BUY AND SELL – PACTUM SUCCESSORIUM OR NOT
The buy and sell agreement and pactum successorium

1. Introduction

1.1. A recent appellate division case sparked a debate whether a buy and sell is a pactum successorium and therefore invalid. The importance of the question cannot be underestimated since for decades the South African Financial Services and South African lawmakers and industry recognized and gave effect to buy and sell agreements.

1.2. A pactum successorium is part of the common law that stems from the Roman Dutch law and is in essence an attempt to limit the ability of a testator to testate.

1.3. The difference between a buy and sell and a pactum successorium is not subtle. It is blatant.

1.4. A buy and sell agreement is an eloquent way to effect succession planning in a business and ensures the continuation of a business should one of the co-owners in a business die or become disabled.

1.5. If anything, it protects the value of the asset for the benefit of the heirs to ultimate enable the testator to bequeath it to his heirs by way of his will. A buy and sell does not attempt to complete or in part replace the will.

1.6. A buy and sell agreement is NOT a pactum successorium.

2. Background

2.1. I will attempt to provide a brief background on buy and sell solutions.

2.2. The buy and sell solution has been an accepted business practice in South Africa for decades, and not without reason.

2.3. Many stakeholders are affected by a business which places a strong obligation on the owners to ensure smooth transition of a business in the event of an untimely demise or disability of a co-owner as part of the succession planning process of the business.

2.3.1. Credit providers need certainty that their debts will be settled and going forward that the business will be able to settle new debts;
2.3.2. Employees need to know that their salaries will be paid and that they will have jobs going forward even after the death of an owner / co-owner;

2.3.3. On a macro level the country’s economy would need the business to remain open to ensure that:

2.3.3.1. the tax base is protected;
2.3.3.2. the jobs that was created in the business are protected; and
2.3.3.3. the businesses remains open and continues to contribute to the GDP.

2.4. There are a number of other stakeholders that would be affected if the business closes down after the death / disability of an owner:

2.4.1. employees are potentially affected;
2.4.2. clients are potentially affected; and
2.4.3. suppliers are potentially affected.

2.5. On a micro level, the stakeholders are severely affected with the death or disability of a co-owner. When a co-owner in a business dies or become disabled, it can leave the deceased owner’s estate severely exposed, but it can also create potential problems for the remaining owners.

2.6. The potential problems created for the deceased owner are:

2.6.1. The remaining owners might not have the resources to purchase the shares from the deceased estate;
2.6.2. The spouse of the deceased owner may not want to participate in the business which means that he/she is left at the mercy of the existing owners;
2.6.3. The deceased owner may have had unique skills that he/she brought to the business, and thus the risk in the business increases if those skills are no longer available to the business;
2.6.4. The deceased owner may have earned a salary in the business, and when he/she dies the spouse cannot simply
claim that salary unless he/she actually works in the business on the same basis as the deceased owner. It would be an unfair burden on the company to pay a salary to heirs of the deceased owner who do not make any contribution to the success of the business.

2.7. The potential problems it creates for the remaining owners are:

2.7.1. The executor of the estate of the deceased owner might interfere in a business of which he knows nothing;

2.7.2. He might want to sell the owner’s interest to the highest bidder, opening the business to outside investors; and

2.7.3. The existing owners may not have the funding to repurchase the owners interest at that stage.

2.8. The buy and sell solution offers an elegant succession plan for the business.

2.9. The primary purpose of a buy and sell arrangement is to provide the business with a chance to survive by enabling the surviving partner(s) with cash to purchase the interest of a deceased or disabled partner.

2.10. A buy and sell solution presents a smooth exit to a partner in the event of death or disability of a co-owner and ensures continuity of business at the demise of an owner.

2.11. The suggested solution is based on two parts i.e.:

2.11.1. Co-owners enter into a buy and sell agreement to force the sale at a predetermined or determinable value at occurrence of a certain event (death and/or disability); and

2.11.2. Provides liquid capital through a policy to fund the forced sale.

2.12. It is important to note that in the shareholders, association or partnership agreement a pre-emptive right is normally awarded to the remaining owners.

2.13. Under normal circumstances it creates an opportunity to purchase, but it is not a forced sale. It does not automatically create the funding for the remaining owners to repurchase the deceased or disabled
owner’s interest.

2.14. The buy and sell solution was designed for the specific reason to effectively facilitate an automatic sale in the event of death and/or disability of an owner in a business.

2.15. The solution is funded by insuring the lives of the existing owners to enable the funding of the capital at the time that the event occurs.

2.16. It is once again important to note that the solution consist of 2 parts i.e.:

2.16.1. an agreement that creates an obligation between the parties; and

2.16.2. a long-term insurance policy on the life of each owner to fund the obligation to purchase, created in the aforementioned agreement.

3. Structure

3.1. The buy and sell agreement is structured between the shareholders. To fund this agreement, each of the shareholders (i.e. trustees/individuals as the case may be) will take out a policy on the lives of the other shareholders. The structure is graphically illustrated in the figure on the next page.

Figure- A typical buy and sell structure

4. Agreement

4.1. A buy and sell agreement/contract is entered into between the owners of the business.
4.2. In the agreement (1) rights and (2) obligations are created when the agreement is signed between the co-owners. The rights and obligations are dependent on certain and/or uncertain trigger events, uncertain in time. The agreement is normally triggered in the event of (1) death and/or (2) disability of a co-owner.

5. The rights and obligations created in the agreement

5.1. The agreement affords the remaining owner a right to purchase the affected owner’s share in the business. The event that triggers the sale is uncertain in time and could be the death or disability of the affected owner.

5.2. It also places an obligation on the owner to be able to fund the purchase price with a life policy of which the premiums must be paid to date.

5.3. Please note that this is not a right to inherit the business. This is probably one of the main reasons why it is not a pactum successorium. There is no disposition without value. There is an obligation to sell and a right to the proceeds of the sale. There is NO limit placed on the contracting parties in terms of their ability to bequeath the proceeds of the sale of business to any party. This is dealt with in the respective wills of the parties.

6. Accepted business practice

6.1. This business practice has developed mainly in the life assurance industry and has been an acceptable business practice for decades. Tens of thousands of these agreements have been effected and has been applied by the Master in deceased estates. If nothing else, it became common law.

6.2. It has become an acceptable business practice, and is most certainly not contra bonis mores.

7. Recognition in the South African Law

7.1. It does not end there. Buy and Sell arrangements specifically receives recognition in South African law. In terms of Section 3(3)(a)(iA) of the
Estate Duty Act, the government allows relief from estate duty on the proceeds of a policy funding a buy and sell structure. That is a direct recognition of a buy and sell structure as a valid agreement and the legislator specifically provides a tax dispensation aimed at the buy and sell agreement.

7.2. If a policy to fund a buy and sell arrangement is structured correctly, the proceeds of that policy will be free of estate duty.

7.3. As stated above, policies on the life of a deceased is included in his estate as deemed property, but a policy taken out with the purpose to fund a buy and sell agreement qualifies for the **section 3(3)(a)(iA) of the Estate Duty Act** exemption i.e. the proceeds will not be subject to estate duty.

7.4. In terms of the proviso (iA) of section 3(3)(a) of the Estate Duty Act 45 of 1955, the proceeds of the polices will be free of estate duty if:

"(iA) the Commissioner is satisfied that the policy was taken out or acquired by a person who on the date of death of the deceased was a partner of the deceased, or held any share or like interest in a company in which the deceased on that date held any share or like interest, for the purpose of enabling that person to acquire the whole or part of—

aa) the deceased's interest in the partnership concerned; or

bb) the deceased's share or like interest in that company¹ and any claim by the deceased against that company, and that no premium on the policy was paid or borne by the deceased;"

7.5. Section 3(3)(a)(iA) avoids double estate duty by exempting the proceeds of the policy intended for a buy and sell solution².

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¹ According to the definitions of the Estate Duty Act a company includes any association incorporated or registered under any law in force in the Republic and any association which, although not so incorporated or registered, carries on business or has an office or place of business or maintains a share transfer register in the Republic.

² Since the 2008/2009 tax year estate duty is calculated at 20% of an estate that exceeds R 3.5 million. There are various deductions granted in the Estate Duty Act.
8. **The pactum successorium**

8.1. The common law recognizes the principle of freedom of testation. This is the power to make, amend or revoke a will at any time. A contract in terms which limits the aforementioned right is a so called pactum successorium and it is seen as *contra bonos mores* or against the good morals of society to do it.

8.2. The courts describe a contract by a person to make any other person a beneficiary under his or will is not enforceable as being a *pactum successorium*.

8.3. A *pactum successorium* is effectively an agreement to limit your own ability to bequeath your assets. A pactum successorium is an ‘agreement which purports to limit a contracting party’s freedom of testation by irrevocably binding him to post-mortem devolution of the right to an asset in his estate.

8.4. “If the term ‘*pactum successorium*’ is used to describe a prohibited agreement which seeks, directly or indirectly, to regulate succession on death, and if deprivation or restriction of testamentary freedom is accepted as the basic criterion for the unlawfulness of such an agreement, then the identifying characteristics of a pactum successorium are

(a) that it purports to effect a post mortem disposition of an asset in the estate of a contracting party by providing for a devolution of the right to that asset from the party, after his death, to another person; and

(b) that it seeks to prevent the contracting party from revoking the disposition, either by testament or by act inter vivos. The former characteristic gives the agreement its testamentary nature, while the

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3 Ahrend & Others v Winter 1950 (2) SA 682 (T); Varkevisser v Estate Varkevisser and Another 1959 (4) SA 196 (SR); Costain & Partners v Godden NO and Another 1960 (4) SA 456 (SR); Schauer NO v Schauer 1967 (3) SA 615 (W); Ex parte Calderwood NO: In re Estate Wixley 1981 (3) SA 727 (Z).
latter supplies the ground for its invalidity”⁴.

8.5. A will takes effect on the death of the testator. The testator may revoke his will any time before his death. Any beneficiary in terms of his will has no more than a *spes successionis* and any agreement in terms of which a testator purports not to revoke his will, is invalid. Furthermore, any agreement whereby the testator contracts with another to regulate the transfer of the estate after the death of the testator is viewed as a *pactum successorium, and is invalid⁵*.

8.6. “…A will takes effect on the death of the testator and, therefore, he may at any time before his death revoke his will. A beneficiary under a will has no more than a *spes successionis* and any agreement in terms of which a testator purports not to revoke his will, is invalid. Furthermore, any agreement whereby the testator contracts with another to regulate the devolution of the estate after the death of the testator, the so called *pactum successorium*, is also invalid⁶.

8.7. Van der Merwe⁷ concludes that there are two valid pactum successoriums i.e. a donation in an ante nuptial agreement and a *donatio mortis causa*. Both agreements cause a succession of assets. In the word of Van der Merwe “…beide kontrakte erfopvolging tot gevolg kan hê.” And this is the essence of the “*pactum successorium*”. He further argues that nothing in sec 4 in the Testamentary Act prohibits a person to limit his/her ability to testate. It stems from our common law.⁸

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⁵ McAlpine v McAlpine NO [1997] 1 All SA 264 (A)
⁶ McAlpine v McAlpine NO [1997] 1 All SA 264 (A)
⁷ van der Merwe, NJ *Die Suid-Afrikaanse Erfreg*, 1990
⁸ James v James’ Estate, 1941 E.D.L. 67; van Jaarsveld v van Jaarsveld’s Estate 1838 T.P.D. 343; Berman v Winrow, 1943 T.P.D. 213; Ahrend v Winter, 1950 (2) SA 682 (T);
8.8. No agreement which attempts to testate will be valid outside the 2 cited exceptions.

8.9. In Schauer, NO v Schauer, 1967 (3) SA 615 (W) the judge ruled as follows: “It is a bilateral contract and if it is a true pactum successorium it is invalid, unless it can be established that a quid pro quo had been accorded to the promissor” (My underlining).

9. In essence the pactum successorium has the following elements:

9.1. It is an agreement to bequeath assets to a contracting party outside of the will.

9.2. A pactum successorium is not valid in South African law.

10. The van Aardt Case (Van Aardt v Van Aardt 2007 (1) SA 53(E))

10.1. This is a recent (delivered in 2005) high court decision which sparked quite a debate on buy and sell agreement.

10.2. In the Eastern Cape division case of Van Aardt v Van Aardt and 2 others 2007 (1) SA 53(E) the court was confronted with an agreement of sorts (not a buy and sell agreement) and the court had to consider whether this agreement constituted a pactum successorium and was consequently invalid.

10.3. Two brothers entered into an agreement to state the following:

10.3.1. The purchaser was identified as brother STEPHANUS CORNELUIS VAN AARDT (“B”) or his descendants.

10.3.2. The seller was identified as JACOBUS VAN AARDT (“A”) (My references of “A” and “B”) to simplify the explanation on the agreement.

10.4. The agreement stated the following:

10.4.1. If A died before B, then B or his descendants would purchase the property.

10.4.2. If B died before A then the life policy would remain in effect and B or his descendants (legal successors) would still have to purchase the property.
10.5. The relevant extracts as quoted in the case is quoted for your convenience:

“UTGESTELDE KOOPKONTRAK

Aangegaan tussen:

STEPHANUS CORNELUIS VAN AARDT
>ID Nommer 571129 5058 08 2

of sy Regsopvolgers (NASATE)

Hierna genome die “KOPER’)

EN

JACOBUS VAN AARDT
>ID Nommer 600426 5212 08 0)

(Hierna genoem die VERKOPER’)

DIE PARTYE KOM SOOS VOLG OOREEN:

1. VASTE EIENDOM

Die KOPER of sy regsopvolgers (NASATE) koop alle vaste eiendom vanaf die VERKOPER by wyse van ’n uitgestelde Koopooreenkoms.

2. KOOPPRYS

Die partye kom ooreen dat die KOPER of sy NASATE by datum van afsterwe van die VERKOPER die eiendom deur ’n Landbank-waardeerder sal laat waardeer en dat die prys gelykstaande aan die waardasie van die Landbankwaardeerder en/of die opbrengs van Liberty Polis, Polisnommer 58953404700, welke Polisopbrengs nie die Landbankwaardasie sal orskry noe, as kooprys vir die eiendom sal aanbied.
3. **RESTAANT VAN LIBERTY POLIS**

Die partye kom ooreen dat indein daar ‘n balans oorbly op die Liberty Polis nadat die Landbankwaardeerder die grond waardeer het en die opbrengs van die Polis aangewend is om in die VERKOPER se boedel in te betaal, die balans daarvan aan die KOPER noorbetaal sal word.

4. **KOPER SE AFSTERWE**

Die partye kom ooreen dat indien die KOPER voor die VERKOPER sou sterf, die polis instand gehou sal word deur die VAN AARDT BROERS se gesamentlik rekening totdat die VERKOPER afsterf.

   4.1 Die partye kom ooreen dat enige betaling wat gemaak word uit VAN AARDT BROERS se gesamenlike rekening afgeskryf sal word teen die lenings rekening wat aan die KOPER deur die VAN AARDT BROERS verskuldig is.

5. **DOMICILIUM**

6. **KONTRAKBREUK**

Die partye kom ooreen dat indien enige van die partye in breek is van die kontrak, die party wat nie in breek is van KONTRAK nie, viertien(14) [dae] kennis aan die partye wat in breek is van die KONTRAK kan gee om sy gebrek in die KONTRAK te herstel. Indien sodanige party nie die gebrek binne die genoemde periode herstel nie, sal die benadeelde party spesifieke nakoming kan eis, en/of die KONTRAK kanselleer en skade eis.

7. **BESKRYWING VAN DIE EIENDOM**

Die eiendom van die VERKOPER soos in KLOUSULE 1 uiteengesit se beskrywing is soos volg:

2 eenhede saamgestelde eiendomme bekend as Krantzkloof en Niekerksberg in Somerset Oos Distrik.’

10.6. The inherent problem with this contract is 3 fold;
10.6.1. The class of purchasers is indeterminate; meaning that before B's death, we do not know who the purchasers are;

10.6.2. The purchasers are mutually exclusive ("B or his descendants"); and

10.6.3. The contract limited B's ability to testate by limiting the transfer of his right to purchase the property from his brother A.

10.7. In the event of A's death, the purchasers are effectively mutually exclusive because we cannot determine whether the purchaser is going to be B or his descendents. It is the one or the other but not both. A further question was raised by the panel of judges i.e. who will be the purchaser if A predeceases B? The contract did not state that it is going to be B whilst he is alive, and if he predeceased A and A dies, the purchaser will be B's descendents. The contract bluntly stated that the purchaser is either B or his descendents.

"The first problem identified is addressed by the learned judge as follows: not take into account that the agreement confines successors in title to descendants. There can never be certainty that the seller will be survived either by the purchaser or his descendents. Secondly, the purchaser is named in the agreement as Stephanus Cornelius van Aardt or his descendents, whoever they may be. This is not a case of the nomination of purchasers as members of a class whose membership is determined on the date of the agreement. The nomination of descendents therefore gives rise to possible uncertainty about the identity of the ultimate purchaser. There may be a number of descendents and those of them who survive the seller, if any, are undetermined until the death of the seller. Rights cannot vest in undetermined members of a class, whether or not the undetermined members all belong to a specified group, such as descendents." (My emphasis)

10.8. This is unfortunately not where the problems end with this agreement. The learned judge states very specifically the following
“The identity of the descendants is not the only difficulty. The agreement describes the purchaser as Stephanus Cornelius van Aardt or his descendants. The purchaser cannot be both. This is a case of two possible categories of purchaser what [who] are nominated in the alternative and whose nominations are mutually exclusive. The following question arises: if there was a vesting of rights that occurred immediately upon the conclusion of the agreement as Plasket J. held, in whom did those rights vest? They cannot have vested in both the respondent and his descendants at the same time because they are not joint purchaser. The judge further states:

“[9] In my view the conclusion from this is inescapable that by providing for the person who buys the farms to be either the purchaser or his successors in title (descendants), the parties have by necessary implication postponed vesting to the date of the seller’s death, and the only rights that Stephanus Cornelius van Aardt or his descendants acquires on the date of the agreement are contingent. A further conclusion is also inescapable: it is that the contract makes an irrevocable post mortem disposition of the right to acquire the seller’s farms. It is therefore a prohibited pactum successorium. “

(my emphasis)

10.9. In the words of the learned judge the pactum successorium lies with the purchaser in this case if he predeceases the seller. The contract makes an irrevocable post mortem disposition of B’s right to purchase the sellers (A’s) farm.

10.10. It is because of the specific wording of contract being:

“Die KOPER of sy regsopvolgers (NASATE) koop alle vaste eiendom vanaf die VERKOPER by wyse van ’n uitgestelde Kooporeenkoms”

10.11. This contract is very different from a buy and sell agreement.

10.12. The practical implication of how the agreement was drafted is that what happens if B predeceases A. Now there remains an obligation
on the estate of B or his descendants to purchase the farm from the seller’s estate.

10.13. This is highly irregular and most certainly not a buy and sell construct.

10.14. This agreement inherently creates a number of problems and the writer respectfully agrees with the judges of the appellate division when they say that THIS AGREEMENT is a “pactum successorium”.

Scenario 1: if A dies first then B or his decedents purchases

Problem 1 – Who buys – Is it B or his descendants? They are mutually exclusive.

Scenario 2: B Dies first then B or his descendants still purchases

Problem 2. Descendants are not identified.

Problem 3. Because of the way the agreement was drafted, if B dies, he is prevented from bequeathing the asset because he contracted that he (B) or his descendants will purchase from his brother. That was indicated by the court as the pactum successorium.

10.15. I fully understand the courts view and fully agree with it.

10.16. Think of the practical problems such an agreement creates. It could potentially mean that B’s estate cannot be wound up until A dies. That could literally be decades. Further if B dies, before A, his
descendants are now forced to purchase the farm from A.

10.17. This constitutes another problem – The unidentified descendants were not party to the agreement. The courts did not touch on that aspect because it was not necessary to touch on it, but it speaks to the fundamental principles of a valid agreement.

10.18. The punch line however is that the judge said that B was prohibited in terms of his will to transfer / bequeath his right to purchase the farm from A. This is the pactum successorium in the agreement in relation to B and his estate and his ability to testate. This is very different from a buy and sell.

11. Compare the pactum successorium and the buy and sell

<table>
<thead>
<tr>
<th>Pactum Successorium</th>
<th>Buy and Sell</th>
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<tbody>
<tr>
<td>Attempt to bequeath assets outside of the will.</td>
<td>Does not attempt to limit the ability to testate. A practical way to convert a non-liquid asset to cash. The cash is bequeathed in the will. No attempt to limit the ability of the testator to testate.</td>
</tr>
<tr>
<td>There is no quid pro quo i.e. the contracting party does not pay for the promised asset</td>
<td>There is a clear quid pro quo. The parties agree on a performance for the asset which is in a form of cash, which cash forms part of the estate and can be bequeathed to the heirs.</td>
</tr>
<tr>
<td>No rights are created.</td>
<td>Rights are created in the agreement in that the purchasing party has a right to purchase in the event of death and disability.</td>
</tr>
<tr>
<td>No obligation is created in the agreement on the receiving party to pay for the asset. It is an attempt to bequeath the asset.</td>
<td>Obligation to pay for the asset is created on the receiving party. The testator while in life exercises his right to sell an asset when he/she dies or becomes disabled. He/she does not</td>
</tr>
<tr>
<td>Attempt to bequeath the converted asset.</td>
<td>Attempts to limit the testators ability to testate</td>
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<td>----------------------------------------</td>
<td>-----------------------------------------------</td>
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<tr>
<td>Not a valid agreement in South African law but for 2 exceptions i.e. the donation mortis causa and a donation in an ante-nuptial agreement.</td>
<td>Valid agreement recognized in South African law (Estate Duty Act), a responsible business practice for decades in South Africa.</td>
</tr>
</tbody>
</table>

12. Conclusion

12.1. The difference between a *pactum successorium* and a buy and sell agreement is not a subtle...it is blatant.

12.2. A buy and sell is an eloquent way to solve a dire real need in the economy being to provide a business with a viable succession plan. With a proper succession plan (of which the buy and sell agreement is central) for a business, the business is given a chance to survive to enable the business to pay its creditors, further contribute to the tax base of the country, contribute to stability in the job market, provide certainty to suppliers, certainty to credit providers, and finally certainty to employees.

12.3. On a micro level it protects the remaining owners and the deceased owner’s assets.

12.4. This cannot be contra bones mores, in fact, quite the contrary. A proper succession plan for business is an **obligation on every single business owner**. If anything, it protects the ability to bequeath the fruit of the asset to his/her heirs in their wills.

**Kobus Barnard**

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