Kuda Chimedza
Senior Associate:
Finance & Banking
T +27 (0)11 562 1737
E kuda.chimedza@cdhlegal.com

Tsele Moloi
Senior Associate:
Finance & Banking
T +27 (0)11 562 1399
E tsele.moloi@cdhlegal.com

Brian Muchiri
Senior Associate | Kenya
T +254 731 086 649
+254 204 409 918
+254 710 560 114
E brian.muchiri@cdhlegal.com

Thato Sentle
Senior Associate:
Finance & Banking
T +27 (0)11 562 1844
E thato.sentle@cdhlegal.com

Michael Bailey
Associate:
Finance & Banking
T +27 (0)11 562 1378
E michael.bailey@cdhlegal.com

Damaris Muia
Associate | Kenya
T +254 731 086 649
+254 204 409 918
+254 710 560 114
E damaris.muia@cdhlegal.com

Lloyd Smith
Associate:
Finance & Banking
T +27 (0)11 562 1426
E lloyd.smith@cdhlegal.com

Zipho Tile
Associate:
Finance & Banking
T +27 (0)11 562 1464
E zipho.tile@cdhlegal.com

Sidumisile Zikhali
Associate:
Finance & Banking
T +27 (0)11 562 1465
E sidumisile.zikhali@cdhlegal.com

Stephanie Goncalves
Professional Support Lawyer:
Finance & Banking
T +27 (0)11 562 1448
E stephanie.goncalves@cdhlegal.com

BBBEE STATUS: LEVEL ONE CONTRIBUTOR

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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

NAIROBI

Merchant Square, 3rd floor, Block D, Riverside Drive, Nairobi, Kenya. P.O. Box 22602-00505, Nairobi, Kenya.
T +254 731 086 649 | +254 204 409 918 | +254 710 560 114
E cdhkenya@cdhlegal.com

STELLENBOSCH

14 Louw Street, Stellenbosch Central, Stellenbosch, 7600.
T +27 (0)21 481 6400 E cdhstellenbosch@cdhlegal.com

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