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HC 4408/03

FINHOLD SERVICES (PRIVATE) LIMITED
versus
ZIMBABWE FINANCIAL HOLDINGS LIMITED
and
ZIMBABWE BANKING CORPORATION LI MITED

HIGH COURT OF ZIMBABWE
MAKARAU J
HARARE, 22 April and 19 May 2004

Opposed Application

Mr E Morris, for applicant
Mr R Fitches, for respondents

MAKARAU J: The parties to this application are all related. The second respondent Zimbabwe Banking Corporation Limited, (Zimbank) is a wholly owned subsidiary of the first respondent, Zimbabwe Financial Holdings ("Finhold"). The applicant was initially incorporated by the first respondent as a shelf company in or about 1993. It was to be jointly owned by the first respondent's workers and management. Its first nominee shareholders were directors of the first respondent. By resolution of the Board dated 1 June 2001, the directors of the first respondent stood down and workers of the first respondent were appointed in their stead.

Prior to 1996, the first respondents and its subsidiaries sold certain debts to a company called Climax Investments (Private) Limited ("Climax"). Climax borrowed part of the purchase price from the Reserve Bank and the other part from a third party but through the auspices of the Reserve Bank. The first respondent and its subsidiaries gave guarantees and stood surety for the due performance of Climax in its obligations to the Reserve Bank. Later, in December 1996, these guarantees were altered and substituted by the creation and issuance of 16 million Convertible Shares of $1 each in Zimbank, to be

allotted to a subsidiary of the Reserve Bank of Zimbabwe, Fintrust. Each preference share was vested with a dividend right of 3,5 times the dividend declared on each ordinary share for a period of about 5 years after which the shares would convert to ordinary shares on the day after the last day to register for the 2001 dividend. Prior to the conversion of the preference shares into ordinary shares, the first respondent had the right to buy back these shares at a price that would fully pay the outstanding amount of the loan to Fintrust. In the event that the first respondent did not take up the option, then Fintrust would be entitled to dispose of the shares to a third party.

The 16 million preference shares were duly created and issued to Fintrust in terms of the agreement of December 1996.

On 2 October 2001, Fintrust gave notice that it wanted to dispose of its shares that had now been converted to ordinary shares. It requested the second respondent to find it a buyer, presumably on the basis that the first respondent had not taken up the option to purchase the shares prior to the conversion date. The applicant was identified as the purchaser and the shares were subsequently sold to the applicant who sourced the funds to make the purchase from a local financial institution.

Emboldened by its acquisition of the 16 million shares in the second respondent, the applicant expected to exchange its 16 million shares for an equivalent number of shares in the first respondent, the holding company. The matter of the share swap came up during an Extraordinary General Meeting of the first respondent. At that meeting, the shareholders of the first respondent were requested to ratify the conversion of the 16 million shares in Zimbank held by the applicant to 16 million shares in the first respondent. The shareholders of the first respondent declined to ratify the conversion. The shareholders then requested the board to investigate the issue of the 16 million shares in the second respondent.

On 4 December 2002, a joint meeting was held between the boards of the applicant and that of the first respondent were it was alleged that the acquisition of the shares by the applicant had been fraudulently done and action would be taken against those members of staff involved.

In May 2003, members of the applicant's board were suspended from service only to be reinstated by an order of the Labour Court. An attempt was made to coerce the applicant into transferring to the first respondent the 16 million shares. This was in vain.

On 13 May 2003, the first respondent purported to cancel the shares and sought to reimburse the applicant the amount it had paid to its financiers in the purchase of the shares. Again, this effort was resisted. This was the state of affairs when the applicant filed this application. In the application, it seeks an order declaring a nullity the first respondent's purported cancellation of the sale of the 16 million shares to it and another compelling the respondents to recognise it as the lawful holder of the 16 million shares in the second respondent.

The respondents have opposed the application. In the opposing affidavit, the respondents aver that the issue of the option to purchase the 16 million shares was never brought up to the board of the first respondent for its consideration. Thus, the board of the first respondent did not engage itself as to the economic consequences of buying back or failing to buy back the shares. On this basis, the first respondent resolved to cancel the 16 million shares and informed the applicant and the public of such cancellation through its half-year results published in the local press in May 2003.

It is common cause that there was nothing irregular concerning the creation of the 16 million shares. If anything, the creation and issuance of the shares was meticulously done with the requisite resolutions passed at board and at shareholder level. Everything was done according to the book.

In the opposing affidavit, the respondents aver that the issuance of the 16 million shares was to increase the authorised share capital of the second respondent, which had become necessary as a part of its financial restructuring exercise. Thus, the purported cancellation of the shares is a reduction in the authorised share capital of the second respondent to the position it was in prior to the issuance of the shares.

S 92 of the Companies Act provides that:

> "Subject to confirmation by the court, a company may, if so authorised by its articles, by special resolution reduce its share capital in any way and in particular, without prejudice to the generality of the foregoing power, may-

a) ……
b) ……
c) ……
and may, if and so far as is necessary, alter its memorandum by reducing the amount of its share capital and of its shares accordingly."

The respondents did not follow any of the above in reducing the authorised share capital in the second respondent. No court confirmation was sought before the shares were purportedly cancelled. The need to seek the confirmation of the court is paramount and the courts jealously guard the discretion vested in them to decide whether a company may reduce its share capital, even where the other paper formalities have been met. (See Ex *Parte Vlakfontein Gold Mining Company Limited* 1970 (2) SA 180 (TPD[1]). The purpose of the procedures detailed above is to preserve the issued capital of the company as a reserve fund to which creditors can look for payment.

In *casu*, it further appears that there was no special resolution to reduce the share capital was passed and it has not been established before me that the Articles of the second respondent do allow the reduction of its authorized share capital. In the absence of due observance of the dictates of the law in this regard, and particularly in the absence of confirmation by this court, the purported cancellation of the 16 million shares is of no force and effect. The respondents were ill advised to purport to cancel the 16 million shares.

In my view, the position remains the same even assuming the first respondent was able to prove that the applicant fraudulently acquired the shares. It is common cause that no irregularity taints the creation of the shares and their subsequent allotment to Fintrust. It is further common cause that the shares were held by Fintrust for a period of about 5 years. If just cause existed for their cancellation after their creation and after being held by Fintrust for 5 years, then it becomes trite that the shares had to be cancelled after the procedures laid out in the Act had been followed, for the protection of the second respondent's creditors. The shares could not be summarily cancelled and at the whims of the respondents and without the necessary procedures having been followed and without

1 S 92 of the Zimbabwean Companies Act cited above is similar to s42 of the South African equivalent Act under which the case was decided.

the confirmation of this court having been obtained.

On the basis of the foregoing, the purported cancellation of the 16 million shares was not only ill advised but, is of no force and effect.

I will turn to consider whether there exists any legal basis upon which the sale of the shares to the applicant may be set aside. In this regard, I have reminded myself not to lose sight of the fact that the sale of the shares was between the applicant and Fintrust and not between the applicant and the respondents.

It is common cause that the sale of the shares to the applicant from Fintrust was in accordance with the terms of the agreement between the respondents and the Reserve Bank of December 1996. The sale to the applicant was only permissible in terms of that agreement after the first respondent had failed to exercise the option in its favour to buy back the shares. It is further common cause that the first respondent did not exercise the option in its favour. It alleges that it did not take up the option because its board was not advised to consider the option. I shall return to this allegation in slightly more detail later. At this stage, I wish to examine whether, as option holder, the first defendant has any legal basis upon which it can nullify the sale of the shares between Fintrust and the applicant after the lapse of the option.

Taken from the viewpoint of Fintrust, the first respondent failed to exercise the option in its favour on due date. It is a settled position at law that an option must be exercised in the manner and within the time provided in the agreement and the taking up of the offer must be communicated to the grantor of the option. If there was any doubt in the legal position in this regard, the case of *Laws v Rutherford* 1924 AD 261, a Southern Rhodesian judgement upheld on appeal in Transvaal, put paid to that doubt. In that case, the respondent had up to 26 July 1923 to exercise an option to cut timber on the applicant's farm. The 26th came and went without the respondent communicating his desire to take up the option. When the applicant requested him to remove his equipment from her farm, the responded then communicated his acceptance of the option. The court held that the option had lapsed before the respondent accepted it and that was that.

On the basis of the foregoing, there was no impediment in the way of Fintrust to

stop it from selling the shares to the applicant and passing good title in the shares to the applicant. In the circumstances, the first respondent cannot compel Fintrust to sell the shares to it now as the option lapsed without the first respondent exercising it. In my view, because the respondents have no basis for compelling Fintrust to sell the shares to them, there is therefore no basis upon which the sale of the shares to the applicant can be canceled. The sale of the shares to the applicant is valid.

The respondent's main contention in opposing this application is that its board of directors was not advised to consider the option or the financial consequences flowing from shying away from taking up the option. The contention raises the immediate question of who had to advise it to consider the option. It is trite that the management of the respondents was in the trust of the board of directors. How they chose to exercise that management and to whom they delegated duties does not take away their primary responsibility to manage the respondents. To submit as has been done in this matter that the board was not advised to consider the option is with the greatest of respect, nonsensical. It amounts to saying that the respondents did not advise themselves!

Even assuming, as the respondents allege that Taruvinga as secretary to the board of the first respondent did not bring the issue of the options to the board for discussion, the position remains the same. He was the agent of the board and his failure is the board's failure too. There is no way that the third party in the transaction, Fintrust would have known that the internal machinery of the respondents was not working as it ought to and that the secretary to the board had not brought up the matter of the 16 million shares to the board for consideration.

Although the issue is not directly before me and is not necessary for the decision I must reach in this matter, I will briefly comment on the issue of the responsibilities of a board of directors as that has been the mainstay of the opposition in this matter.

The power of directors of any company to manage the company is granted to the directors by the Articles of Association of the company. Management styles differ and each board chooses a style. Whatever management style a board chooses, it remains responsible for directing and managing the affairs of the company and cannot stand aside

and apportion blame on the workers of the company in the event that something goes wrong.

In *casu*, the respondent at board level created the 16 million shares, allotted them to Fintrust and, reserved to itself the right to purchase back the shares. The respondents were represented in the agreement with the reserve Bank by the deponent to its opposing affidavit, himself a member of the board of directors. The issue of the 16 million shares was therefore an issue that the board was dealing with directly and it cannot allege that it was denied by the applicant or by any other person for that matter, the opportunity to consider the option to purchase back the shares. It has not been disclosed on the papers before me why the board of the respondents on its own was unaware of the need to consider the option. In my view, the board of the first respondent has paid the price of overly relying on management for business to transact at its meetings. The shares were created as part of the financial restructuring of the respondent. It was a major exercise that saw the injection of $1 billion into the respondent in 1996. Then it was a considerable amount of money and an alert board should have kept track of the performance of Climax and of the repayments the respondent was making towards retiring the debt due to the Reserve Bank.

The issue of the failing of the workers of the respondents to properly advise the board is a matter to be resolved between the respondent and its workers. It cannot be used as the basis for setting aside the sale of the shares to the applicant.

There is no merit in the opposition by the respondents in this matter. The respondents rather half-heartedly applied that the matter be referred to trial to establish the allegations of fraud and improper conduct on the part of its officers. This is clearly a fall back position on the part of the respondents. I am not persuaded to take that course. No facts giving rise to any fraud have been laid out in the application. Oral evidence cannot prove facts that the affidavits fail to lay out. Even if it is proved that its agents acted fraudulently in the matter, that proof would not avail the respondents as the fraud of an agent against his principle still binds the principle to third parties in contract. (See *Randbank Bpk v Santam Versekeringsmaatskappy* 1965 (40 SA 363 (A).

In the result, I make the following order:

1. The resolution of the respondents' boards purporting to cancel the 16 million shares in the second respondent is hereby set aside;

2. The resolution of the board of the first respondent purporting nullify the sale of the 16million shares to the applicant is declared of no force and effect.

3. It is declared that the applicant is the holder of 16 million ordinary shares in the second respondent.
4. The respondents shall bear the applicant's costs jointly and severally, the one paying the other to be absolved.

Costa and Madzonga, applicant's legal practitioners
Dube Manikai & Hwacha, respondents' legal practitioners