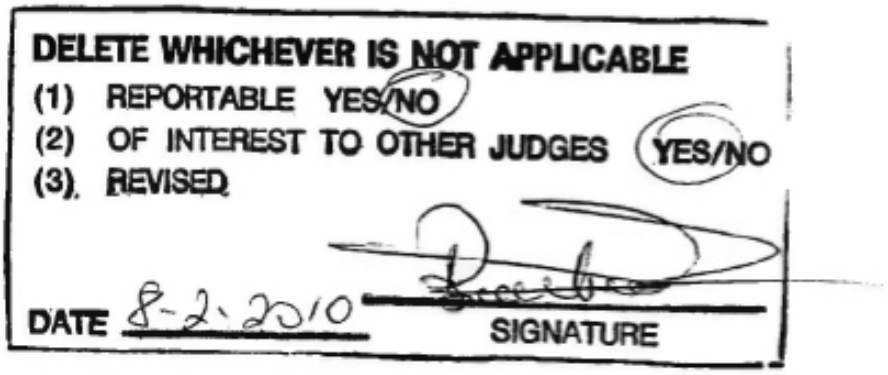
LOM Business Solutions t/a Set LK Transcribers/LR

IN THE SOUTH GAUTENG HIGH COURT

JOHANNESBURG CASE NO: 14698/04

DATE: 06/11/2009



In the matter between

SHAPIRO, COLIN BEN 1ST APPLICANT

GALETA, HOTEP 2ND APPLICANT

and

SOUTH AFRICAN RECORDING RIGHTS RESPONDENT

J U D G M E N T

BORUCHOWITZ J: This is an application for an order placing the respondent company under winding-up on the ground that is just and equitable [Section 344 (h) of the Companies Act 61 of 1973 (the Act)], alternatively for relief in terms of Section 258 of the Act directing the appointment of an inspector by the Minister of Trade and Industry to investigate the affairs of the respondent.

The respondent known as Sarral was incorporated in 1963 under the predecessor of the present Companies Act. It is a company limited by guarantee and does not have a share capital. The Respondent is a non-profit organisation which principally carries on the business of collecting on behalf of its members and non-members who are composers and publishers of musical works, royalties in respect of all mechanical recordings and reproductions of music compositions of its members and non-members who contract with it for that purpose. It also represents them in the protection and advancement of their rights with regard to musical compositions owned by them.

In the Respondent's financial statements for the year end 31 December 2006 it is said to represent 4 455 composers, 2 359 performers, 1 085 publishers and 114 South African music labels.

On 5 March 2007 the respondent was accredited as a Representative Collecting Society in terms of Regulation 3 (7) of the Copyright Act, 98 of 1978 to collect fees and remuneration due to its members in respect of what is termed "needletime royalties", that is royalties in respect of broadcast rights and transmission through a diffusion service. The respondent is said to have some 1 746 members who it represents in respect of the collection of needletime royalties.

It is as well to at this stage dispose of a contention that the applicants have no *locus standi*.

The application is brought at the instance of two members of the respondent; Mr Colin Ben Shapiro, the first applicant and Mr Hotep Galeta, the second applicant.

The application was initially brought by the first applicant by way of a Notice of Motion dated 5 July 2004 as a result of the termination or purported termination by the board of directors of the first respondent's membership and to remove him as a director of the respondent. The second applicant was permitted to intervene as a co-applicant by an order of this court dated 10 March 2006.

The purported termination of the first applicant's membership has no bearing on his *locus standi* to bring and to proceed with the instant application, as it is common cause or not in dispute that the first applicant was a member at the time of the launch of the application and was registered as a member for a period of at least six months immediately prior to the date of the application. (See Section 346 (2) of the Act .) The subsequent loss of membership does not deprive the first applicant of his *locus standi.* A court which at the outset has jurisdiction retains that jurisdiction until the suit is concluded. See *Thermo Radient Oven Sales (PTY) Ltd v Nelspruit Bakeries* 1969 (2) SA 295 (A) at 301 C – D.

The same reasoning applies to the second applicant. His purported termination of membership cannot avail the respondent and would not affect his *locus standi* as at the time that the intervention took place as he was then a member registered in the register of members for the requisite period referred to in Section 346(2) of the Act.

The respondent took the point that there had been non-joinder of the Registrar of Copyright, however, that point fell away when the Registrar, in writing, effectively waived his right to be joined as a party to

the proceedings.

The papers in this matter are voluminous. The main application comprises some 3 500 pages made up of some 14 sets of affidavits. The record also includes various interlocutory applications; an intervening application brought by the second respondent; the pleadings in an action brought by the applicants to declare the resolutions of the board of the respondent purporting to terminate their membership invalid as well as pleadings in the actions brought by the applicants for alleged unpaid royalties and for a statement of account. There is before the Court evidential material concerning the domestic affairs of the respondent covering an eight year period, beginning 2001 to July 2008. Some seven and a half days was taken up in legal argument.

In view of the magnitude and complexity of the evidential material laid before the court it is neither necessary nor practicable to refer to every aspect raised in the papers or heads of argument. I will therefore only refer to those aspects that I consider material to the outcome of the application.

Reduced to its essentials the applicant's case for winding-up, or the appointment of a ministerial investigator is premised on the following contentions:

1. That the respondent is factually insolvent.
2. That the respondent has been systematically mismanaged. Royalties or members' funds have been misappropriated or wrongly applied and distributed.
3. That the respondent's financial statements materially misstated its

financial position and are characterised by material irregularities.

The fundamental issue between the parties concerns the respondent's treatment of the royalties collected by it and more particularly the respondent's entitlement to apportion royalty monies to supplement its revenues in order to meet operational costs.

It is common cause or not in dispute that from the date of its incorporation until 2003, a period of some 40 years, the respondent recognised and treated royalties collected as belonging to its members. The respondent's audited financial statements were always drawn on the basis that it was an agent and that royalties did not accrue to it or form part of its revenue. The respondent's revenue was derived from essentially two sources namely commissions and interest on royalties. Royalties were consistently reflected in its financial statements as a liability to its members. This is evident from the financial statements for the years ending 31 December 1996 to 2002 which are to be found in the papers at pages 453, 460, 498, 513 and 528.

All of this changed after the launch of the present application. The respondent's new-found approach, as reflected in the answering affidavit deposed to by its former chief executive officer Mr Mutloatse and supported by an accountant Mr C H Kocks, is that the respondent acts as principal and not as agent in the collection of royalties. Their view, which they claim is supported by the express provisions of the memorandum of association, articles and rules of the respondent (The constitutive documents) as well as agreements entered into between the members, is that the respondent's revenue consists of all royalties

received and interest income earned prior to distribution of such royalties. And that payments made to members and non-members fall within the discretion of the respondent's directors. It is asserted that the respondent has no commercial obligation, or accounting liability arising from the receipt of royalties until such time as the directors decide upon the size of the payment to members. (See Mutloatse's affidavit paragraphs 819 pages 553 to 558 and Kocks' paragraph 8.10 pages 785 to 786.)

The approach postulated by them is said to be based on legal or professional advice that they obtained as to the proper meaning of the respondent's constitutive documents.

Since 2004 the respondent has not only changed its method of business, but also its accounting policy. In the 2003 and 2004 annual financial statements, which were issued simultaneously in 2005, the respondent treated royalties collected as its own revenue and not as a liability to members and from the amounts distributed is also deducted a commission.

The notes to the 2003 financial statements are particularly instructive, (see page 1793). Note 1.1 reads

1. 1. "**Revenue recognition**

> Royalties collected, interest received and other income constitute total income. In prior years up to and including the previous financial year total income consisted of commissions deducted from royalties allocated together with interest received and other

income."

Note 2 reads as follows

2. **Changes in accounting policy**

The company revised the format of the financial statements to comply with the company's constitution. The change in accounting policy is now that of an ownership basis whereas previously the accounting policy was that of an agency basis."

Note 3 (at page 2264) provides as follows:

3. **Fundamental error**

The method of revenue recognition is being revised in the current period. In the past the financial statements were incorrectly drawn up on the basis that the company was an agent and thus royalties did not accrue to it; this does not fairly represent the substance of the company's business. The revenue recognition policy has been revised to include the full royalty revenue; this more fairly presents the economic substance of the business. This change is performed to ensure that the revenue is recognised in accordance with the company's constitution and that fair presentation is achieved. The prior year comparative figures had been restated to reflect the correction. The effect of the correction is as follows: ...."

It is clear from the objective evidence including the evidence of

the accounting experts who have deposed to affidavits that the revenue generated from commissions and interest on royalties has been insufficient to enable the respondent to meet its operational costs. On the assumption that royalties are a liability owed to members and that operating expenses cannot be deducted there, from the respondent is insolvent as there are insufficient funds or assets to meet the royalty liability.

In commenting on the annual financial statements of the respondent for the years ended 31 December 2003 and 2004 Professor Wainer (the applicant's accounting expert) says [at page 1813] that if the respondent had not changed its accounting policy then these financial statements would have reflected a significantly insolvent situation.

The effect of the change in the 2003 and 2004 financial statements is that the royalties collected are reflected as the respondent's own income and accordingly the significant liability of SARRAL, reflected in all its prior financial statements was converted into the respondent's own revenue and profit. Had the respondent not changed the basis of dealing with the royalties then the 2003 and 2004 financial statements would have reflected a deficit, that is an excess, of liabilities over assets of R11.005 million:

But for the change in the manner in which the royalties are dealt with the respondent would have reflected significant losses for both 2003 and 2004. The losses are corroborated by the significant decline in the cash held by the respondent. As at 31 December 2002 the

respondent reflected cash on call deposit of R13.489 million. By 31 December 2004 the cash on call deposit declined to R4.595 million.

The respondent's expert Mr Friedman of the accounting firm KPMG Services (PTY) Ltd concedes in a report dated 27 October 2006 [page 2654], that the respondent did not have sufficient revenues to absorb the costs incurred in the 2003 and 2004 financial years. He disputes the correctness of Wainer's computation of the deficit, but concedes that if royalties are considered as a liability the respondent would be insolvent as there are neither sufficient funds or assets available to meet the liability, nor sufficient funds to address the negative reserves of R9 879 191.00 as at 31 December 2004.

The insolvent financial position of the respondent is further corroborated by the applicant's expert accountant Mr Gross. Both Wainer and Friedman accept that if the full amount of operating expenses incurred during the 2003 and 2008 financial years could permissibly be deducted from the royalties collected as has been done in the 2003 and 2004 financial statements, then the respondent would not be insolvent.

Apart from the expert opinions to which I have referred it is clear from a reading of the respondent's audited financial statements for the period 2000 to 2004 that its revenue, if confined to commissions and interest on royalties was insufficient to meet its operational expenses.

During the period in question there had been a significant decline in royalty receipts. The following are the recorded royalty receipts during that period.

1999 – R23 391 431.00,

2000 – R22 170 959.00,

2001 – R23 138 519.00,

2002 – R20 756 815.00,

2003 – R18 086 046.00,

2004 – R11 625 162.00.

A significant drop in royalty receipts was incurred when the SABC stopped payment under what is termed the "blanket license agreement". This apparently comprised between 60 to 70% of the respondent's royalty receipts.

Interest on royalties also dropped significantly during the period in question. This is evident from the annual financial statements which reflect the following interest receipts:

1999 – R3 053 571.00,

2000 – R2 223 775.00

2001 – R2 031 322.00

2002 – R1 959 385.00

2003 – R1 428 425.00

2004 – R386 298.00.

During the same period the respondent's operating costs increased significantly. This is depicted in the following schedule:

1999 – R4 306 435.00,

2000 – R5 010 406.00,

2001 – R5 204 784.00,

2002 – R6 393 467.00,

2003 – R6 817 459.00,

2004 – R515 636.00.

During the period 1999 to 2002 the respondent's gross revenue, presumably principally from commissions, was the following:

1999 – R2 344 288.00,

2000 – R2 813 220.00,

2001 – R2 894 128.00,

2002 – R3 378 688.00.

The vital issue that therefore falls to be determined is whether the respondent is entitled in terms of its constitutive documents to treat royalties collected as its own revenue and not as a liability to members, and whether operating expenses incurred by the respondent can permissibly be deducted from royalties collected. A finding one way or the other on this issue is fundamental to the question whether the respondent is factually insolvent or has been systematically mismanaged, or guilty of material misstatements in its audited financial statements as is alleged by the applicant.

The respondent seeks to justify its new-found approach to the treatment of royalties on the basis of what it contends is a proper interpretation or construction of its constitutive documents.

Before embarking on an interpretation of the constitutive documents of the respondent it is necessary to dispose of a contention which was strenuously relied on by the respondent and which it was submitted weighed heavily, if not decisively, with the Court in considering whether to grant a winding-up order on the just and

equitable ground.

It is common cause that on 5 March 2007 the respondent was accredited as a Representative Collecting society in terms of Regulation 3 (7) of the Copyright Act, 98 of 1978. The accreditation placed the respondent under the supervision and control of the Registrar of Copyright. The Registrar's function and obligation under the statute and regulations is to ensure that the respondent discharges its obligations under the law.

It was submitted on behalf of the respondent that accreditation could not have been granted unless the Registrar was satisfied that the respondent was able to ensure adequate, efficient and effective administration of the rights entrusted to it. This is provided for in Regulation 3 (3) of the Collecting Society Regulations published on 1 June 2006.

Regulation 4 provides that in the exercise of its supervisory powers the Registrar has the right to attend annual or special general meetings, receive an annual activity report from each collecting society setting out information on its activities, financial records and such other records as may be necessary to assess the degree of compliance of the collecting society with the regulations.

In addition an accredited collecting society is to keep the Registrar informed at all times as to it organisational structure and operational features and also in regard to changes concerning the persons entitled by law or in terms of the organisational structures to represent it. The information to be furnished includes details of

auditors, lists of members updated annually, annual audited financial statements, etcetera.

The regulations also provide that in the event that the Collecting society does not comply with its obligations under the regulations, the Registrar may if the defects are not remedied within a period of time either withdraw the collecting society's accreditation and or apply to court for appropriate relief including relief in terms of the common law or the law governing the entity acting as Collecting society and including but not limited to relief by placing the Collecting society under judicial management or by seeking its winding up or dissolution.

The manner in which distributions are to be made is regulated in Regulation 5. This provides among other things that a collecting society shall distribute at least once every year amounts collected by it according to a distribution plan after deducting such amounts as are necessary to cover the costs incurred in the administration of the collecting society.

The costs and expenses incurred in the administration of the society in question shall be calculated in conformity with Generally Accepted Accounting Practices [GAAP] set from time to time by the professional bodies of South African Chartered Accountants and the manner of bookkeeping and maintenance of records by a collecting society shall be such as to enable the ready verification of revenue received or accrued as well as expenditure and costs incurred.

The respondent places emphasis on the aforesaid wording in Regulation 5 to justify its treatment of the royalties collected. This, in

addition to its construction and interpretation of the constitutive documents of the respondent.

The respondent submits further that the alleged mismanagement and or alleged incapacity to manage on the part of the respondent, the question of the fairness or adequacy of the distribution of royalties as well as the disputes as to the manner in which the respondent's financial statements are recorded have all fallen away as a result of the accreditation. So too has the question of the entitlement of the respondent to meet its administrative expenses from royalty income.

It also submits that in consequence of the accreditation, the parties cannot by way of contract vary or modify the statutory imposed regime; any such modification or alteration would at worst be in *fraudem legis* and at best void and unenforceable and that any difference contractually agreed upon is at best no longer enforceable. According to the present statutory regime what is required of the respondent is to distribute at least once every year amounts collected by it according to a distribution plan and after deducting such amounts that are necessary to cover the costs incurred in the administration of the collecting society.

I do not agree with the respondent's submissions. The regulations make it plain that their object is not to supplant or modify what is contained in the respondent's constitutive documents and agreements. Regulation 5 (5) specifically provides as follows:

5. "Nothing in these regulations shall reduce, detract or affect in any way the rights or remedies that members

of the collecting society are entitled to or any relief available to them under their membership agreement, the common law or any applicable legislation governing the legal entity accredited as a collecting society."

Apart from that it is clear from the evidence that the accreditation does not pertain to the whole of the respondent's business. It is common cause that the regulations apply only to the collection of "needletime royalties"; that is royalties relating to the broadcasting of sound recordings. This is conceded by Mr Gilfillan, a director of the respondent in an affidavit deposed to on 29 February 2008 [page 3262].

There is no dispute that the main or principal business of the respondent pertains to the collection of mechanical royalties in respect of mechanical reproductions of composers' works and not needletime royalties. The Registrar has no powers or rights to regulate or to seek to regulate the respondent's non-needletime royalty collections.

For these reasons I do not agree with the respondent's contention that the accreditation of the respondent is decisive of the question whether to wind up or not. It follows also from what I have said that the manner in which the respondent's royalties collections are administered is governed by the constitutive documents and agreements of the respondent and not the statutory regime embodied in the regulations.

I turn therefore to an interpretation of the respondent's constitutive documents and relevant agreements. These comprise

1. The memorandum of association,
2. The articles of association,
3. The rules,
4. The charter, and
5. The agreement with the applicant which is representative of agreements entered into with all members.

The following extracts therefrom are relevant for present purposes.

The objects of the respondent are set out in clause 2 of the Memorandum of Association. It is there specified that the objects for which the respondent is established are, among other things, the following:

2. "To exercise and enforce on behalf of the members of the company and others all rights and remedies provided by the Designs, Trademarks and Copyright Act 9 of 1916 (as amended) or other legislation, or otherwise, in respect of the making of any discs, tapes, perforated rolls, cinematographic films or other devices (hereinafter referred to as 'the records') in which sounds are embodied so as to be capable (with or without the aid of some other instrument) of being automatically reproduced there from;

In the exercise or enforcement of such rights and remedies to make and from time to time rescind, alter or vary any arrangements and agreements with respect

to any such exploitation of such records or other works in regard to the manner, periods or extent in, for or to which and the terms on which any such exploitation of such records may be made or employed, and to collect and receive and give effectual discharges for all royalties, fees and other monies payable under any such agreements or arrangements or otherwise in respect of any such exploitation by all necessary actions or other proceedings and to recover such royalties, fees and other monies and to restrain and recover damages for the infringement by means of any such exploitation as aforesaid of the copyright of such records or any other rights of the members or others, or the company on their behalf in respect of such records and to release, compromise or refer to arbitration any such proceedings or actions or any other disputes or differences in relation to the premises.

To obtain from the members or others such assignments, assurances, powers of attorney or other authorities or instruments as may be deemed necessary or expedient for enabling the company to exercise and enforce in its own name or otherwise all such rights and remedies as aforesaid, and to execute and do such assurances, agreements and other instruments and acts as maybe deemed necessary or

expedient for the purpose of the exercise or enforcement by the company of such rights and remedies as aforesaid. (My emphasis)

To make and from time to time alter or vary any rules for regulating: -

(a) The manner in which the works of members or others are to be communicated or declared by them to the company;

(b) The manner in which the periods or period for which and the conditions under which the members or others are to authorise the company to exercise and enforce the rights and remedies aforesaid of the members or others in respect of such records as aforesaid;

(c) The manner and shares in which and the times at which the net monies received by the company in respect of any such records as aforesaid are to be divided and apportioned amongst the members or other interested therein respectively;

(d) The provision either directly or through trusts or associations, of gratuities, donations or pensions for members or ex members of a company, or their wives, widows, families or dependents; and

(e) The administration of the property or business of

the company and matters incidental thereto.

To distribute the net monies received by the company in the exercise of the foregoing powers after making provision thereout for the expenses and liabilities of the company incurred in such exercise or otherwise carrying out the purposes and operations of the company and contributions or payments for any of the purposes specified in the next following subclause hereof, amongst the members or others entitled thereto in accordance with the rules to be for the time being in force with respect to the distribution thereof." [My emphasis].

In the Articles of Association the following terms are assigned specific meanings

"The rules" mean the rules from time to time made for the purposes mentioned in Clause 2 (1) of the Memorandum of Association.

'Distribution' means any distribution which may pursuant to the rules, be made among the members and others out of the monies received by the company, and 'distributed' and 'distributable' having corresponding meanings."

Clause 3 (b) of the Articles provides, among other things, as follows:

(b) "Subject to Article 5 (g) below each member shall, upon becoming a member grant to the company the sole power and authority;

(iii) to collect fees, subscriptions and all monies whether for the performance of any such works, or the exploitation of any such recording and or mechanical and or any other right or by way of damages or compensation for unauthorised performance of such works or exploitation of such recording right."

Articles 43, 44, 48 and 50 regulate the following powers and duties of the board of directors of the respondent as follows:

(43) "All monies received by the company in respect of the exercise of the rights, licence or authority granted by the members, societies and others shall, subject to the memorandum of association, these articles and any agreements be distributed or otherwise dealt with by the board in accordance with the rules.

(44) The board may before making any distribution among the members and or others set aside out of the receipts such sums as it thinks proper as a reserve fund to meet contingencies, or for future distribution, or for repairing, improving and maintaining any of the property or premises of the company, and for such other purposes that the board shall in its absolute

discretion think necessary or conducive to the interests of the company.

(48) The board shall pay and defray the expenses and liabilities of the company, incurred in the exercise or enforcement of the rights vested in or controlled by the company, out of the monies received by the company. (My emphasis)

(50) The board may and from time to time alter the rules specified in Clause 2 (1) of the Memorandum of Association and, without prejudice to the generality of the aforegoing, may also make, and from time to time alter, separate or additional rules for regulating the provision, through trusts or associations, of gratuities, donations or pensions, for members, ex members or employees of a company, or their wives, widows, families or dependents. Provided that any rules (other than such separate or additional rules) or any alteration of such rules (other than as aforesaid), shall not take effect or come into operation unless or until the same had been approved by the company in general meeting."

I turn now to the Rules. The following rules which are said to be promulgated in terms of the respondent's Memorandum and Articles are relevant for present purposes.

7. "The company is a non-profit making entity and by

virtue of this, nett monies referred to in the Memorandum and Articles Association of the company shall be determined by having regard to the total monies received including interest in any financial year less total expenses and liabilities of the company incurred in the exercise or in otherwise carrying out the purposes and operations of the company and less transfers to reserves which the board of directors in their sole discretion shall determine having reference to any potential liabilities of the company. (My emphasis)

8. Royalties collected shall where possible be identified to actual recordings and be allocated less a commission to the respective members and non-members' accounts. As soon after receipt of such royalties is possible. Where royalties and / or levies are not identifiable to actual recordings and are distributable on a so-called blanket license or levy arrangement, such royalties and / or levy shall be allocated proportionately to members and non-members alike as the use of their works bear to the total for a particular accounting period and transferred, less a commission to such members and non-members' accounts as soon after the accounting period as possible. (My emphasis)
9. The distribution of the monies standing to the credit of the members and non-members shall be made at least

twice a year viz. within 60 (sixty) days of 31 March and 30 September for all amounts standing to the credit of those accounts on those dates.

10. Any excess derived may be held in reserve to offset any future deficits incurred. Any deficits incurred shall be recouped from available accumulated excesses and if these are insufficient, such deficits shall be recouped in terms of the Memorandum and Articles Association in the determination of net monies for the final period under review or to the extent necessary in the next and succeeding financial periods.

11. The administrative costs necessarily incurred in the efficient conduct of the business of the company shall be a first charge on revenue received. The administrative costs and capital expenditure shall be set out in sufficient detail in the company's annual financial statements. (My emphasis)

13. The directors may from time to time establish and maintain reserve funds for any specific purpose, in the interest, directly or indirectly of members and or non-members. (My emphasis)

17. The board of directors may from time to time determine the rates of commission. It will charge any member and or non-member. (My emphasis)

21. The board of directors may from time to time create

rules to set aside before making any distribution such amount as it thinks fit and proper as reserve fund to meet any contingencies or for future distribution or for repairing, improving and maintaining any of the property or premises of the company and for such other purposes that the board may think necessary and may invest the several sums so set aside in such investments as it may think fit, any may vary such investments. (My emphasis)

22. Apart from any other investment the company shall invest monies awaiting distribution as the board directs, and the interest from any source shall be deemed to be an ordinary income for the company, to be dealt with in terms of these rules." (My emphasis)

In the preamble to the Charter of the respondent it is specifically recorded that

"SARRAL is a non-profit making organisation, subscribes to the ethos progressive non-racial and equal opportunity, people resource employment and endorses MAPP-SETA in terms of human development and training and that... SARRAL acts in a capacity of trust on behalf of its members and others."

The first applicant became a member of the respondent on 23 July 1996. In terms of a written agreement signed by him, which is

reflective of the standard form of agreement entered into with members, the following is provided:

1. "SARRAL are hereby authorised to licence and collect all mechanical royalties in respect of all recordings and mechanical reproductions of all musical compositions controlled by the owner (hereinafter referred to as 'the said works' for the territory of the world (hereinafter referred to as 'said territory'). (My emphasis)

3. SARRAL agrees to forward the owner quarterly statements of royalties collected and credited to his account reckoned from 01/07/96 accompanied by monies shown to be due within sixty (60) days after the expiration of each such quarterly period.

4. In consideration therefore SARRAL shall be entitled to retain a commission of 7½ % of the gross total of royalties collected. (My emphasis)

7. Where necessary to protect, enforce and or collect mechanical royalties due to the owner, the owner shall cede, transfer and assign his copyright to SARRAL for the sole purpose of instituting action for the necessary legal relief in SARRAL's or its nominee's name. In such event SARRAL shall bear all legal costs and disbursements in regard to the action brought. After the action referred to has been entirely disposed of, SARRAL shall cede, transfer and assign all and any

rights it might have received in terms of this clause to the owner."

The applicable interpretational principles are well settled. It is incumbent upon the Court to ascertain the intention of the parties which, in the first instance must be gathered from the language of the provisions themselves. The words of the constitutive documents must be given their plain, ordinary, popular and grammatical meaning unless it clearly appears from the context that the framers intended them to have a different meaning. Absent ambiguity, the meaning conveyed by the words themselves must be given effect to, unless this would give rise to absurdity, repugnancy or inconsistency with the rest of the documents. In order to ascertain what the drafters intended by the language used the Court is required to consider the documents as an interrelated whole rather than isolated expressions and is to have regard to their object and purpose. The relevant provisions must also be construed in accordance with sound commercial principles and good business sense so that they receive a fair and sensible interpretation. These well established principles are encapsulated in *Jaga v Donges NO and anoher; Bahna v Donges NO and another* 1950 (4) SA 653 (A) at 662 G – H, *Swart en 'n andere v Cape Fabrics (PTY) Ltd* 1979 (1) SA 195 (A) at 202 B – C and *Coopers and Lybrand and others v Bryant* 1995 (3) SA 761 (A) at 767 E to 768 C.

As previously indicated it is the respondent's contention that it acts as principal and not agent in the collection of royalties and that the royalties collected are not a liability owed to members, but an integral

part of its revenue or income; it submits that in terms of the constitutive documents the respondent is afforded the unfettered right to deduct all of its expenses and an amount in respect of reserves as well as commission from the gross royalties collected. Distributions to members and non-members are subject to its discretion.

Counsel for the respondent submitted that the express wording of Clause 2 of the Memorandum of Association read with Article 48 and Rules 7 and 10 support the respondent's contention that it can defray expenses from the royalties collected. Clause 2 of the memorandum specifies, among other things, that the object of the company is to "distribute the net monies received ... after making provision thereout for the expenses and liabilities of the company ... in accordance with the rules...." Article 48 provides that the board shall pay and defray the expenses and liabilities of the company out of the "monies received" by the company.

Reliance is also placed by the respondent on the wording of Rule 7 which provides that the company is a "non-profit making entity" and by virtue of this "net monies referred to in the Memorandum of Articles of Association shall be determined by having regard to the total monies received including interest in any financial year, less total expenses and liabilities of the company incurred in the exercise or when otherwise carrying out the purposes and operations of the company and less transfers to reserves which the board of directors in their sole discretion shall determine having reference to any potential liabilities of the company."

Rule 10 which deals with excesses is worded in such a way, so, it is submitted, to permit any deficits to be recouped from available accumulated excesses and if these are insufficient in the determination of the net monies for the financial period in question, or to the extent necessary in the next and succeeding financial periods.

These clauses, so submits respondent's counsel, are supportive of the respondent's approach to the treatment of royalties and disclosure in the annual financial statements.

On the face of it, and taken in isolation, the extracts upon which respondent's counsel relies appear to be supportive of the construction contended for by the respondent. Many of the terms such as "net monies", "monies received by the company" and the terms which I have underlined as set out above, if read in isolation, are consistent with the construction which the respondent seeks to place on the constitutive documents.

On the basis of the authorities to which I have referred, the court is required to adopt a purposive construction and to consider all of the relevant provisions in the context of the constitutive documents as a whole. Approached from that viewpoint the clauses upon which the respondent relies take on a different meaning and which is consistent with that contended for by the applicant.

In summary what the respondent contends for is the following:

1. In collecting royalties the respondent is not an agent occupying a position of trust, but acts as a principal for its own account.
2. Royalties received form part of the income or revenue of the

respondent. Royalties are not to be treated and accounted for as a liability owed to the members and non-members.

3. The respondent has an unfettered right to deduct from the gross royalties collected all of its expenses and a commission.

The following are in my view contextual indications that the respondent is indeed required to act as an agent and not as a principal in its collection of the royalties. Clause 2 of the Memorandum of Association records that one of the stated objects of the respondent is "to exercise and enforce on behalf of its members" certain rights and remedies "and to collect and receive and give effectual discharge for all royalties, fees and other monies ..." The phrase "on behalf of" is a clear indication of agency.

Provision is specifically made in Rule 8 for the deduction of a commission from all royalties collected and in terms of Rule 17 the board of directors is given the power to from time to time determine the rates of commission that it will charge any member. The fact that a commission is chargeable against royalties is a most significant feature. The ordinary meaning of "commission" is a remuneration for services for work done as an agent in the form of a percentage on the amount involved in the transactions, a *pro rata* remuneration to an agent or factor. In *Commissioner for Inland Revenue v Wandrag Asbestos (PTY) Ltd* 1995 (2) SA 197 (A) Corbett J had occasion to consider the meaning of the term "commission" in the context of Section 11 [*bis 4*] of the Income Tax Act 58 of 1962. In the course of the judgment the learned judge said the following (at 214 B to D).

> "... I would point out that the word 'commission' is not a term of legal art. The relevant meaning in the Oxford English Dictionary reads: 'A remuneration for services or work done as agent in the form of a percentage on the amount involved in the transactions; a pro rata remuneration to an agent or factor.'"

In *Drielsma v Manifold* (1894) 3 CH 100 at 107, Davey LJ said:

> "Commission is *prima facie* the payment made to an agent for agency work, usually according to a scale – it may be an *ad valorem* scale, but not necessarily an *ad valorem* scale. It is in my opinion the most general word that can be used to describe the remuneration paid to an agent for an agency work other than a salary ..."

In the present context the term "commission" in Rules 8 and 17 is no different. It is remuneration paid to an agent for services or work done. *In casu* this is the collection of royalties and the representation of members in enforcing their other remedies referred to in the Memorandum and Articles.

That this was the intention of the parties is evident from the terms of the agreement concluded between the first applicant and the respondent which, as I have indicated, is representative of the agreements concluded with members and non-members alike. In terms thereof the respondent was authorised to license and collect all

mechanical royalties in respect of all recordings and mechanical reproductions of all music compositions controlled by the applicants. Moreover the respondent agreed to forward the applicant's quarterly statements of royalties collected and credited to his account. In consideration therefore the respondent was entitled to retain a commission of 7½ % of the gross total of royalties collected. Where necessary to protect, enforce and collect mechanical royalties due to the applicants the member ceded transfered and assigned his copyright to the respondent for the sole purposes of instituting action for the necessary relief in the respondent or the nominee's name.

Clause 7 of the agreement as reproduced above makes it plain that after any action is disposed of the respondent is required to cede and transfer any rights it might have received to the owner of, or member. This is a clear indication that ownership of the proceeds was never intended to vest in or to accrue to respondent.

If as the respondent seeks to contend, the royalties collected form part of its revenue from which it could offset or defray expenses there would be no point in charging a commission. The commission would constitute a source of profit which is contrary to the *raison d'être* of the respondent. The constitutive documents make it plain that the respondent is a non-profit making entity. This is clearly spelt out in Rule 7 and the extracts in the charter to which I have referred.

On a proper construction of the constitutive documents the commission was intended to constitute a source of income; In fact the principal source of income of the respondent which together with

interest on royalties was to be used to defray operating expenses and for transfers to reserves. This is also the manner in which for some 40 years the controllers of the respondent interpreted the constructive documents and conducted its affairs.

It was only after the launch of the present application and to meet the allegations of insolvency that the respondent, as a reflexive reaction, altered its method of doing business and accounting treatment of royalties.

Rule 22 is also of material significance. It provides that apart from many other investment the company shall invest monies awaiting distribution as the board directs, and the interest from any source shall be deemed to be an ordinary income for the company to be dealt with in terms of these rules. If interest on royalties awaiting distribution ordinarily formed part of the respondent's income there would have been no purpose in having to introduce this rule, that is to deem such interest the ordinary income of the company. This is a further indication that royalties were not intended by terms of the constitutive documents to form part and parcel of the respondent's revenue.

For these reasons I reject the respondent's interpretation of the constitutive documents. I hold that on a proper construction thereof the respondent is obliged to act as an agent occupying a position of trust in its collection of royalty payments on behalf of its members and non-members. The royalties are to be treated and accounted for as a liability owed to such members. The respondent's operating expenses ought properly to be deducted or defrayed from the commissions earned

by the respondent and from interest on royalties or any other independent source of income which it might receive, and not as a first charge against royalties as has been done since the launch of this application.

I further hold that the change in accounting policy and method of doing business as reflected in the 2003 and 2004 financial statements is contrary to what is provided for in the constitutive documents of the respondent. There is no indication that the rules were ever altered in a general meeting to conform to what the respondent has been doing with royalties since 2004.

In consequence of these findings and in the light of the evidence to which I have referred it is clear that the respondent is factually insolvent. Its legitimate revenue or income and reserves are insufficient to pay the royalty liability due to its members. It presently only distributes between 50 to 60% of the royalties that it collects.

By wrongly appropriating royalties which properly belong to members the board of directors and controllers of the respondent continue to operate in contravention of the respondent's constitutive documents. Such conduct can properly be characterised as a systematic mismanagement of the affairs of the respondent. Not to govern the respondent in accordance with its constitutive documents is a form of mismanagement.

The annual financial statements for the periods 2003 to 2007 clearly misstate the financial affairs of the respondent by treating royalties as part of its revenue and deducting therefrom expenses and

commission.

A particular cause for concern is the fact that the respondent on its past and current website misrepresents to the public the manner in which it meets its expenses. The following is stated on its current website:

"7. How does SARRAL meet its expenses?

Being a non-profit organisation SARRAL's only objective is to cover expenses. This is done in two ways:

- Any income that is earned by investing money awaiting distribution is offset against expenses.
- The balance of the expenses is covered by charging a commission on the royalties collected.

In this way, everyone participates proportionate to its earnings in all income and all expenses incurred by SARRAL."

The evidence to which I have referred shows that what is stated on the website is not correct. This misrepresentation on the website evidences a lack of probity in the conduct of the affairs of the respondent. It goes without saying that to conduct the affairs of the respondent contrary to its constitutive documents also constitutes a lack of probity.

The documentary evidence clearly demonstrates that when the instant application was launched in 2004 the affairs of the respondent were in disarray. At a meeting held on 24 May 2004 the management committee of the respondent submitted a report for the year ended 31

April 2004, the contents of which indisputably reveals that the respondent was then in an insolvent position.

Annexure CS87 to the papers reads as follows:

"Financial summary."

"We have attached an annual comparison of the company's financial performance for the past three years and forecasts for the next two years.

It is evident that income has decreases (sic) in the 2003 year and continues to decrease. The factors contributing to this decrease are as follows:

- Drop in the interest rates.
- Decrease in the commission rates as a result of the following:
  (a) SABC blanket licence collections.
  (b) Phono sales collections.

SARRAL's expenses have also increased in the 2003 and the forecasted 2004 year. This attributable the increased costs as a result of the following:

- Transformation phase i.e. staff development, motivational costs, training costs etcetera.
- Consultants' contracted to SARRAL i.e. Khayyam, Le Roux, Deloittes.
- Legal costs, i.e. pending costs.
- Staff costs, i.e. appointment of new financial and

administration manager.

- Computer costs, i.e. new IT system being developed over the 2004 year. Thereafter these costs should decrease. Little maintenance would be required.

However it must also be noted that some of the expenses have decreased in this period due to a major cost cutting exercise maintained by SARRAL management.

In the 2005 year we have forecasted a decrease in these expenditures result of the following:

- Implementation of stable, robust and reliable administration system resulting in lower maintenance costs.
- Non-executive role of the chairman.

Khayyam contract ends in April 2006.

- Additional decrease in office administration costs due to new system.

The forecast assumptions have been conservative in that we have assumed that no change occurs in the collection of the SABC blanket license. The other income generators have not been included as income.

As a result of the abovementioned issues SARRAL's accumulated loss has increased, thus

bringing SARRAL to a situation of negative reserves."

Attached to this report is a comparative schedule listing the actual results for the past two years and projected results for a five year period. What they demonstrate is that for each of the past years there has been a net loss which is anticipated to grow exponentially. Negative reserves likewise will grow significantly and only exacerbate the respondent's poor financial position.

Correspondence that passed between the applicant and certain officials of the respondent are also of moment and clearly demonstrate that the respondent is in straightened financial circumstances. The respondent's officials appear to concede that they have acted wrongly in appropriating royalty receipts in order to meet operating expenses.

Annexure CH89 to the founding affidavit is a letter written by a person known as Kuselwa. It reads:

"Dear all, Please find the schedule of expenses discussed earlier. Mothobi, I am now not sure how you would like us to deal with this issue. I had a brief chat with Daphne this morning and she expressed that we should keep it amongst us for until we find income. I think with our overhead we need to (sic) careful and advice (sic) the board at least so that we are not blamed for negligence. The reason for this is the decrease in the SABC collection, less interest rate, thus with NT many

investment therefore not much interest earned. For three months we have only interest at R98k. Our commissions for the current year incl distr is R250k. Our current cash available is R5mil plus the R1.5 bond with Stabilitas. Our distribution is R2.5mil. The balance of the is royalties and not SARRAL's money. We have already utilised some of the royalty receipts. Can we meet when you get back to the office to discuss as a matter of urgency.

We need other means of income. Kind regards. Kusalwa." (My emphasis)

The applicant wrote a letter to one Peter Klatzow on 2 June 2004 in which he stated, among other things, that he could not acquiesce in any attempt to conceal or gloss over these shortcomings. He indicated that given the tone of Kuselwa's email he did not believe that he was in a position to rely upon representations made or financial reports produced by the current management. He wanted access to all the respondent's documentation relating to its management.

Klatzow responded in this way:

"Dear Colin, regrettably one. You are quite right in each and every observation. I think we are now reaping the harvest of having chairman and CEO in the same person. It just does not work this way. The degree of accountability is dramatically diminished.

However I am inclined to wait until MM ties up negotiations with the SABC (and this has to be very soon). If that fails, we must ring the bell. I have informed Chris that he has to tell us when SARRAL should cease trading. He has been mandated by the compliance committee to see that SARRAL's directors don't get into a legally liable situation. There has been concealment, no doubt about it. It took an outsider to wave the red flag.

Incidentally, I asked Kuselwa to identify areas where we could save. According to her, the only way would be to get rid of staff as all other payments are contractual. Wade though the stuff below."

The respondent has purported to terminate the first applicant's membership of the respondent. This was prompted by the fact that the respondent was engaged in litigation in respect of allegedly unpaid royalties. The respondent admits in the papers that it purported to terminate the first respondent's membership in order to stifle the litigation. The respondent also admits having terminated the second applicant's membership for the same reason. This admitted conduct of the respondent's directors can clearly be characterised as oppressive of the applicants.

What constitutes a proper basis for a winding-up of a company under the just and equitable ground [Section 344 (H) of the Act] has

been variously stated:. See *Moosa v Mavjee Bahwan (PTY) Ltd* 1967 (3) SA 131 (T); *Rand Air (PTY) Ltd v Ray Bester Investments (PTY) Ltd* 1985 (2) SA 345 (W); *Securefin Ltd v KNA Insurance and Investment Brokers (PTY) Ltd* 2001 (3) All SA 15 (W) at 48; *Alfa Bank Bpk v Registrateur Van Banke* 1996 (1) SA 330 (A); *Erasmus v Pentamed Investments (PTY) Ltd* 1982 (1) SA 178 (10).

These legal principles have been applied to Section 21 companies. (See for example *Pienaar v Thusano Foundation and another* 1992 (2) SA 552 (BGD)). It is clear that the winding up provisions are equally applicable to companies limited by guarantee, such as the respondent.

A relevant category falling under the just and equitable ground for winding up a company is whether there is a justifiable lack of confidence in the conduct and management of the company's affairs, grounded on conduct of the directors in regard to the company's business. The loss of confidence must be justifiable, that is, it must be founded on conduct by the directors or the members which is fraudulent or otherwise wrongful, oppressive or unfair.

In this regard the late Professor Blackman in his seminal work "Commentary on the Companies Act" at 14-110 to 14-111 states the following:

> "Where there is a justifiable lack of confidence in the conduct and management of the company's affairs, it is usually just and equitable that the company wind up. This principle is not confined to

small domestic companies, but is of general application. Mere dissatisfaction at being outvoted is not enough, for a person who becomes a member under a constitution that provides that the majority votes shall prevail cannot invoke a form of equitable relief in order to alter the legal relations between himself and the company, nor is the fact that the company not being efficiently run a basis for liquidation. For loss of confidence here to be justifiable it must be grounded on a lack of probity in the controller's conduct, not in regard to their private affairs, but in regard to the company's business. That is to say the conduct must be unfair, or harsh, burdensome and wrongful. It is just and equitable to wind up where the loss of confidence is of such a degree that there is no reason or hope of, or other remedy which would make possible, cooperation in the future, and the controller's misconduct is such as to justify that degree of loss of confidence. Companies had been wound up on this ground where those in control were guilty of treating the company's property as their own or misappropriating it kept the minority in ignorance of the company's financial position in order to acquire their shares as an undervalue, minimised the value

> of property belonging to the company in order to purchase it at undervalue and as directors committed a breach of their fiduciary duties by earning secret profits."

It was argued on behalf of the respondent that the vast majority of members of the respondent are against liquidation; that the application is brought by two recalcitrant minority members who are engaged in litigation against the respondent and that this must weigh with the court in dismissing the application.

In the present matter the controllers of the company have wrongly dealt with monies in the form of royalties that properly belong to its members and have kept the majority of members in ignorance of its parlous financial position. The majority of members do not have a proper insight into the interpretation of the constitutive documents.

I am not suggesting that the dealings or appropriation of membership funds was done with criminal intent; the controllers appear to have acted upon professional and/or legal advice given to them as to the meaning and effect of the constitutive documents.

It is a matter of concern that the respondent's controllers have seen fit to change the *modus operandi* in which the respondent has conducted its affairs for over 40 years and its method of accounting solely in order to meet its profound insolvent situation. The respondents revenue, in the form of commissions and interest on royalties, has been depleted and is insufficient to meet its operational expenses; it is factually insolvent and continues to trade in insolvency. To compound

matters it continues to solicit membership via its website based on false misrepresentations that it earns its income only through commissions and interest on royalties.

The current method of doing business is in breach of the respondent's constitutive documents and also in breach of the position of trust occupied by the respondent in the administration of what is essentially trust monies that belongs to its members. To my mind there is indeed a grave and justifiable lack of confidence in the conduct and management of the respondent's affairs.

The only appropriate remedy is to place the respondent under winding-up, particularly in cases such as the present where there are breaches of trust and fiduciary obligations.

The appropriateness of granting a winding-up order is similar or related circumstances was emphasised in the Australian case, *Australian Securities Commission v A S Nominees Ltd and others* 18 ACSR 459, a judgment of the Federal Court of Australia. I am in agreement with the dictum of Finn J at 519 where he states the following:

> "There has been misconduct and mismanagement in the conduct of the trust business in such a degree as to make it unacceptable for these three companies to solicit, hold manage and deal with investors' money on a fiduciary basis ... Such is not conduct that an investor, who is seeking to make provision for his or her future and who in a real

sense entrusts that future to persons holding themselves out as skilled and reliable in funds management, would at all expect – or should be required to endure. To order the winding up of these companies is not merely a convenient means of securing their removal from the control and managements of the trusts with which I have been concerned – notwithstanding that there is an urgent need for effective external administration of the trust business. Rather it is the appropriate expression of the lack of confidence one must have in the directors of these companies and their conduct and management of the affairs of their companies. Such an order should also convey a message to companies which hold or manage funds on a trust basis.... The one concern I have had in deciding to make this order is as to possible effect on the beneficiaries of the trust. I am persuaded, however, that short of granting no relief at all - and that is not an available option - the appointment of a liquidator is likely to provide the greatest protection to the beneficiaries that is possible in the circumstances. It is to be expected that further legal proceedings by or against the companies could ensue from any order I make."

I too hold the view that of all the alternatives, liquidation is the most reasonable and proper order to grant.

What remains is the question of costs. Following the usual practice in matters of this nature the costs of the application should be in the liquidation. This matter has a long and tortuous history. The main application was postponed on various occasions. There were a number of interlocutory applications including intervention applications; a Rule 35 (12) application; an application for stay of liquidation proceedings launched by the respondents; a counter-application which was brought by the respondents and then abandoned and there were proceedings before Ancer AJ which were postponed. The respondent then tendered costs but the scale of costs was reserved.

The following order is granted:

1. The respondent is hereby placed under winding-up in the hands of the Master.
2. The costs of the application are to be costs in the liquidation. These costs are to include the costs that were reserved when the application was postponed on 4 March 2005; the costs of the second respondent's intervention application and postponement of such application on 23 August 2005; the costs of the respondent's counter-application; the costs of the application in terms of Rule 35 (12) and the costs of the respondent's application for a stay of the liquidation proceedings. The scale of costs when the matter was postponed by Ancer AJ should be paid on the ordinary party and party scale.