SCZ Judgment No. 5 of 2013 **(76)**

IN THE SUPREME COURT FOR ZAMBIA **APPEAL NO. 174/2010**
HELD AT LUSAKA **SCZ/8/202/2010**
(Civil Jurisdiction)

IN THE MATTER OF: THE INTERPRETATION OF THE SHAREHOLDERS AGREEMENTS EXECUTED BY AND BETWEEN THE APPELLANT AND THE RESPONDENTS HEREIN CONCERNING NECOR ZAMBIA LIMITED AND APPLICATIONS SOLUTIONS ZAMBIA LIMITED;

AND

IN THE MATTER OF: THE INTERPRETATION OF THE ARTICLES OF ASSOCIATION OF NECOR ZAMBIA LIMITED AND APPLICATION SOLUTIONS ZAMBIA LIMITED

AND

IN THE MATTER BETWEEN:

FRIDAY MWAMBA **Appellant**

AND

SYLVESTER NTHENGE **1st Respondent**
MONICA KAPING'A **2nd Respondent**
DERRICK CHEKWE **3rd Respondent**

CORAM: Mumba, Ag/DCJ, Chibomba and Wanki JJS
On 26th June, 2012 and 17th May 2013

FOR THE APPELLANT: Mr. M. Musonda of Messrs. M. Musonda & Co.

FOR THE RESPONDENTS: Mr. Nchima Nchito and Mr. Isaac Chewe of Nchito and Nchito Advocates

---

JUDGMENT

---

(77)

Mumba, Ag/DCJ, delivered the Judgment of the Court.

Legislation referred to:

1. *The Companies Act, Cap. 388 of the Laws of Zambia*

Cases referred to:

1. *Printing and Numerical Registered Company Vs. Simpson (1875) LR19 Eq 462*
2. *National Drug Company Limited and Zambia Privatization Agency v. Mary Katongo Appeal No. 79/2001*

Works referred to:

1. *Graham Steadman and Janet Jones:- Shareholders Agreements, 3rd edition, 1998*
2. *John Farrar: Farra's Company Law 1998*
3. *Company Law Handbook, by Prof. Steven Griffin, 2nd edition, 2010*
4. *Chitty on Contracts General Principles, Vol. 1, 20th edition*
5. *Kim Lewison: The Interpretation of Contracts, 1997, 2nd edition*
6. *Palmer's Company Law Manual 2000 edition.*
7. *Evan Mckedrick's Contract Law, 3rd Edition*

This is an appeal against the judgment of the High Court delivered on 26th August, 2010. This appeal is about the interpretation of Shareholders Agreements executed by the appellant and the respondents regarding the management of two companies, NECOR (Z) Limited and Application Solutions (Z) Limited, both registered in Zambia.

The trial court summarized that the dispute was about the interpretation of two similar Shareholders' Agreements executed by

and between the shareholders concerning the two companies aforementioned. The relevant clauses of the Shareholders'

Agreements which were similar for both companies in question and, which, in this Judgment will be referred to as Common Clauses, read as follows:

"8.0.0 DIRECTORS OF THE COMPANY

8.1.0 The parties shall procure that, in so far as it lies within their respective powers to do so the Directors shall be appointed in accordance with the provisions of this Agreement and the Board shall be composed in accordance with all applicable legislation and regulations.

8.1.1 The Board shall be responsible for the management of the Company and shall consist of at least three (3) Directors subject to a maximum of six (6) (or such greater number as the Company in general meeting shall determine).

8.1.2 A shareholder with Ten or more per centum holding shall be entitled to a

seat on the Board of Directors. One of the directors

(79)

shall be appointed Executive Director of the company by the board of directors.

8.2.0 If the total number of issued shares in the company are increased pursuant to the establishment of a share incentive or similar scheme or pursuant to the listing of the shares in the company on a stock exchange, such additional shares shall be disregarded for the purposes of determining the entitlement to nominate directors described in clause 8.1.2.

8.3.0 Each director of the company shall be entitled on notice to the company to appoint an alternate director to act during his absence…"

In construing these common clauses as to eligibility for the status of director in the two companies concerned, the court below referred to the law on Shareholders Agreements and to that on the interpretation of contracts.

For purposes of this appeal, it is helpful to give a brief overview of the events leading to these proceedings, according to the evidence on record. The shareholding between the parties was that the 1st, 2nd and 3rd respondents held 48.5%, 1.5 % and 1.5% shares

(80)

respectively, whereas the appellant held 48.5% in **NECOR (Z)** Limited, whereas **NECOR (Z)** Limited held a 51% share interest in Application Solutions (Z) Limited. The appellant held 17.82%, 2nd respondent held 0.18%, the 3rd respondent also held 0.18% whereas the 1st respondent held 17.82% in Application Solutions (Z) Limited. There were other minority shareholders in the two companies concerned but they are not parties to this appeal.

From the evidence on record, the dispute arose when the annual general meeting for the two companies concerned was convened after a High Court order and after the parties agreed to adjourn in order to resolve the question of appointment of directors to the boards of the two companies. The two Shareholders Agreements which were due for interpretation in the trial court were signed by all the shareholders and their witnesses. The relevant common clauses of the Shareholders' Agreements were 8.1.2 and 8.2.0 as quoted above, they hinge on the status of director for the two companies.

After analyzing the evidence on record, the trial court found that the Shareholders' Agreements were valid and were binding

on the parties. The trial court also held that whereas the shareholding of 10% or more entitled a member to sit on the board of directors, the said Agreements did not exclude those holding less than 10% shares from sitting on the Board through nomination according to

(81)

the articles of association as well as the provisions of company law which allow shareholders to nominate or appoint directors in the normal manner. The trial court differentiated the entitlement to sit on the board from the right to be nominated to sit on the board in the normal provisions of the law. In effect, the judgment of the trial court meant that apart from the shareholders with 10% or more shareholding, those with less than 10% or more shareholding could also sit on the board of directors if nominated at a members' meeting to sit on the board and could also nominate directors for the board. The appellant disagreed with the trial court's interpretation of the common clauses of the Shareholders' Agreements, hence the appeal. There were seven grounds of appeal, as follows:

"1. The learned Judge in the court below erred when he interpreted Clause 8.1.2. of the Shareholders' Agreements whose interpretation was the subject matter of the application before him as

conveying the meaning that '… *a shareholder with ten or more per centum holding [had] the undisputed right to a seat on the board of directors [of the 2nd and 3rd respondent companies]. REGARDLESS (emphasis supplied) of the history leading to the formation of*

(82)

***the companies [in question] and [the] execution of the Shareholders Agreement"* when, in fact it was the subject of Shareholders' Agreements in question that had made the 10% or more shareholding threshold prescription condition precedent to entitlement to a seat on the Board of Directors of the companies in question.**

2. **The learned Judge in the Court below misdirected himself in law and in fact when he took the view, relying on the Applicants' Counsel's speculative contention from the Bar, that *"I agree with counsel for the Applicants that clause 8.2.0 was included to protect the rights of the initial shareholders with a ten percent or more stake in the two companies to a seat on the Board [of***

directors] in the event that they lost such a stake on account of a dilution in their shareholding" **when no appropriate or relevant evidence of any nature had been deployed before the learned Judge to warrant or justify his Lordship's said view.**

3. **The learned Judge in the court below erred and misdirected himself in law when he held as *"untenable"*, counsel for the 1st respondent's**

(83)

argument that clause 8.2.0 of the Shareholders' Agreements in question extended the meaning of Clause 8.1.2 so as to have the meaning of the phrase, *"entitlement to a seat on the board"* include "*entitlement to nominate directors to the board"* without assigning any reason for taking his aforesaid view or holding.

4. **The learned Judge erred and misdirected himself in law when, having regard to the general theme of his judgment, he took the apparently contradictory view that "*the right to a seat on the board by virtue of a ten per centum or more holding is unassailable"* when the converse of the**

said view (which is inconsistent with his Lordship's judgment) is that if a shareholder held less than ten per centum shareholding, their right to seat on the board was *assailable.*

5. The learned Judge in the Court below erred in law and misdirected himself when he took the view that *"the right to nominate any person to serve as director IS (emphasis added) the preserve of the members of the Companies and, as counsel for the Applicants has*

(84)

correctly pointed out, is done by ordinary resolution
***in a general meeting"* which view negated the very raison d'tre for the execution of the Shareholders' Agreements in question.**

6. The learned Judge in the Court below erred when he (apparently) took the clearly erroneous view that the Shareholders' Agreements in question did not operate or serve to alter the rights which, without the said agreements, would have been otherwise or ordinarily available to the shareholders who held less than ten per centum shares in the companies in question.

7. **The learned Judge in the Court below erred in law when he failed to find and hold that as the Applicants and the 1st respondent had, by their own conduct subsequent to the execution of the Shareholders' Agreements, interpreted or given such effect or meaning to the Shareholders' Agreements as suggested that the 2nd and 3rd Applicants had been excluded from being appointed as directors, none of them could be allowed to back on their own interpretation."**

(85)

We do not find it necessary to discuss the grounds of appeal *seriatim* because we have come to the conclusion that in this appeal

issues for determination are limited to the common clauses of the Shareholders' Agreements, in particular, clauses 8.1.2 and 8.2.0.

The gist of the appellant's submissions is that the Shareholders Agreements excluded shareholders with less than 10% shareholding from the status of director whereas those with 10% or more shareholding, qualified as directors of the board, and could also nominate other persons to sit on the board.

In responding to the appeal, the respondents submitted that the trial court correctly interpreted the common clauses in both agreements as well as the law and came to the correct conclusion, that is, that those shareholders with less than 10% shareholding could also qualify for the board by way of articles of association as well as provisions of company law which entitles members of the companies concerned to nominate or appoint directors to the board at a members' meeting.

We are grateful to Counsel for their submissions and the authorities cited. As we have indicated, this appeal is centered on the interpretation of the common clauses in the Shareholders' Agreements.

(86)

In our view, the common clauses, that is, 8.1.2 in both Shareholders' Agreements created two classes of shareholders; those shareholders with 10% or more and those with less. As is common practice in many companies, directors for the board need not be shareholders. Qualifications for the board, in the relevant sections of the Companies Act, do allow non-shareholders to be appointed to the board of a company provided that such appointees or nominees meet qualifications spelt out in those relevant sections. In this appeal, the parties decided to place qualifications for those who can sit on the board of the two companies by executing the two Shareholders' Agreements. The parties understood the purpose of the agreements because they

already knew the existing provisions of company law as well as the provisions in the articles of association of the two companies concerned. Clauses 2.1.9 and 2.1.10 in NECOR (Z) Limited and Application Solutions (Z) Limited respectively, reads as follows:

> ***"any reference to the agreement or consent of the parties or the shareholders shall mean their unanimous agreement or consent".***

This Clause appears in part 1 in the interpretation section of both Shareholders Agreements. Further, Clause 5.2.0 read as follows:

(87)

> ***"Without detracting from the provisions of this agreement, to the extent that the provisions of the agreement may conflict with the provisions of the company's articles of association or other charter documents or any prior agreement between the shareholders regarding the subject matter of this agreement, the provisions of this agreement shall take precedence and shall be given effect to accordingly by the shareholders to the extent that it is legally possible"***

It goes without saying that the Shareholders Agreements in this appeal were meant to regulate the way the two companies were going to be managed. Articles of association were thus varied by these unanimous and voluntary agreements.

The two agreements were designed to specifically deal with the circumstances of the two companies which required a particular type of management to run them. In the class of shareholders, these agreements created two classes, those with 10% or more and those with less than 10% shares. It follows that those who could sit on the board could also nominate others who could sit on the board. Similarly, those who could not sit on the board could also not nominate anyone to sit on the board. On account of this distinction, those not eligible were not expected, as such, in terms

(88)

of status and entitlement, to sit on the board. It would be absurd to allow those who were not entitled to sit on the board, *ab initio*, to nominate directors to sit on the board. We hold that the learned trial judge misdirected himself when he held that even those with less than 10% share holding could be nominated to the board.

In considering the nature and effect of Shareholders Agreements, Counsel for the appellant referred us to ***Graham Steadman and Janet Jones***[(1)] in their text, at page 58, thus, ***"a shareholder agreement is a contract between persons who***

are parties to it and is enforceable in accordance with normal contractual principles". By the same authors, shareholders agreements are described as useful in conferring rights on shareholders, which rights would not be enforceable if contained in the articles of association.

At the hearing, Mr. Nchito, learned Counsel for the respondents, submitted that he was in agreement with the law on shareholders agreements as stated in the appellant's written heads of argument. Suffice to say that acceptance of the submissions on the law makes the work of the court much easier in determining whether or not a correct interpretation of the Shareholders Agreements in question was pronounced by the trial court. We have examined the authorities cited on behalf of the appellant in the written heads of argument and we have concluded that the law

(89)

regarding shareholders agreements has been correctly stated. In particular, a citation in ***Farrar's Company Law***[2] to the effect that;

> ***"Since 1856, the Companies Acts have provided for a constitution in the form of memorandum and articles of association. The proprietors of a company***

sometimes wish to supplement these for a variety of reasons. Although they value the limitation of personal liability as regards the outside world, they [may] wish to agree among themselves how risk, profit and control shall ultimately be distributed (emphasis supplied).[one] of their reasons [for] supplementation [would be that] it may be felt, in the case of an incorporated …company that the

statutory form provides an inadequate record of their understanding. Some additional agreement [would be] necessary to deal with the composition of the board, removal of directors [etc]…"

is precise as the facts in this case show.

Moreover, the learned author continues to explain that methods used to supplement articles of association through shareholders agreements have been in form of those agreements

(90)

between all shareholders relating to participation in management, a right to be bought out, etc. Thus, it is clear that shareholders themselves can decide the manner in which their companies may be managed or controlled.

Further, **Prof. Steven Griffin** [(3)] has stated, thus;

"in addition to those terms of a company's articles which purport to regulate the relationship of members inter se, the shareholders of a company may lawfully bind themselves by way of an independent membership agreement (a contractual agreement) to act or vote in a specific way on issues governed by the terms of the agreement…The agreement seeks to regulate matters of internal management with the effect that members who are a party to the agreement must act and vote on specific issues in a predetermined way…In the case Russell v Northern Bank Development Corporation Limited [1992] 1 WLR 588, the House of Lords upheld the validity of a membership agreement by which all five (current) members of the company were bound. In that case, the company's five shareholders agreed to refrain from voting to increase the company's share capital, save in a situation where all parties consented in writing to the increase. Subsequently, as the company's circumstances changed, four of the members proposed

(91)

that the company should increase its issued share capital. However, the fifth member challenged the proposal in so far as it contradicted the terms of the membership agreement. The House of Lords held the

agreement to be binding as it was separate and distinct from the company's articles and was of a personal nature".

It is clear therefore, that shareholders can contract amongst themselves through a shareholder agreement to specify certain entitlements or obligations as the case may be. Such shareholders' agreements will be personally binding on each shareholder who has executed the same, courts will honour such agreements.

In this appeal, shareholders bound themselves to those Shareholders Agreements which determine the level of shareholding for purposes of directorship on the board. It follows therefore that all the shareholders in the companies concerned understood that those holding less than 10% shareholding could not sit on the board and could not nominate anyone to sit on the board. Other persons who were not shareholders with less than 10% shareholding in the two companies concerned, could be nominated to sit on the board if they qualified according to the provisions of the law and if they were nominated by the shareholders holding 10% or more shareholding. It follows that persons who are not

shareholders have no shareholding impediment unlike the shareholders with less than 10% shareholding. We agree with the submission by Mr. Musonda, that these Agreements provided for one process only for purposes of constituting the boards of the companies concerned.

The ***Companies Act***, Section 206 (13) provides for replacement of directors out of office. For the two companies concerned, this is open only to those shareholders with 10% or more shareholding. The restriction to entitlement and nomination to the board to those with 10% or more shareholding was the chosen mode of control of the two companies concerned by the shareholders themselves.

It follows from this text that the normal rules in the construction of contracts apply as stated in the respondents' written submissions, when referring to ***Chitty on Contracts***[(4)] at paragraph 12 to 40, that words should be given their natural meaning and that the intentions of the parties may be gleaned from the surrounding circumstances. In particular counsel for the respondents relied on the paragraph which reads as follows:

> ***"The cardinal presumption is that the parties have intended what they infact said, so that their words must be construed as they stand. That is to say, the meaning of the document or a part of it is to be sought in the document itself: one must consider the meaning of the***

(93)

words used, not what one may guess to be the intention of the parties. However, no contract is made in a vacuum. In construing a document, the court may resolve the ambiguity by looking at its commercial purpose and the factual background against which it was made."

On the other hand, the appellant also cited **Kim Lewison**[5] who stated as follows:

"In construing any written agreement the court is entitled to look at evidence of the objective factual background known to the parties at or before the date of the contract, including evidence of the "genesis" and objectively the "aim" of the transaction. However, this does not entitle the court to look at evidence of the parties' subjective intentions."

It is therefore clear that the factual background leading to the execution of these Agreements is an important part when considering the meaning of the Agreements as it has been repeatedly stated that an agreement is not made in a vacuum.

In ***Palmer's Company Law Manual*** [(6)] shareholders agreements are discussed. It is stated that shareholders

(94)

agreements are accepted as being capable of departing from articles of association in the manner directors are appointed and, or, in the management of a company.

In this appeal, Shareholders Agreements were voluntary and unanimous. All shareholders agreed to sign the Agreements which are now binding on them personally, *inter se* and which must be interpreted according to the principles on interpretation of contracts.

The law of contract regarding contracts entered into voluntarily by legal persons, has been honoured since time immemorial.

In ***Printing and Numerical Registered Company Vs. Simpson*** [(1)]**,** it was decided that:

> ***"…if there is one thing more than another which Public Policy require, it is that men of full age and competent understanding shall have the utmost liberty in contracting and that their contract when entered into freely and voluntarily shall be held sacred and shall be enforced by courts of justice."***

(95)

In recent times, this court has held, in ***National Drug Company Limited and Zambia Privatization Agency v. Mary Katongo*** [(2)], that,

> ***"It is trite law that once the parties have voluntarily and freely entered into a legal contract, they become bound to abide by the terms of the contract and that the role of the Court is to give efficacy to the contract when one party has breached it by respecting, upholding and enforcing the contract".***

In this appeal, it is apt to quote **Evan Mckedrick's** ***Contract Law,*** [(7)] at page 3, that:

> ***"The Law of contract is perceived as a set of power conferring rules which enable individuals to enter into agreement of their own choice on their own terms. Freedom of contract and sanctity of contract are the dominant ideologies. Parties should be as free as possible to make agreements on their own terms without the interference of the courts or parliament and their agreements should be respected, upheld and enforced by the courts".***

(96)

One can therefore see that where eligible persons voluntarily and unanimously enter into a contract, the contract will be personally binding and will be honoured by the courts except where there is a legal impediment. In this appeal, parties to the said shareholders agreements were unanimous. We assume, as there was no evidence to the contrary, that parties understood the implications of the Agreements to which they appended their signatures. As parties sign contracts consciously they cannot say that what was agreed upon has become untenable or unconscionable, the courts can only offer equitable intervention. In this appeal, facts do not permit such intervention.

The historical facts known to the parties in this appeal is that those holding less than 10% shares had no business nominating anyone to sit on the board of either NECOR (Z) Limited or Application Solutions (Z) Limited. Those were the circumstances surrounding the execution of the Shareholders Agreements. The evidence on record also shows that through the incorporation of NECOR (Z) Limited and Application Solution (Z) Limited, the appellant and the 1st respondent have constituted a board and have also nominated members of the board. The 2nd and 3rd respondents did not hold 10% shares and no evidence was adduced by them of having nominated any board member previously. A memorandum dated 1st November, 2006, exhibited

as **“FM1”** in the Affidavit in Opposition to the Originating Summons, is telling. Exhibit **“FM1”**

(97)

on page 135 of the record was written by the 1st respondent to the appellant. The memorandum reflected members of the board of directors for NECOR (Z) Limited. It also discussed the proposals to nominate other members of the board. This discussion was between the appellant and the 1st respondent, members who held more than 10% shares.

For clarity, exhibit **“FM1”** is reproduced herein;

“To: Friday Mwamba

From: Sylvester Nthenge

Date: 1st November, 2006

Before tomorrow’s meeting, I would like us to discuss following issues on a-one-to-one basis. I suggest we met today if possible at 16:00 hrs. or tomorrow 9.00 hrs. whichever is convenient for you:-

NECOR BOD composition in readiness for AGM 2/11/2006

Current composition:

- ***Abel Mkandawire (Chairman)***
- ***Friday S. Mwamba (Member)***
- ***Sylvester Nthenge (Member)***

- ***Basil Nundwe (Member)***
- ***Jonathan Mainga (Member)***
- ***Jonardhan Lavu (Secretary)***

(98)

It is my wish that the BOD reflects the shareholding of each one of us all. In this regard I propose that I nominate 2 people and you propose 2 people to the new board.

1. ***<u>Operational issues</u>***

   I need us to discuss following:-

   EDC's Shareholding issue

- ***HoF appointment***
- ***SD's appointment***
- ***Necor Data***
- ***NECOR audited accounts***

2. ***<u>Any other matter you may have</u>***

   You had raised some issue in various email correspondences with me. We may discuss these if you wish.

Thanks

<u>(signed)</u>

Sylvester Nthenge”

We have made this pertinent observation and cited the relevant texts and submissions by the parties to demonstrate that

(99)

the parties do agree on the law regarding contracts. The bone of contention is the applicability of the Shareholders Agreements to the operations of the companies concerned. As it has been accepted that the factual background forms an integral part of the interpretation of an agreement, exhibit **“FM1”** is evidence of the factual background on how the companies concerned were run. It follows therefore, that the minority shareholders cannot be nominated to the board.

In this appeal, the shareholders themselves decided through their agreements to vary the manner in which directors of the board would be appointed, that was perfectly legal. Clause 8.1.2 means exactly what it says, that only members with 10 or more per centum shareholding may sit on the board of directors. Clause 8.2.0 simply protects those shareholders with 10 or more per centum shareholding from losing their entitlement. This clause completes a factual expectation of those entitled to sit on the board of directors as prescribed in Clause 8.1.2, notwithstanding the changes that may occur in terms of shareholding.

The appeal succeeds. Costs follow the event, to be taxed if not agreed.

.....
F.N.M. MUMBA
ACTING DEPUTY CHIEF JUSTICE

(100)

.....	.....
H. CHIBOMBA	**M.E. WANKI**
SUPREME COURT JUDGE	**SUPREME COURT JUDGE**