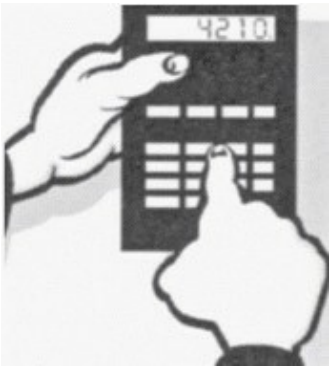
Again considering buy-and-sell agreements and the prohibition against the *pacta successoria*



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There is no doubt that creative drafting is not easily going to solve the problem satisfactorily. From the arguments presented, including those of the authors cited in this article, it cannot be said that certainty will exist, irespective the method of contractually structuring in a buy-and-sell agreement. We will be hesitant to legally endorse any form of structuring in a buy-and-sell agreement because of the prohibition against pacta successoria *and the concomitant uncertainties.*

There exists a real need to legally regulate commercial contracts in anticipation of death. Also considering that many buy-and-sell agreements are in use as a solution to succession planning, it is perhaps time for the legislator to intervene and bring certainty in respect of existing and future agreements.

Scenario 1

A fiduciary specialist (Ben) was given the power of attorney to attend to the affairs of a trusted client of his (Jim). Because of his old age and the deterioration of his physical and mental abilities, Jim became so dependent on the business acumen and brilliance of Ben, that he would do anything to retain the services of this trusted expert. Ben decided to conclude a contract with Jim that he would attend to Jim's financial affairs without compensation, in lieu of which Jim agrees to amend his will to bequeath his share portfolio to Ben.

Scenario 2

Jacques and Peter were the co-shareholders of a company in which an import-export business was undertaken. They decided to conclude a buy-and-sell agreement with each other where they undertook that the shares of the first-dying shareholder's shares would be bought at a market related price. They have agreed that the family of the first-dying of them should not be allowed as a shareholder of the company, but instead that that person's family be afforded a cash sum from the disposal of the shares. The deceased's loan account will also be bought out in the process.

Scenario 3

Jaco and Rian were the co-owners of a commercial business. The offices of the business were situated in a commercial property owned by Jaco. In order to secure a passive income for his family, Jaco decided to conclude an agreement with Rian that, should he (Jaco) pass away, Rian would be obliged to rent the commercial property for another ten years thereafter.

Are these three contracts validly concluded and will they survive the sanction of the courts when subjected to scrutiny?

We will again be revisiting the well-known South African legal principle that the law does not generally permit a person to regulate the succession of his estate after his death by means of a contract-succession agreement (the prohibition against *pacta successoria*). More specifically, we will consider whether buy-and-sell agreements could be classified as *pacta successoria*, and whether or not a buy-and-sell agreement, concluded to acquire only the shareholding of a deceased co-shareholder, as opposed to only the loan account of that shareholder, would have a different legal stance when measured against the legal principles applicable to *pacta successoria.*

1. Problem statement

The existence of the type of ***C***ontract referred to above in the second scenario amongst business associates is certainly the norm, rather than the exception. To consider the validity of these types of agreements is in itself ironic, considering the multitude of them in circulation. The well-being of any commercial enterprise depends upon the appropriate management and expertise, and can seldom accommodate any passengers, although it may sometimes happen in family businesses that descendants are allowed the time to be groomed into a selected position. Business continuity plays a very important role in any business. The passing of one key individual cannot result in a

"sinking ship". Clients, employees and co-management rely on the continuation of the business and it is therefore important that co-business partners or shareholders regulate their relationship in case one of them passes away or becomes permanently incapacitated. It is for the greater good of all involved that their share ends up in the appropriate hands. It is also to the benefit of their family that they be allowed the benefit to extract funds by exiting the arena and not being involved in the unknown subtleties in which the deceased or disabled person flourished. It sounds like a win-win situation for all involved.

But, can all involved rely on the enforceability of the agreement? Can it not be said that this agreement divests the shareholder of the opportunity to bequeath their share to whomever they may choose? Say a son, as the years go by, grows in stature in his father's line of business, and his father then realises that his son may indeed follow in his footsteps and wants to amend the buy-and-sell agreement. Should his endeavours invoke resistance from his co-business partners or shareholders? Does the law allow him to argue that such an agreement constituted a *pactum successsorium* and that it is invalid insofar as it relates to the disposal of his share, and or loan account, in the company after his death?

The conflict that exists between the freedom of contract and the freedom of testation in South African law creates uncertainty and tension in the business environment, which ultimately denies business associates to regulate their affairs in a sensible and morally acceptable manner. The begrudged shareholder in the example above would clearly argue that the freedom of testation weighs heavier than the freedom of contract. In the leading court case, *McAlpine v McAlpine*[1] it was indeed stated that:

> "The *pactum successorium* occupies a somewhat shadowy position between contract and testation[2]."

We will endeavour to digest and analyse the legal principles, relevant authority and characteristics of *pacta successoria* and draw a comparison with the traditional buy-and-sell agreement, often funded with life assurance policies. This will hopefully shed light on the question of the enforceability of these types of agreements.

2. Introduction - the *pactum successorium*

A *pactum successorium* has been defined in *Borman* and *De Vos v Potgietersrusse Tabakkorporasie Bpk*[3] as:

> ". . . [*pactum successorium* (or *pactum de succedendo*)] is, to put it briefly, an agreement in which the parties regulate the devolution (*successio*) of the inheritance (or a part of it, or of a particular thing that is a part of it) of one or more of the parties after the death (*mortis causa*) of the party or parties concerned."

In *Ex parte Calderwood*: *In re Estate Wixley*[4] it was mentioned that:

> "The foundation of a *pactum successorium* is that the person who contracts with regard to his own succession purports to bind himself to that contract. He does not seek to retain the unilateral right to revoke his promise. Should he do so, then the contract is not one which conflicts with the general rule of our law that inheritances must devolve *ex testamento* or *ab intestato*."

It is clear that reference is made to an agreement which:

- is concluded between two or more parties;
- cannot be revoked unilaterally by any of them;
- has the effect of irrevocably binding the promissor to a post-mortem devolution of the right to an asset in his estate; and
- effectively inhibits the power to devolve an asset *ex testamento* or *ab intestato*.

A *donatio mortis causa* cannot, for example, be classified as a *pactum successorium* because it remains revocable until the promissors' death (i.e. falling foul of the second requirement).

Barring the exception of an agreement made in terms of a valid antenuptial contract, *pacta successoria* are invalid. From the leading court case quoted above, it is clear that a *pactum successorium* is invalid regardless of whether it relates to the whole of the person's estate or to a particular property only. It is invalid, first, because it restricts the individual's freedom of testation, and secondly, because it seeks to evade the formality requirements laid down by the Wills Act.

Authorities on this matter point[5] out that there are many potential forms that a *pactum successorium* could take, namely:

- Mr A undertakes to make a bequest in favour of Mr B in his Will.
- Mr A and Mr B enter into a contract in which Mr A purports to dispose of his property *mortis causa* in Mr B's favour.
- Mr A and Mr B enter into an agreement in which Mr B undertakes to make a bequest of his property, or part of it, to Mr C.

It is clear that the type of contract alluded to in the preamble under Scenario A is an example which can fit within the ambit of the first bullet above, whilst the buy-and-sell agreement is an example of the *genus* mentioned in the second bullet above.

One cannot but agree that all three types of agreements referred to in the preamble have the effect of inhibiting the owner's freedom of testation over that specific asset. With reference to the agreement mentioned in the second scenario, the co-shareholders want to restrict the specific shareholder's ability to bequeath the shares and or the loan account he held, to his son, or to anybody else for that matter. The parity in the matter, we believe, lies in the

fact that all the shareholders agreed to that fact and that each and every shareholder is regulated in the same manner by the agreement. Because we do not know who will pass away or become disabled first, all the shareholders are in exactly the same position and nobody is being discriminated against. It is clearly in the public and commercial interest that certainty and enforceability be bestowed upon these agreements. This sentiment was echoed by many commentators, for example Barnard K, 2015, "*Buy and Sell - Pactum Successorium or not*" and Van Gijsen and Van Vuren in a recently published article entitled: "*Defining buy-and-sell agreements in the light of the prohibition against pacta successoria*".6

3. Introduction - the buy-and-sell agreement

Agreements between shareholders are very common and govern or regulate various aspects of their relationship. For purposes of this article we refer to provisions in a shareholder's agreement which regulate the disposing and buying of the shareholders' shares and or receivable loan account at the death of one of them.

A starting point is to establish the real intention of the shareholders in a typical buy-and-sell agreement funded with life assurance policies? What do the shareholders purport to achieve with this agreement?

They wish to conclude a binding agreement:

. whereby enforceable rights will be created for all of them;

. which none of them will be able to revoke unilaterally;

. which will have the effect of the deceased shareholder disposing of their share and or loan account to the other shareholder/s *post-mortem* for an agreed upon *quid pro quo* which is payable only after their death;

. which effectively inhibits any shareholder's power to devolve an asset *ex testamento* or *ab intestato*.

Is it not exactly how we have defined the characteristics of *pacta successsoria* above?

Although there is no denying that the owner's freedom to bequeath the specific share or loan account is restricted, the proceeds emanating from the disposal of the share will substitute the share as an asset in that shareholder's estate on death, and he will indeed have the freedom to bequeath such proceeds as he pleases. Is the buy-and-sell agreement discernible from the *pactum successorium* based on the fact that a consideration was received? The court in *Schauer v Schauer*7 found that the agreement in that case constituted a *pactum successorium* unless evidence could be provided to show that a *quid pro quo* was given to the *promissor*. This judgement was, however, severely criticized and Prof D Huthinson,8 as well as Fagan J in *Jubelius v Griesel*,9 were of the opinion that a *quid pro quo* attached to the promise would make no difference (see also *Van Aardt v Van Aardt*10 where the agreement to dispose of a farm involved the payment postponed until date of death). We agree with this.

The relevant question is whether the terms of the buy-and-sell agreement divested the *promissor* of his right to devolve property during his lifetime or *post mortem*.

Where an agreement confers a right to the asset which becomes vested in the purchaser during the lifetime of the *promissor*, an *inter vivos* disposal takes place and capital gains tax will be applicable. Such asset will not constitute an asset in the *promissor's* estate. Although the enjoyment or enforceability or payment of the proceeds may well be postponed until death, the disposal has taken place during the lifetime of the *promissor*. The construction of the agreement is important.

4. Identification of a *pactum successorium*

In *McAlpine v McAlpine*11 it was mentioned that:

> "whether or not the reciprocal promises in clause 1 of agreement B constitute *pactum successoria* is the so-called **vesting test**. This test is applied by asking in a particular case whether the promise disposing of an asset in favour of another (whether by way of donation or other form of contract) causes the right thereto to vest in the *promisee* only upon or after the death of the *promissor* (which points to a *pactum successorium*); or whether vesting takes place prior to the death of the *promissor*, for instance, at the date of the transaction giving rise to the promise (in which case it cannot be a *pactum successorium*). Counsel were agreed that this is the appropriate test to be applied. It is the test which has been applied in a number of cases in this country." (Our emphasis.)

The time of vesting is therefore determined to be the *litmus* test for identifying a *pactum successorium*. Although this test has not escaped criticism (Nienaber JA minority decision in *McAlpine* and Rautenbach 1999)12 it is accepted by the Supreme Court of Appeal.

The term "vesting" has been the subject of many discussions, commentaries and court decisions and it is not the intention to legally analyse and explain what the term means.13 For our purposes it is sufficient to state that a *promisee* has acquired a vested right to the asset if the agreement states that he will receive the property at an agreed price upon a future date, namely the death of the *promissor*. In this scenario a contractual disposition would have been effected, the asset would have been disposed of during the lifetime of the *promissor*, and the enjoyment thereof is merely postponed.

In instances where an agreement is subject to a suspensive condition, or the parties intended the identity of the *promisee* to be determined only at the date of death of the *promissor*, the *promisee* acquires vested rights to the asset at the time of death of the *promissor*. It is a contractual disposition which is similar to a testamentary disposition, where vesting occurs for the *promisee* upon or after the death of the *promissor*, which constitutes an invalid *pacta successorium*.

5. Authority from the courts

The underlying nature of the rights to the asset with which the *promisee* was clothed until the date of death of the *promissor* is critical to the identification of a *pactum successorium*. Stated differently, if it is determined to be a vested right (*a ius in personam ad acquirendam*, i.e. a personal right to claim an asset after the demise of the *promissor*), as opposed to a contingent right, the *promissor* would have disposed of the asset *inter vivos*, which does not constitute an invalid *pactum successorium*.

However, as can be seen from the following leading court cases on the topic, to determine the nature of the rights of the *promisee*, is easier said than done.

5.1 Borman v Potgietersrusse Tabakkorporasie Bpk (1976) (A)[14]

Facts: During his lifetime the testator was a member of the "Potgietersrusse Tabakkorporasie". The company was regulated by Statute and binding upon the company and its members as if they agreed to it contractually. In terms of one of the statutory provisions each member was obliged to deposit 4% of the proceeds of his tobacco sales in a membership account with the company. In certain prescribed situations the amount held as credit in the loan account could be paid out to him. If he should pass away whilst still holding a credit on loan account, the statute dictated that it be paid to his widow, i.e. restricting his testamentary powers over the asset. The testator bequeathed this loan account to his son in his Last Will and Testament. After the death of the testator, his son and the executors approached the court for a declaratory judgment that the agreement constituted an invalid *pactum successorium*.

Conclusion: Rabie JA had placed emphasis on the personal rights enjoyed by the deceased against the company until the date of his death and concluded that his loan account remained an asset in his estate until that date. He therefore decided that the statute embodied an agreement which had the effect of divesting the member of his right to bequeath the said loan account, and hence that it constituted a *pactum successorium* which rendered the agreement unenforceable.

5.2 *Jubelius v Griesel* (1988) (K)[15]

Facts: The applicant and his uncle concluded a partnership agreement in 1965 in which they had regulated their joint farming undertaking. A sales agreement was simultaneously concluded by the same parties. In terms of this agreement, the applicant had purchased the farm from his uncle for R20 000 payable upon the registration in his name, but only after the demise of his uncle. After the uncle's death, his executor awarded the farm to his heirs. The applicant applied to the court for an order declaring that ownership of the farm be transferred to him in terms of the agreement. The heirs (respondents) argued that the agreement constituted a *pactum successorium*.

Conclusion: Judge Fagan had accepted that a resolutive condition (and not a suspensive condition) was present in this case, namely that the uncle had disposed of the farm to him when concluding the agreement, but on condition that it would lapse if the applicant should predecease the uncle. He further found that the asset had vested in the applicant during the lifetime of his uncle, and hence that the agreement did not constitute a *pactum successorium*.

5.3 *McAlpine v McAlpine*[16]

Facts: Two brothers each owned 50% of the shares in a company. They concluded a contract which provided, amongst other provisions, that in the event of either party's death the other party would get 100% of the shares in the company. The deceased party's shareholding would go to the remaining (surviving) shareholder. There was no provision for a *quid pro quo* for the shares. Upon the death of one of the brothers, the other claimed transfer of his deceased brother's share in accordance with the contract. The executor in the deceased brother's estate (his widow) refused to transfer the shares in accordance with the agreement on the grounds that the particular provision amounted to an invalid *pactum successorium*.

Conclusion: After analysis of the facts it was found that the agreement was subject to a suspensive condition of survivorship as, for either brother to receive a benefit in terms of the agreement, he would have had to outlive the other.

5.4 *Van Aardt v Van Aardt*[17]

Facts: It again involved an agreement between two brothers. The two brothers previously farmed in partnership. During the existence of the partnership they entered into a purchase and sale agreement in terms of which the one brother sold his farms to the other brother, or his descendants. The registration of the farms, as well as the payment of the proceeds, was postponed until the death of the seller. However, the seller, upon dissolution of their partnership, sold his farm to a third party in order to raise capital to enable him to continue farming in his own name. As a result of this sale, in conflict with their agreement, the original purchaser of the farm applied for an interdict against the sale and transfer of the farm to the third party. The success of this application depended on whether or not the contract between the two brothers constituted a *pactum successorium*.

Conclusion: Jones J concluded that by providing for the purchaser of the farms to be either the brother, or his brother's successors in title (descendants), the parties had by necessary implication postponed vesting to the date of the seller's death, which meant that vesting could not have occurred during the lifetime of the selling partner. The only rights that the brother or his descendants acquired on the date of the agreement were contingent in nature. It was held that rights cannot vest in undetermined members of a class, whether or not the undetermined members all belong to a specified group, such as descendants. It meant that an irrevocable *post mortem* disposition of the right to acquire the seller's farms had been agreed upon, hence a prohibited *pactum successorium*.

6. Do the Companies Act and the Close Corporations Act allow for statutory exceptions to the prohibition against *Pacta Successoria*?

6.1 The Companies Act

Section 8 of the Companies Act, 71 of 2008 specifically provides that a company is a private company, only if

"its Memorandum of Incorporation[18]-

(*aa*) prohibits it from offering any of its securities to the public; and

(*bb*) restricts the transferability of its securities."

In section 20 of the previous Companies Act[19] it was stipulated that:

"the expression "private company", means a company having a share capital and which by its articles-

(*a*) Restricts the right to transfer its shares; and

(*b*) . . ."

It should be noted that in the 2008 Act, the restrictions in the Memorandum of Incorporation (hereafter the MOI) must be in respect of "secureties", which is a wider concept than "shares" (1973 Act). The term "securities" include shares in a private company but, in our opinion, not a loan account payable by a private company to a shareholder. "Securities" are defined as "*any shares, debentures or other instruments . . . issued or authorised to be issued by a profit company*". Also, the notion of "transferability" (2008 Act) implicates a much wider scope than "the right to transfer".[20] Clearly these provisions have a very broad application. There are a number of ways in which the transferability of securities can be restricted, for example the recordal of pre-emptive rights in favour of existing security holders, or requiring the directors of a company to approve the transfer of securities. The restriction on the transferability of securities (2008 Act) can seemingly, at the discretion of the functionaries of a private company, be held in the MOI to apply only at a shareholder's demise, or only during their lives, or both. The manner in which these restrictions should apply should be spelled out in the MOI. It seems to be insufficient for a MOI merely to record that the transferability of its securities is restricted.

The Companies Act of 2008 requires a restriction on the transferability of its securities, but does not specify how it should be done. Therefore, if the MOI and or underlying shareholder's agreements are worded in such a manner that the shareholding of a deceased private company shareholder cannot be devolved after their demise in terms of testament, it would be safe to say that it is in line with what the Companies Act allows as a restriction on the transferability of the securities. It is however clear that it is not a requirement to have a restriction at the demise of a shareholder. Although the restriction must be contained in the MOI, it can be elaborated on in a shareholder's agreement or a separate buy-and-sell agreement. The question is, would such a restriction, if applied, constitute a *pactum successorium*, notwithstanding the fact that it has as an originnating cause the MOI, which is allowed by legislation? If the Companies Act requires restrictions on the transferability of the securities of private companies without elaborating on how this should or can happen, can one argue that this can also be effected in a manner that, in terms of age old common law principles, is prohibited? We are of the opinion that it cannot. The MOI and the shareholder's buy-and-sell agreements are merely a series of mutual covenants entered into by all the shareholders *inter se*, which must accord to the Companies Act, but must still be in line with the common law principles where the legislation is silent. We do not think that legislation in the form of the Companies Act afforded a statutory exception to the rule which prohibits *pacta successoria*.

The facts and findings in *Borman v Potgietersrusse Tabakkorporasie* are, in our opinion, important in this regard to indicate that the underlying members' agreements, although being founded in and allowed by statute, can be found to contravene the common law principles. In that case it was found that section 101 of the internal regulations of the farming company, which was registered in terms of the Co-operative Societies Act, 29 of 1939, intended to ensure, by means of contract, how the member's interest fund account, should be devolved at his demise. In terms of section 17(1) of the said Act the internal regulations of the farming company were binding on the company and its members in the same extent as if it had been signed by each member. It was found that section 101 embodied an agreement which deprived a member of the company of his freedom of testation and that the agreement had, accordingly, to be regarded as invalid.

One must also take into account that the requirement of the transferability in private companies is only applicable to their securities, i.e. shares but not loan accounts. So, even if one should succeed to successfully argue that the Companies Act indeed provides for such a statutory exception, it would not encompass restrictions regarding shareholders' loan accounts. Also, agreements limiting the transferability of interests in partnerships at the demise of the partners will obviously not be regulated by the Companies Act.

6.2 The Close Corporations Act, 69 of 1984

In section 35 of this Act, in contrast to the wide ambit allowed for in the Companies Act, specific reference is made to the restriction on the member interest at the demise of a deceased member.

"**35. Disposal of interest of deceased member.**-

Subject to any other arrangement in an association agreement, an executor of the estate of a member of a corporation who is deceased shall, in the performance of his or her duties-

(*a*) cause the deceased member's interest in the corporation to be transferred to a person who qualifies for membership of a corporation in terms of section 29 and is entitled thereto as legatee or heir or under a redistribution agreement, if the remaining member or members of the corporation (if any) consent to the transfer of the member's interest to such person; or

(*b*) . . ."

In this instance the Close Corporations Act has indeed provided a specific statutory exception whereby the member of a CC's freedom of testation is limited. The member cannot bequeath their membership interest to whomever they please.

We agree with the remarks of Prof Hutchinson21 as to why these types of agreements seem to be common cause and are not often overturned by courts or subjected to legal scrutiny:

> "The problem with these agreements is that many of them appear to be ordinary commercial contracts, so that the courts are understandably reluctant to strike them down. What, for example, are the courts to make of a contract in terms of which children agree to look after their elderly parents for the remainder of their lives, in consideration for which they are to be given property after the death of the parents? Or of an agreement between co-owners that the survivor of them is to have the sole use and enjoyment of the entire property for life? Or of an option exercisable only after the death of the offeror? Or of a partnership agreement in terms of which the surviving partner is given the right to continue the business, or to continue occupying the partnership premises, after the death of the first-dying partner? Or of an agreement between a co-operative society and its members that each member will pay an annual levy into a fund administered by the society, the accumulated sum to be paid out on the member's death (if he has not previously withdrawn it) to his widow or the beneficiary in his estate?
>
> . . .
>
> It is quite dear that not all of these agreements are prohibited by law, indeed, were it not for the decision in *Borman's* case, it would be tempting to say that agreements of this type can never fall foul of the rule against *pacta successoria*. But that is not the law."

7. Should a person's freedom of testation indeed be preferred to their freedom to contract - what about the constitutional principles?

The Constitution of the Republic of South Africa22 (the "Constitution") and specifically the Bill of Rights as set out in chapter two of the Constitution, does not expressly guarantee a person's freedom of contract or a person's freedom of testation. However, section 25 of the Constitution does provide, in the negative, that *no-one may be deprived of property except in terms of law of general application, and no law may permit arbitrary deprivation of property*. "Property" in section 25 includes rights which form part of one's bundle of rights which constitutes ownership, including the right to dispose of an asset.23 The conclusion is thus that the constitutional guarantee of the right to property, include the right to freely dispose of the property. Such protection invariably results in the concomitant and implicit guarantee of a person's freedom of testation.

At the same time, freedom of contract is a leading principle of our common law of contract. The Constitution does not infringe on this common law right, but only limits it with the fundamental rights of the Constitution, markedly that of freedom to trade, freedom of association and the right to dignity and equality.

It is clear that a buy-and-sell agreement brings freedom of contract and freedom of testation in direct conflict with each other. There is no persuading argument that a person's freedom of testation should weigh heavier than a person's freedom of contract. On the contrary, as suggested by Rautenbach, these two freedoms should stand on equal ground and it should be up to a person to decide which freedom he wishes to exercise.24

Section 36(1) of the Constitution provides that a right may be limited only *if the limitation is reasonable and justifiable in an open and democratic society based on human dignity, equality and freedom, and by taking into account all relevant factors*.25

Section 8(3) further provides that a court must apply the common law where legislation does not give effect to that right. Our common law prescribes that when a contract is *contra bones mores* or against public policy, it cannot be validated. But at the same time public policy should properly take into account the doing of simple justice between man and man.26 South African law already acknowledges two instances of *pacta successoria* as valid, namely the *donatio mortis causa*27 and a *pactum successorium* in an ante-nuptial contract drawn up in terms of the Matrimonial Property Act, 88 of 1984 and which complies with the formalities of section 87 of the Deeds Registries Act, 47 of 1937.28 It is submitted that there is a need to develop the common law and enact legislation which will prescribe formalities for buy-and-sell agreements to be valid. Indeed, one cannot allow dogma to override common sense.29 Such legislation shall ensure that simple justice is done between man and man.

8. Commentaries

In an article by Gerald Peters titled, "Are Buy and Sell Agreements *Pactum Successorium*?", the author does deal with both the cases of *Van Aardt v Van Aardt* and *McAlpine v McAlpine* and concluded from these cases that buy-and-sell agreements (or provisions) are *pacta successoria*. Mr Peters went on to suggest that shareholders should rather bequeath their shares to one another subject to a bequest price. One must remember that certainty and enforceability are the two things that shareholders try to achieve with a buy-and-sell agreement. If the disposal of the shares is to be regulated in a Last Will and Testament, the other shareholders would always be in doubt since the testator/shareholder could amend his Will at any time during his lifetime. This would not present them with an elegant solution which offers the required certainty and enforceability, and hence we cannot endorse this as a workable solution.

Van Gijsen and Van Vuren also recently published an article titled "*Defining buy-and-sell agreements in the light of the prohibition against pacta successoria*".30 The authors argue, as we understand it, that a buy-and-sell agreement has as its intention the conclusion of a valid sale, but that it is not in itself an agreement of sale. It allegedly provides the parties to it with reciprocal rights and obligations which they suggest should be labelled a "*slightly unusual form of option agreement*". They suggest that it is an agreement where all parties acquire both rights and obligations, i.e. an agreement both to buy and to sell, unlike the normal option contract where only one party is obligated to a performance and the other acquires only a right. They however acknowledge that the sale agreements between

the shareholders, although separate agreements from the buy-and-sell agreement, are inextricably part and parcel of the contractual arrangements between the parties. They agree that these separate sale and purchase agreements are made subject to the condition of survivorship. This condition of survivorship is an unfulfilled suspensive condition in respect of the sale and no sale has as yet taken place. So, they agree that vesting with reference to the shares (the promised item) are postponed because of this condition of survivorship, but explain as follows when confronted with the "vesting test" which has been accepted in our courts to be applied when required to determine whether an agreement constitutes a *pactum successorium*:

> "what vested are not rights which entitle the parties to the agreement to any rights in the shares that form the subject matter of the eventual sale. Rather, what vested are the rights to claim performance from one another in terms of the provisions of the buy-and-sell agreement." (Our emphasis.)

In other words, they argue that the rights and obligations emanating from the distinct buy-and-sell agreement affords the contracting parties the vested rights which would satisfy the vesting test as laid down in our courts.

9. Our opinion

With respect, we cannot agree with the approach followed by Van Gijsen and Van Vuren.

We could not determine authority for the averment that a buy-and-sell agreement does not constitute an agreement of sale and that it should be labelled as an option agreement. An option agreement essentially provides the holder of the right with a choice whether to enforce the agreed upon right or not. An option is an irrevocable offer which, when accepted, becomes a binding contract.31 A buy-and-sell agreement in turn essentially purports to bind the parties to buy the shares of a deceased shareholder and leave the surviving shareholders with no choice thereto. In our opinion, if you transform or curb the holder's right of choice to such an extent that he is indeed contractually bound to it, the essence of an option agreement is lost.

We can also not agree with the application of the vesting test, as suggested by those commentators. The vesting test as applied by the courts always commences with a consideration of the nature of the owners' rights *vis-à-vis* the promised item. One cannot divorce the vesting test from the promised item. The reality is that the buy-and-sell agreement restrains the shareholder's freedom of testation with reference to the promised item, i.e. the shares. The sale of those shares is subject to the condition of survivorship and vesting *vis-à-vis* that promised item is indeed postponed, and in terms of the common law that falls squarely within the ambit of the rules governing *pacta successoria*.

The sentiments and pleas of all the commentators in favour of the validity of buy-and-sell agreements do indeed resonate positively with us and we are also of the opinion that buy-and-sell agreements amongst individuals who enjoy freedom to contract should not lack the full protection of the law. These sentiments are, however, emotionally driven and seem to stem from the acknowledged fact that these types of agreements are well known and well used in our commercial world, but we are of the opinion that when applying the accepted common law principles, we must accept that buy-and-sell agreements as we know it, do constitute agreements which can be categorised as *pacta successoria* and may fall foul when scrutinised by our courts.

Our courts still seem to cling dearly to the principle of freedom of testation, and, when required to scrutinise such agreements, will probably not uphold agreements which infringe that principle.

A solution to this conundrum probably only resides in legislative changes to be effected on this matter, or a court declaring that the freedom of testation is not preferential in all circumstances to the freedom to contract. Buy-and-sell agreements are commercially useful agreements and serve a need in our modern society. It is thus submitted that the legislator should enact legislation with formality requirements similar to the Deeds Registries Act, 47 of 1937 in order to regulate and validate buy-and-sell agreements.

There are indeed statutory regulations governing the succession of retirement funds of a person, or the life insurance proceeds emanating from a policy on the life of a person. The Pension Funds Act indeed allows the trustees of the accumulated funds to allow funds to be devolved upon the dependants of the deceased member and the owner cannot dictate this in their Will. Clearly these regulations impinge on the person's right to bequeath his accumulated retirement funds. Surely the legislation was promulgated with the person's greater good in mind, but also for the benefit of the country which would otherwise had to take care of that person's well-being.

10. Repercussions in the meantime

The *pactum successorium* is still part of our law and the Supreme Court of Appeal has accepted the vesting test on more than one occasion. Clearly the current state of affairs is untenable for business partners who wish to arrange for the contractual sale of their business interest upon their death, considering that the primary object of the agreement is to have certainty that the sale will take place at death.

When one considers the legal position as depicted in this article, the only logical conclusion to guarantee an enforceable buy-and-sell arrangement of business interests between two or more business partners, is to ensure that the agreement complies with the vesting test. This entails that the purchaser must acquire vested rights to the promised item at the conclusion of the agreement. The contracting parties can, of course, encompass resolutive conditions in the agreement which relates to the death of a business partner. This will mean that the contract is immediately binding after the parties thereto have signed it, and will remain binding subject to the future event stipulated in the condition being fulfilled.

If an agreement to sell is concluded in the manner described above and the disposing shareholder has been divested of the promised item, they might become liable for Capital Gains Tax (CGT) when such divesting takes place.

We agree that this is not the legal position which commercial business partners would aspire to be in.

Consider the following scenarios.

Scenario 1

Mr A agrees to sell his business interest to Mr B upon Mr A's death (one sided buy-and-sell agreement) at a determinable amount (e.g. equal to the proceeds from a policy). The business interest will only be transferred to Mr B when Mr A dies. It is certain that Mr A will die, but uncertain when, and therefore the term is suspensive in nature. Accordingly, vesting will take place prior to death since the term will be fulfilled. The possibility that Mr B can predecease Mr A should not be leveraged as a suspensive condition of the agreement (i.e. a condition of survivorship), as this will result in vesting taking place only at the demise of Mr A.

The facts in this scenario can be distinguished from the facts in the *Van Aardt* case since the purchaser will clearly be Mr B. In *Van Aardt's* case the identity of the purchaser was not certain, since it may have been the purchaser or his descendants.

Since most buy-and-sell agreements comprise reciprocal agreements, it is concerned with the earlier death of A or B, albeit as seller or purchaser. One can always conclude two free-standing one-sided agreements to try to circumvent this condition of survivorship, but it is unlikely that one will be successful with such an approach, since it could be argued that there cannot be certainty that the seller will be survived by the purchaser. Furthermore, the true intention of the two free-standing contracts could be read as one, since the overriding intention of the parties is to purchase the business interest of the survivor, which remains uncertain. A court will have regard to the true nature of the agreements and disregard the description given to it by the business partners.

Also, because there was an *inter vivos* disposal, capital gains tax will become leviable from the disposer at time of divesting of the asset (assuming the business interest has increased in value), as the vesting of an asset is also defined as a disposal for CGT purposes.

Scenario 2

In terms of an agreement, Mr A disposes of the shares held by him to the surviving business partners (shareholders) to be transferred to them at the date of his death, at a market related price to be determined by the auditor of the company at that stage, but should Mr A NOT be the first-dying shareholder, then this agreement shall lapse. Two similar contracts are then to be drafted for the two business partners (shareholders).

Since the sale of the business interest takes place *inter vivos*, a binding contract comes into being, but subject to a resolutive condition. A resolutive condition creates vesting rights during the lifetime of a business partner. The vesting of rights occur prior to death and therefore it cannot be said that the agreement is suspensive since the death of a business partner is not a condition to the agreement. The only uncertainty is the purchase price but this uncertainty does not relate to the identity of the purchasers and sellers, but the price, which can be quantified upon the happening of the uncertain event.

Because there was an *inter vivos* disposal, CGT will again need to be considered. Because of the fact that the consideration for the business interest is unquantifiable, section 24M might provide some respite from CGT in this instance. Section 24M(1)[32] applies when a person disposes of an asset for a consideration, all or part of which cannot be quantified in that year of assessment. Under general principles the proceeds from such a sale of an asset would accrue to the seller in the year of sale irrespective of arrangements regarding the payment of the proceeds. This can bring about cash flow difficulties if the disposer needs to pay the CGT without having received the proceeds to pay it from. Section 24M is aimed at alleviating the cash flow difficulties that may be experienced by the disposer. It does this by deferring the accrual of the purchase price in the disposer's hands to the extent and until the amounts become due and payable. It is suggested that the agreement makes provision for a valuation method that will apply in the event of the death of a business partner.

Such an arrangement brings about much certainty, which is important. But also, such certainty creates other rights and obligations. From a legal perspective, ownership is transferred and how will such ownership be viewed in a divorce or insolvency matter? In particular, who will be entitled to the dividends and voting rights, aspects that are inherent to the rights of a shareholder?

Estate duty questions also arise, but seem less problematic. The estate of a person consists of all property of such person as at the date of his death. Where the deceased sold property during his lifetime, but it has not been delivered or transferred at the date of his death, such property is also part of his estate and must be valued at fair market value, with the contractual obligation to transfer as a liability. Any claim that the deceased was obliged to transfer, is a debt due for purposes of estate duty.[33]

Policies effected on the lives of co-business partners are exempt from deemed property in terms of section 3(3)(*a*)(iA) of the Estate Duty Act, provided certain requirements are met.

Two considerations are of importance. The purpose of the life policy must be to acquire the shareholding of the deceased at the date of death of the deceased. The purpose requirement relates to the time at which the policy is taken out or acquired. Whether Mr A was the owner of his business interest prior to the sale, or the owner of Mr B's shares after the sale, is immaterial. The purpose remains the same, namely to purchase the shares of the deceased. In particular, where life policies were effected prior to the sale agreement for purposes of acquiring the shares of a deceased, it will still qualify for the exclusion since the object of the sale may have changed, but not the purpose.

It is also required that a policy must be taken out by a person, who at the date of death of the deceased was a business partner of the deceased. Since the business partners are co-business partners at the date of death, albeit it as seller or purchaser, the fact remains that they are business partners at the date of death and the requirement is fulfilled.

11. Final remarks

There is no doubt that creative drafting is not easily going to solve the problem satisfactorily. From the arguments presented, including those of the authors cited in this article, it cannot be said that certainty will exist, irrespective the method of contractually structuring a buy-and-sell agreement. We will be hesitant to legally endorse any form of structuring a buy-and-sell agreement because of the prohibition against *pacta successoria* and the concomitant uncertainties.

There exists a real need to legally regulate commercial contracts in anticipation of death. Also considering that many buy-and-sell agreements are in use as a solution to succession planning, it is perhaps time for the legislator to intervene and bring certainty in respect of existing and future agreements.

Disclaimer

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Footnotes

1 1997 1 All SA 264 (A).
2 *McAlpine v McAlpine* 1997 (1) SA 736 (SCA) at 268.
3 1976 4 All SA 18 (A) at 23.
4 *Ex parte Calderwood: In re Estate Wixley* 1981 4 All SA 389 (Z) at 397.
5 *Law of South Africa* Volume 31 Second Edition Volume at 396.
6 *Insurance and Tax;* Vol 3; September 2015; page 3.
7 *Schauer NO v Schauer* 1967 (3) SA 615 (W).
8 *Isolating the Pactum Successorium* (1983) 100 SALJ 223.
9 *Jubelius v Griesel NO en Andere* 1988 (2) SA 610 (C).
10 *Van Aardt v Van Aardt* 2007 (1) SA 5 (E).
11 1997 (1) SA 736 (SCA) at 270.
12 *Die pactum successorium: stiefkind van die Suid-Afrikaanse reg*; Koers 64 (2 & 3) 1999; 357-377.
13 Corbett for example went to considerable trouble to discuss the concept of "vesting" in approximately 200 pages in the 1980

edition of his book "*The Law of Succession in South Africa*"; Corbett, Hahlo, Hofmeyer and Kahn; Juta and Co Ltd; 1980.

14 *Borman en De Vos NNO en 'n Ander v Potgietersrusse Tabakkorporasie Bpk en 'n Ander* 1976 (3) SA 488 (A).

15 *Jubelius v Griesel NO en Andere* 1988 (2) SA 610 (C).

16 *McAlpine - supra.*

17 *Van Aardt - supra*.

18 "*Memorandum of Incorporation*" is defined in section 1 of the Companies Act, 2008, as "*the document that sets out rights, duties and responsibilities of shareholders, directors and others within and in relation to a company, and other matters as contemplated in section 15*".

19 Act 61 of 1973.

20 *Henochsberg on the Companies Act, 71 of 2008*, commentary on section 8 of the 2008 Act.

21 Isolating the *Pactum Successorium* (1983) 100 SALJ 223.

22 Act 108 of 1996.

23 De Waal, Currie and Erasmus *The Bill of Rights Handbook* 403-405.

24 *Rautenbach* 1998 THRHR 654-655.

25 Including the nature of the right, the importance of the purpose of the limitation, the nature and extent of the limitation, the relation between the limitation and its purpose and any less restrictive means to achieve the purpose.

26 *Barkhuizen v Napier* (CCT72/05) [2007] ZACC 5, Ncobo J at paragraph 159.

27 A donation in contemplation of the death of the donor.

28 The Deeds Registries Act requires an ante-nuptial contract executed in the Republic to be attested by a notary and shall be registered in a deeds registry within three months after the date of its execution or within such extended period as the court may on application allow.

29 *Hutchinson* 1983 SALJ 238.

30 *Supra*.

31 *Grey Global v Khumalo* (725/100 [2011] ZASCA 161 (28 September 2011).

32 Income Tax Act, 58 of 1962.

33 Meyerowitz on Administration of Estates and their Taxation, 2010 Edition, paragraph 27.21 and 28.4.