PIERCING THE CORPORATE VEIL: A CRITICAL ANALYSIS OF SECTION 20(9) OF THE COMPANIES ACT 71 OF 2008

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DECLARATION

I, **SIPHETHILE PHIRI**, student number 11613064 hereby declare that the dissertation for the LLM degree at the University of Venda, hereby submitted by me, has not been submitted previously for a degree at this or any other university, and that it is my own work in design and execution, and that all reference materials contained therein have been duly acknowledged.

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DEDICATION

To God the Almighty who made this work possible and to my present and future family including Vanessa Mandisa Phiri.

WITH LOVE

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I am so thankful to God the Almighty who made this work possible and for me to walk through such a tempestuous journey. At times it had been difficulty such that I desired to quit but because of His love and perseverance He gave me power and strength to pursue.

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Once a company is incorporated it becomes a juristic entity, distinct and separate from its incorporators. Thus, the company bears its own liabilities. However, section 20(9) of the Companies Act 71 of 2008 grants the courts the discretion to disregard the separate legal personality of a company where there is unconscionable abuse of the juristic personality of the company. However, the challenge is that the section fails to define what constitutes "unconscionable abuse". This research thus investigated what constitutes unconscionable abuse of the juristic personality of the company as the ground for piercing the corporate veil. Simply put, this research identified the circumstances under which the corporate veil may be pierced, given the confounding provisions of section 20(9). In unravelling the problems posed by the said section, the researcher employed a combination of doctrinal legal research methodology and comparative research methodology which involve the scrutiny of 'black letter of the law' and the laws of other jurisdictions. The result from this extensive inquiry is that the term 'unconscionable abuse' is a legislative derivate from the various terms used by the courts at common law to justify the disregarding of the separate legal personality of the corporate entity. Therefore, the inescapable conclusion reached is that just as those terms used at common law are confounding, so shall this legislative innovation. Therefore, in order to resolve this problem each matter should be dealt with based on its peculiar facts.

Keywords: Company, director, juristic person, lifting of the veil, piercing the corporate veil, juristic person and unconscionable abuse

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CHAPTER ONE

INTRODUCTION

1.1 BACKGROUND TO THE STUDY

It is crucial to note from the beginning that South African company law is an import of English law.[1] However, in the past decades, internal statutes have been promulgated and are amended from time to time to suit the needs of the country. At present the South African company law is regulated by the Companies Act[2] which is complemented by the principles of common law and case law.

The formation of companies by way of registration which granted companies juristic personality status started in England in 1844 in terms of the 1844 Joint Stock Companies Act and was followed by the doctrine of limited liability in terms of the 1855 Limited Liability Act. In 1897 the concept of separate legal personality of a company was acknowledged in the leading English case of *Salomon v Salomon & Co Ltd* [3] where the House of Lords held that as a general principle, shareholders, directors and incorporators of a company cannot be held liable for the debts and liabilities of a company given the separate legal personality status of a company.

In that matter, the House of Lords came up with dual concepts of corporate entity and limited liability. The concept of corporate entity entails that when a company is formed it acquires legal personality entirely separate from that of the shareholders, directors and any other persons related to the company. This was confirmed by Lord Macnaghten where he held that 'the company is at law a different person altogether from the subscribers to the memorandum'.[4]

In addition, the separate legal personality of a company is viewed by many scholars *inter alia* Cassim[5] as the foundation of company law, since most of the concepts of company law are founded on it. This concept leads to the concept of limited liability which entails that the company's liabilities do not extend to the shareholders of the company but is only confined to the company itself.[6] It should be noted that even though shareholders incur some liabilities in relation to the company, such liabilities do not extend beyond the number of shares subscribed to by the shareholders.[7] The company directors like shareholders, as a general rule are excluded from liability for the conduct they perform on behalf of the company provided such

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[1] JT Pretorius and P A Delport (ed) *Companies in General: Hahlo's South African Company Law Through the Cases A Source Book, A collection of Cases on Company Law with Explanatory Notes and Comments* (1999) 1-2.
[2] Act 71 of 2008, hereinafter referred to as 'the Act'.
[3] [1897] AC 22.
[4] *Supra* at 48.
[5] R Cassim 'Piercing the Veil under Section 20(9) of the Companies Act 71 of 2008: A New Direction' (2014) *Vol. 26 No. 2, South Africa Mercantile Law Journal* 307.
[6] RB. Thompson 'Piercing the Corporate Veil: An Empirical Study' (1991) *Vol. 76 No. 2, Cornell Law Review* 1036.
[7] JJ Henning, D H Botha & E M De La Rey *Introduction to Company* (1985) 2.

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conduct fall within the scope of their fiduciary duties. To support the above submissions, section 19(2) of the Act provides as follows:

> A person is not, solely by reason of being an incorporator, shareholder or director of a company, liable for any liabilities or obligations of the company, except to the extent that this Act or the company's Memorandum of Incorporation provides otherwise.

The principle of separate legal personality of a company also entails that the assets of a company are not owned by the company incorporators, shareholders or directors, rather they belong to the company itself.[8] This was bolstered by Innes CJ in *Dadoo Ltd v Krugersdorp Municipal Council*[9] where he held as follows:

> Taking the intention then to be the prohibition of ownership of fixed property by the Asiatic and prohibition of the acquisition and occupation of mining rights by the Coloured people, I come to enquire whether the transaction complained of is a contravention of the statutes. In other words, whether the ownership by Dadoo Ltd, is in substance ownership by its Asiatic shareholders. Clearly in law it is not. A registered company is a legal persona distinct from the members who compose it.

Additionally, the company shareholders lack proprietary interests in the assets of the company despite the fact that they hold shares in the company because of the separate legal *persona* of a company.[10] This was buttressed by the House of Lords in *Macaura v Northern Assurance Company Ltd*[11] where Lord Sumner stated as follows:

> My Lords, this appeal relates to an insurance on goods against loss by fire. It is clear that, the appellant had no insurable interest in the timber described. It is not his. It belongs to the Irish Canadian Sow Mills Ltd of Skibbereen, Co Cork.

Notably, section 19(1)(a)(b) of the Act which confirms the separate legal personality of a company, is in line with the doctrine established by the House of Lords in *Salomon's* case.[12] The section provides as follows:

> (1) From the date and time that the incorporation of a company is registered, as stated in its registration certificate, the company-
> (a) is a juristic person, which exists continuously until its name is removed from the companies register in accordance with this Act;
> (b) has all of the legal powers and capacity of an individual, except to the extent that-
> (i) a juristic person is incapable of exercising any such power, or having any such capacity; or
> (ii) the company's Memorandum of Incorporation provides otherwise.

The section, in other words, entails that when the incorporation of a company is registered, from that date and time a veil is metaphorically formed which separates the company from its

[8] *The Shipping Corporation of India Ltd v Evdomon Corporation 1994* (1) SA 550 (A) at 565-566.
[9] 1920 AD 530 at 550.
[10] R Cassim *'The legal Concept of a Company'* in Cassim FHI, Cassim M.F, Jooste R, Shev J & Yeast J (eds) *Contemporary Company Law* (2013) 26.
[11] [1925] AC 619 HL 289.
[12] *Salomon's* case (note 3 above).

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incorporators, shareholders and directors.[13] This concept is known in law as the 'veil of incorporation'.[14] The greatest significance of this concept is the separate legal personality status of a company which treats a company as a legal person separate from its members.

It should also be taken into cognisance that the separate legal personality of a company is a figment concept of law though it is the foundation of company law.[15] This is attributed to the fact that, even though a company in law is viewed as a juristic person which has separate existence distinct from that of its shareholders and directors, it lacks existence of its own.[16] Lack of physical existence by a company implies that a company lacks capacity to engage in acts that are inherently human in nature, for instance companies can be a party to a lawsuit as well as to a contract.[17] Lack of physical existence of companies was demonstrated in the *Continental Tyre and Rubber Co (GB) Ltd v Daimler Co*[18] where the Court held that; "the artificial person called the corporation has no physical existence. It exists only in contemplation of law. It has neither body, parts nor passion".

The artificial nature of companies has compelled the companies through their shareholders to employ qualified persons known as company directors to be responsible for the administration of the company's daily affairs.[19] The administration of the business and the affairs of a company by company directors is made peremptory by the Act which explicitly provides in section 66(1) as follows:

> The business and affairs of a company *must* be managed by or under the direction of its board, which has the authority to exercise all of the powers and perform any of the functions of the company, except to the extent that this Act or the company's Memorandum of Incorporation provides otherwise.

The number of directors which comprise a board[20] depends on the type of a company. For instance, a non-profit company must have at least three directors whereas Profit Company requires a minimum of one director.[21] However, according to section 66(3) of the Act, a company's Memorandum of Incorporation may specify a higher number of directors in substitution for the stipulated minimum number of directors.[22]

Getting back to the topic of concern; the separate legal personality of a company, in a number of cases the separate personality of a company has been abused by the controlling minds of

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13 Cassim (note 5 above) 38.
14 FHI Cassim *The Practitioner's Guide to the Companies Act 71 of 2008* (2011) 21.
15 *Prest v Petrodel Resources Ltd and Others* [2013] UKSC 34 para 8 where Lord Neuberger stated that the separate legal personality of a company is indeed a fictitious concept of company law and the English company law and law of insolvency are founded on this fiction.
16 Cassim (note 14 above) 17.
17 *Ibid.*
18 [1915] 1 KB 893 at 916.
19 Cassim (note 14 above).
20 Section 1 of the Act, a board refers to the board of directors of the company.
21 Section 66(2)(a)(b) of the Act.
22 See section 66(2).

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the company who tend to hide behind the corporate veil in order to avoid liability.[23] Therefore, to obviate such conduct of the controllers, the courts have in certain justified circumstances disregarded the separate legal personality of a company and pierced the veil of incorporation in order to reach the perpetrators hiding behind the veil of incorporation. The piercing of the corporate veil has been described by Lord Neuberger in *Prest v Petrodel Resources Ltd & Other*[24] as a *bona fide* exception to the principle established in the case of *Salomon.* The concept of disregarding the corporate veil is variously referred to as the piercing, lifting, ignoring, peeping or looking behind the corporate veil.[25] It is however, not settled as to the appropriate expression to be used to describe the disregarding of the separate legal personality of a company. In most cases these terms had been used interchangeably. Cassim[26] observed that, "'piercing the veil' and 'lifting the veil' are in actual fact distinct and different legal terms with different legal consequences. The two concepts must not be used interchangeably".

In the case of *Atlas Maritime Co SA v Avalon Maritime Ltd, The Coral Rose (No. 1)*[27] Staughton LJ held that:

> To pierce the corporate veil is an expression that I would reserve for treating the rights or liabilities or activities of a company as the rights or liabilities or activities of its shareholders. To lift the corporate veil or look behind it, on the other hand, should mean to have regard to the shareholding in a company [in other words, to its controllers] for some legal purpose.

However, Van Heerden JA in the case of *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd and Others*[28] stated as follows:

> What is entailed on any approach, whether it be called a 'piercing' or a 'lifting', is a facts-based determination by the courts in certain cases to disregard some or all of the characteristics of separate legal personality that statute law ordinarily attributes to a duly incorporated company.

The researcher would not delve into this judicial matter but will rather focus on the circumstances under which the courts will pierce the corporate veil in order to reach the controlling minds of a company for the purposes of imposing liability upon them where there is unconscionable abuse of the juristic personality of a company. Based on Staughton LJ's decision in *Atlas Maritime Co SA v Avalon Maritime Ltd, The Coral Rose (No.1)*[29] the researcher favours the phrase 'piercing of the corporate veil' since it is the one which relates

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[23] *Prest* case (note 15 above) para 27.
[24] *Ibid* para 16.
[25] A Dignam and J Lowry *Company Law* (2013) 31.
[26] Cassim (note 14 above) 22.
[27] [1991] 3 All SA 769 at 779.
[28] 1995 (4) SA 790 (A) at 808.
[29] *Atlas Maritime Co SA* case (note 27 above).

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to the treating of the liabilities or activities of a company as the liabilities or activities of its directors or shareholders.

Piercing of the corporate veil in South Africa is provided for by section 20(9)(a)(b) of the Act which provides as follows:

> If, on application by an interested person or in any proceedings in which a company is involved, a court finds that the incorporation of the company, any use of the company, or any act by or on behalf of the company, constitutes an unconscionable abuse of the juristic personality of the company as a separate entity, the court may –
> (a) declare that the company is to be deemed not to be a juristic person in respect of any right, obligation or liability of the company or of a shareholder of the company or, in the case of a non-profit company, a member of the company, or of another person specified in the declaration; and
> (b) make any further order the court considers appropriate to give effect to a declaration contemplated in paragraph (a).

The provisions of common law in respect of piercing of the corporate veil at present applies where the section is not applicable or where the requirements of the section are not fulfilled. Therefore, this demonstrates that common law and section 20(9)(a)(b) of the Act are compliments rather than substitutes. This observation was strengthened by Binns-Ward J who stated that it is appropriate to regard s 20(9) of the Companies Act as supplemental to the common law, rather than substitutive.[30]

It is to be noted that in spite of the provisions of section 20(9), the courts are still facing serious challenges with regard to the piercing of the corporate veil due to the fact that the section does not define what amounts to unconscionable abuse of the juristic personality of a company. The section only provides that the courts may disregard the corporate veil where there is "unconscionable abuse" of the juristic personality of a company as a separate entity in relation to the company's formation, use or acts by the company or on its behalf.

At common law where the corporate personality of a company has been used to perpetrate fraud or where the company is said to be a sham or mere façade, the courts have ignored the corporate veil in order to reach the controllers of the company.[31] These circumstances according to section 20(9) undoubted fall within the ambits of unconscionable abuse of the juristic personality as would be shown in the succeeding chapter.

Even though the courts have always grappled with the circumstances under which the corporate veil may be pierced, each case has been considered based on its unique facts. This

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[30] *Ex parte Gore NO and Others NNO* [2013] 2 All SA 437 (WCC) para 20.
[31] *Ibid.*

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was noted by Smalberger JA in the *Cape Pty Ltd v Lubner Controlling Investment (Pty) Ltd & Others*[32] by stating as follows:

> The law is far from settled with regard to the circumstances in which it will be permissible to pierce the corporate veil. Each case involves a process of inquiring into the facts, which, once determined, may be of decisive importance.

The challenge of determining the circumstances under which the corporate veil may be pierced has also been alluded to by Cassim[33] who stated that:

> The grounds on which the Courts will pierce the corporate veil have been difficult to state with certainty. Courts have grappled with the correct approach to adopt in determining whether or not to pierce the corporate veil.

The principle of piercing the corporate veil is also described by Farrar as 'inconsistent and unprincipled'.[34] As such, one of the reasons for conducting this research is to discover and objectively analyse the circumstances under which the corporate veil may be pierced. Since section 20(9)(a)(b) of the Act which deals with the issue of the piercing of the corporate veil does not define the circumstances under which the corporate veil may be disregarded by the courts.

1.2 Statement of the problem

It seems that section 20(9) of the Act grants the courts very wide discretion as compared to common law, to disregard the separate legal personality of a company where there is unconscionable abuse of the juristic personality of a company. However, courts and even scholars are not clear as to what constitutes 'unconscionable abuse' which formed the basis for the exercise of the discretion under that provision.

As such, this study examines the circumstance under which the courts may disregard the legal personality of a company in terms of section 20(9) of the Act. In other words, the study identifies and discusses the conducts which constitutes unconscionable abuse of the juristic personality of a company as a broad ground for piercing of the corporate veil in terms of the section.

1.3 Aim and Objectives of the study

1.3.1 Broad Aim

To determine what constitutes 'unconscionable abuse' of the juristic personality of a company as a distinct entity.

1.3.2 Specific Objectives

In archiving the aim of this study, the following objectives were pursued:

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[32] *1995* (4) 790 (AD) para 123.
[33] Cassim (note 14 above) 42.
[34] J. Farrar 'Fraud, Fairness and Piercing the Corporate Veil' (1990) Vol. 474 No. 478 Canadian Law Journal 16.

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- To discuss the consequences of incorporating a company *vis-à-vis* the separate legal personality of a company.
- To assess and examine case laws and statutes in which the doctrine of piercing the corporate veil was considered.
- To examine the duties and responsibilities of company directors.
- To examine the binding effects of the section 15 contract.

1.4 Research questions

The questions addressed in this research are as follows:

- Is the separate legal of a company the foundation of the other consequences of company incorporation?
- What constitutes unconscionable abuse of the juristic personality of a company as a distinct entity?
- Should the piercing of the corporate veil be a remedy readily available to the courts where the separate personality of a company has been abused?
- What are the duties and responsibilities of company directors to a company?
- What are the binding effects of section 15 contract?

1.5 Hypothesis

The present research is based on the hypothesis that even though the Act in section 20(9) grants the courts the discretion to pierce the corporate veil where there is unconscionable abuse of the juristic personality of a company as a separate entity, the term "unconscionable abuse" remains confounding with no clear definition.

The authenticity of this hypothesis was tested by a critical examination of primary and secondary sources such as legislation, case law, textbooks and journal articles, which are known as the 'black letter of the law', information obtained from the internet sources was also used.

1.6 Scope of the research

The study focuses on the powers of the court to disregard the separate legal personality of the company and the imposition of liability on the controllers for transactions which are seemingly those of the company. Specific attention is paid to section 20(9) of the Companies Act being the primary provision that presently encapsulates the judicial powers to disregard the separate legal personality of a company under the South African law.

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The study explores other ancillary areas of the corporate governance such as the duties of the directors as imposed by the law in order to discover the roles which the company directors are expected to play in corporate management and beyond which creates the room for the piercing of the corporate veil.

The research further examines the incorporation of companies and the consequences of such. The binding effects of the section 15 contract which has been given less attention by the scholars in the past is also deeply examined. Other ancillary matters of company law are also addressed.

1.7 Significance of the study

This research adds value both to the academics and judiciary discourse as it examines in depth the circumstances under which the corporate veil may be pierced by the courts, a part of corporate law which is still subject to disputes.

It is important that those investing in the corporate structure should fully understand their status *vis-a-vis* the corporation. Again, the controllers who manage such investments must know the limits of their powers and those dealing with the company should know who to hold responsible where there is a failure by the company to fulfil its obligations to its creditors.

The presently ill-defined approach to the disregarding of the separate corporate personality could, if left unchecked, derail the real purpose of the corporate entity as an avenue for investment for all levels of income earners without assuming the risk of incurring personal liability resulting from the failure on the part of corporation to fulfil its obligations.

1.8 Literature review

Cassim[35] argues that company law is founded on the separate legal personality of a company. This is in line with section 19(1)(a) of the Act which provides that, upon registration of an incorporation of a company, the company becomes a juristic person distinct from its incorporators, shareholders and directors. Consequently, it acquires all the rights just like an individual to the extent to which it is capable to exercise them. Hence, this indicates the importance of separate legal personality of a company in company law. The present research brings out that though the separate legal personality of a company is of paramount importance in company law, the courts will disregard the separate legal personality of a company by piercing the corporate veil in order to impose personal liability upon the controlling minds of the company where there is unconscionable abuse of the juristic personality of a company.

[35] Cassim (note 5 above).

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Mthembu in his Master's thesis also supports the importance of the separate legal personality status of a company. Mthembu posits that in a well-established legal system, there is need to create artificial legal persons with the ability to acquire rights and incur responsibilities similar to those of natural persons.[36] Accordingly, the corporate veil separates the corporation from its shareholders and directors thereby giving the corporation a separate legal personality distinct from that of its members.[37] Despite the fact that Mthembu's paper was written in 2002 prior to the coming into effect of the Act, it remains relevant on the aspect of separate legal personality of a company and the lifting of the corporate veil.

On the contrary, Cilliers *et al* criticise the separate legal personality status of a company and argue that a company lacks separate existence since it does not have a body[38] which results in the company acting through its legal representatives who are the company directors.[39] As such, they accept that the concept of separate legal personality of a company is a mere fictitious concept of law. Contrary to the view expressed by Cilliers *and Benade*[40] on the concept of separate legal personality of a company, this study goes with the submission that a company is a separate legal person as provided in section 19(1)(a) of the Act which regulates the legal status of a company. This is built on the importance of the concept of separate legal personality of a company in the entire company law, thus the concept, deserves great protection by the law.

Notwithstanding the significance of the principle of separate legal personality of a company in company law, this principle like any other principles of law is not absolute, it is subject to an exception. Section 20(9)(a) is an exception to the principle of separate legal personality of a company. The section grants the courts the discretion to disregard the separate legal personality status of a company where there is 'unconscionable abuse' of the juristic personality of a company. As such, the rights and obligations seemingly to be that of a company will be affixed to the rightful individuals.[41] Section 20(9)(b) further provides that the courts may make any further order that they deem necessary and appropriate to the declaration contemplated in section 20(9)(a). According to Cassim[42] 'any further order' also includes holding the directors or shareholders personally liable on the transaction.

Even though piercing of the corporate veil is the most discussed concept of company law by courts, it is however the least understood concept of company law and is criticized by many

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[36] LV Mthembu 'To lift or not to lift the corporate veil-the unfinished story: A critical analysis of common law principles in lifting the corporate veil' unpublished MA dissertation, University of Natal, 2002, 1.
[37] Section 19(1)(b).
[38] HS Cilliers & ML Benade *Cilliers & Benade Corporate Law* (2000) 5.
[39] D French, S Mayson & C Ryan *Mayson, French and Ryan on Company Law* (2013) 127. See also Cilliers *ibid* 6.
[40] Cilliers (note 38 above).
[41] Thompson (note 6 above) 1036.
[42] Cassim (note 14 above) 25.

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scholars for lack of clearly defined boundaries. Cardozo J in the American case of *Berkey v Third Avenue Railway Co*[44] described the concept of piercing the corporate veil as 'enveloped in the mist of metaphor'. This clearly shows that even though piercing of the corporate veil is an eye raising topic in company law, as it is not clearly understood either by courts or scholars as there is not clear understanding and definition of the circumstances in which the corporate veil may be pierced by the courts. In South African law, this challenge is caused by the fact that section 20(9) of the Act which provides for the piercing of the corporate veil failed to define what constitutes unconscionable abuse of the juristic personality of a company or provide any guidelines as to such. The section only stipulates that, if the court finds that there is unconscionable abuse of the juristic personality of a company in relation to the company's formation, use or any acts by the company or on its behalf, the court may disregard the juristic status of a company.

Latty[45] also observed that the principle of piercing of the corporate veil seems to be offering absolutely contradicting principles. Hamilton also states that, the courts appear to be at liberty in deciding whether to apply or ignore these principles depending on the results that the court intends to achieve.[46] Hence, this indicates that despite its wide acceptance and application, piercing of the corporate veil is an ambiguous principle. Although it is undisputed that the courts are at liberty in deciding whether or not to pierce the corporate veil,[47] it is however not justified to argue that the law is creating absolutely confusing doctrines. This is in realisation of the fact that even though the courts strive to uphold and protect the principle of corporate entity, such principle is not absolute hence in certain justified circumstances the courts may disregard this principle in order to obviate its abuse.[48]

Ballantine in his work postulates that the issue of piercing the corporate veil is centered on the manner in which corporate privileges are used.[49] Ballantine's findings demonstrate that *mala fide* and dishonest use of the corporate personality are grounds for disregarding the corporate veil. In addition, Larkin[50] in his article referred to the case of *Lategan v Boyes*[51] where the court held that there is no doubt that the courts will lift the corporate veil where the separate legal *persona* of a company is used for fraudulent conducts.[52] This suggests that fraudulent use of the company's separate legal personality falls within the ambits of unconscionable abuse of

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[43] *Ibid.*
[44] 244 N.Y.602 (1927).
[45] ER. Latty 'A Conceptualistic Tangle and the One-Or-Two-Man Corporation' (1956) Vol. 471 No. *472 North Carolina Law Review* 34.
[46] R W. Hamilton 'The Corporate Entity' (1971) Vol 979 No 979 *Texas Law Review* 49.
[47] Section 20(9) of the Act, where the section uses the word "may".
[48] Thompson (note 6 above) 1041.
[49] HW. Ballantine *'Separate Entity of Parent and Subsidiary Corporations'* (1925) Vol. 12, No. 19 California Law Review 14.
[50] MP. Larkin *'Regarding Judicial disregarding of the Company's Separate Identity'* (1989) Vol.1 No.3, South African Mercantile Law Journal 278.
[51] 1980 (4) SA 191 (T) at 201.
[52] Larkin (note 50 above).

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the juristic personality of a company as a separate legal person, which justifies the courts to brush aside the corporate veil.

Moreover, Larkin[53] in his work quoted the case of *Botha v Van Niekerk*[54] where the court held that for the corporate veil to be disregarded there must be a reasonably pressing need which in the interests of justice calls upon the court to disregard the veil. This also clearly indicates that even though the courts have discretion to disregard the corporate veil they do not easily do so, instead there must be at least 'unusual ground'[55] justifying the piercing of the veil. Harmonizing Larkin's submission with the Act thus implies that the abuse of the juristic personality of a company should be of unique nature for the courts to pierce the corporate veil. Hence, indicating the importance of safeguarding the corporate personality of a company.

In the English case of *Tunstall v Steigmann*[56] the court held that the corporate veil should be disregarded if the corporate personality is used as a mere façade to conceal the truth. The mere façade test has also been applied by South African courts in determining whether to pierce the corporate veil. For instance in *Dadoo Ltd v Krugersdorp Municipal Council*[57] where it was held by the Appellate Division that if the company is used as sham to conceal the real facts, the court will not hesitate to strip off the corporate veil in order to expose those hiding behind the veil. However, the challenge with the test of mere façade or sham is how to determine that a company is a sham.[58] Nevertheless, the Appeal Court in the case of *Skjelbreds Rederi A/S v Hartless (Pty) Ltd*[59] attempted to resolve this challenge and held that, all transactions that do not make commercial sense would be struck down and the company will be viewed as an empty shell, a mere façade or sham.

Another work conducted by Cassim[60] which discussed the topic of lifting the corporate veil focus mostly on *Ex parte Gore No & Others NNO*[61] in which section 20(9) found its first application. Cassim's study attempted to address some of the challenges raised by the section. For instance, the attempt to define what constitutes unconscionable abuse of the juristic personality of a company. Despite those attempts, Cassim's study, however, failed to elucidate what really amounts to unconscionable abuse of the juristic separate legal personality of a company. The author accepts that there is high level of confusion and uncertainty in the application of the doctrine of piercing of the corporate veil. Therefore, the present study

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53 (*Ibid*) 282.
54 1983 (3) SA 513 (W) at 523.
55 Larkin (note 50 above) 279.
56 [1962] 2 QB 593 (CA) at 602.
57 1920 AD 530 at 548.
58 Larkin (note 50 above) 284.
59 1982 (2) SA 710 (A) at 734.
60 Cassim (note 5 above).
61 [2013] 2 All SA 437 (WCC).

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addresses in depth the circumstances which constitutes unconscionable abuse of the juristic personality of a company in the succeeding chapters.

It is crucial to note that piercing of the corporate veil does not imply none recognition of a company but it is only done in respect of a particular transaction.[62] The entire company remains a separate entity in respect to other actives of the company. To illuminate on this, in *Nedco Ltd v Clark*[63] the Saskatchewan Court of Appeal held as follows:

> [T]he fact that the court does lift the corporate veil for a specific purpose in no way destroys the recognition of the corporation on an independent and autonomous entity for all other purposes.

In a nutshell, it is evident that despite the discretion of the courts to pierce the corporate veil, the circumstances under which the corporate veil may be lifted are uncertain and this has caused a lot of confusion and criticisms. Hence, the reason for conducting this study in order to resolve such challenges.

Furthermore, the doctrine of piercing the corporate veil cannot be discussed in isolation of the duties and liabilities of company directors, this is due to the fact that the corporate veil is mostly pierced so as to expose directors who are the controlling minds of the company. It should also be noted that the directors owe their duties directly to the company and not to the company creditors or any other person involved with the company.[64]

Nwafor[65] extensively discusses the elements of the criminal offence of fraudulent trading in company law which leads to the imposition of personal liability on the individuals involved in such acts. The study also discusses the protection of creditors to recover their debts without jeopardy in situations where the company is facing financial straits. In such a situation liability appearing to be that of the company may be imposed on the controlling minds of the company involved in such acts, however, Nwafor's article does not articulate anything about the duties of the directors. Therefore, the present study discuses both the duties and liabilities of directors extensively. This is important in showing how directors may personally incur liability for the breach of their duties to the company.

Hjalti[66] discusses imposition of personal liability upon shareholders where shareholders acted as shadow directors. The study does not, however, cover imposition of personal liability upon directors who are the controllers of the company and highly prone to be held personally liable

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[62] French *et al* (note 39 above) 131.
[63] (1973) 43 DLR (3d) 714 at 721.
[64] AO. Nwafor *'Fraudulent Trading and the Protection of Company Creditors: the Current Trend in Company Legislation and Judicial Attitude'* (2013) *Vol. 42, No. 4 Common Law World Review* 1.
[65] *Ibid.*
[66] HT Gudonundsson, 'Lifting the Veil of Incorporation and the Establishment of Shadow Directorship: A Comparative Analysis of Legal Practices Regarding Shareholder Liability in the United Kingdom, Denmark and Iceland' unpublished MA dissertation, Kobenhavns Universitet, 2011, 45.

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for the acts they perform on behalf of the company. Again, the study does not focus on the doctrine of piercing of the corporate veil in general rather it concentrates on the piecing of the veil from the angle of imposition of liability upon shareholders who are shadow directors. Considering the fact that shareholders do not have much controlling powers in a company, discussion of imposition of liability upon them has little contribution to the development of company law. Instead, more attention should be given to the liability of directors who fail to properly exercise their duties thereby inviting the court to disregard the separate legal personality of company and hold them personally liable for the transactions which they seemingly entered on behalf of the company as a separate legal person. The present study focuses on the piercing of the corporate veil in order to hold the directors of the company liable for the wrongful acts they perform in the name of the company.

Another major challenge that South African company law is facing is the question of whether piercing the corporate veil must be used as a remedy of last resort. It is, however, clear from common law that piercing of the corporate veil is a last resort remedy. This implies that for the court to disregard the separate legal personality of a company, the plaintiff must have exhausted all the possible remedies available or must not be having any alternative remedy available. However, it is not clear whether section 20(9) of the Act still considers lifting of the veil in the same way as the common law. The section grants the courts a wide discretion as compared to common law, to pierce the veil where there is unconscionable abuse of the juristic person of a company.

Therefore, the current study addresses this question. In addressing this challenge, reference is made to case law such as the *Cape Pacific Ltd* v *Lubner Controlling Investments (Pty) Ltd & Others* [67] where the Appellate Division Court held that the Courts must not lightly disregard the separate legal personality of a company rather they should strive to give effect to and to protect the corporate personality given its importance. However, where presence of fraud or other misconduct and policy considerations favours the piercing of the corporate veil the courts will pierce the corporate veil and hold the persons behind such conduct personally liable.[68] Hence, this indicates that whether piercing of the corporate veil should be used as remedy of last resort depends on the facts of each case. Nevertheless, striking a balance between the significance of upholding the separate legal personality of a company in company law and policy consideration favouring the veil piercing is of great importance.[69]

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[67] *Cape Pacific Ltd v Lubner Controlling Investment (Pty) Ltd & Others* 1995 (4) 790 (AD) at 803-804.
[68] *Ibid.*
[69] *Ex parte Gore No & Others NNO* [2013] 2 All SA 437 (WCC) at 542.

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1.9 Research methodology

The method adopted in this research is mainly doctrinal. A doctrinal research methodology deals with what the law is on a particular issue. It mainly analyses legal doctrines, their development and application. The choice of this research method is motivated by the fact that the researcher intensively analysed the doctrine of piercing the corporate veil which is now codified in section 20(9)(a)(b), in order to bring out the circumstances which constitutes unconscionable abuse of the juristic personality of a company. Doctrinal research methodology is also known as pure theoretical research methodology based on theories.[70] Hence, the research methodology adopted involved the study of primary and secondary sources such as legislation, case law, textbooks and journal articles, which are known as the 'black letter of the law'.The study is also desktop based, this implies that information was also be obtained from the internet sources in conducting this research.

In analysing other legal materials, the researcher employed a comparative approach. Here, the researcher compared the South African laws with the law of other jurisdictions in this field of study. Comparative approach was used in order to enhance a better understanding and development of company law in South Africa. Great references were made to English law solely because the South African company law is an embodiment of substantial elements of English law.[71]

1.10 Definition of key terms

The definition of the words given below are the definitions as used in this research, they may however, bear a different meaning elsewhere.

1.10.1 Abuse

No definition of the term abuse contained in the 2008 Companies Act. However, in this context abuse refers to unconscionable abuse of the separate legal personality of the company. In other words it refers to the improper use of the company's separate legal personality which warrant for the piercing of the corporate veil by the courts.

1.10.2 Company

According to the Act[72], a company means a juristic person incorporated in terms of the Act, it also includes the companies that had been registered in terms of the old Companies Act[73] and

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[70] Adilah Abd Razak, *Understanding Legal Research*, 20, available at *http://www.econ.upm.edu.my/researchbulletine/artikel/vol250March%2502009/19-24%2520Adilah.pdf* (accessed 29 May 2015).
[71] Cilliers (note 38 above).
[72] Section 1.
[73] Companies Act 61 of 1973.

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Close Corporations Act that had been converted in terms of schedule 2 of the Act. In simple terms the company means an artificial legal entity which is distinct from its shareholders and directors.

1.10.3 Corporate veil

Means an artificial veil which is created upon the incorporation and registration of the company which separates the company from its shareholders, directors and incorporators thereby giving the company separate legal personality distinct from that of its incorporators, shareholders and directors. The metaphorical veil protects shareholders and directors of the company from being liable for the acts they perform on behalf of and in the name of the company. However, this veil is not absolute as it can be brushed aside by the courts where there is unconscionable abuse of the separate legal personality of the company.

1.10.4 Director

Means a member of the board of the company or an alternate director of the company and it also includes any person occupying the position of the director or alternate director by whatever name designated.[74] Put in simple terms, the director refers to any person by whatsoever title or name who is responsible for the management of the affairs of the company.

1.10.5 Incorporation

Means the formation of the company by company incorporators in terms of section 13 and 14 of the Act. It refers to all the procedure which *inter alia* includes the signing and completion of the memorandum of incorporation, notice of incorporation and also the payment of the required registration fee to the Commission of the Companies and Intellectual Properties.

1.10.6 Juristic person

Means a separate entity distinct and separate from its incorporators which has the capacity to acquire rights and incur responsibilities of its own. Juristic persons have the capacity to continue to exist despite the change in composition of its incorporators or members. Hence, they enjoy perpetual succession. Simply put, in this research context it refers to the company.

1.10.7 Piercing the corporate veil

According to Staughton LJ[75] in *Atlas Maritine Co SA v Avalon Maritine Ltd the Coral Rose No.1* piercing the corporate veil means treating the liabilities of the company as if we the liabilities

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[74] Section 1 of Act.
[75] *Atlas Maritime Co SA* (note 27 above).

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of its shareholders or directors. Hence, this means that piercing of the corporate veil is an act of putting liabilities which appears to be of the company on the rightful individuals. Piercing the corporate veil concentrates most of the substance and not form of the company in order to enable the shifting of liabilities.

1.10.8 Shareholder

According to section 1 of the Act a shareholder means the holder of a share issued by a company and who has been entered as such in the certificated or uncertificated securities register.

1.11 Overview of the chapters

CHAPTER ONE: INTRODUCTION

The chapter covers the background, aims and objectives of the study, research questions, statement of the problem, literature review, proposed methodology, definition of key or technical concepts, overview of the chapters of the research work and limitations of the study.

CHAPTER TWO: INCORPORATION OF THE COMPANY AND THE CONSEQUENCES OF INCORPORATION

The chapter discusses the process of incorporating and registering the company and the consequences of company incorporation. It is clear from this chapter that most of the consequences of incorporating the company germinates from the separate legal personality of the company, which is the foundation of the entire company law. The chapter also pays focus on the binding effects of the memorandum of incorporation of the company. Close examination of the binding effects of the memorandum of incorporation is selected because of the importance of the memorandum of incorporation to the company and also its unclearly defined binding nature. The memorandum of incorporation is deemed to be the constitution and founding document of the company, hence its importance.

CHAPTER THREE: DUTIES AND LIABILITIES OF COMPANY DIRECTORS

The chapter discuses both the statutory and common law fiduciary duties of the company directors to the company. It is undisputed in the chapter that the statutory duties of the directors are mere codification of those duties of the directors which existed at common law. Like the common law duties, directors still owe these fiduciary duties to the company alone and not anyone else. The chapter explores the fiduciary duties of the directors' one after the other with deep reference to cases. In doing so, the researcher bring out what each duty entails.

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Moreover, consequences for breach of the fiduciary duties of the directors are also covered brief in this chapter.

CHAPTER FOUR: THE LIFTING OF THE CORPORATE VEIL

This chapter is the heart of the entire research, it critically discusses what constitutes unconscionable abuse of the juristic personality of the company in relation to section 20(9) of the Act as the broad ground for piercing the corporate veil. In arriving at that point, the research examined the common law, the Act, case law of South Africa and other jurisdictions. Piercing of the corporate veil is the most complicated concept in company law, the chapter clearly demonstrates this. Such is attributed to the fact that the courts have always stumbled with the correct approach to follow when comes to the piercing of the corporate veil and unifying approach has been adopted. To make matters worse the 2008 Companies Act also failed to remedy the common law challenges on piercing the corporate veil. As the Act fails to define what constitutes unconscionable abuse of the separate legal personality of the company as the ground which justifies the piercing of the corporate veil by the courts.

CHAPTER FIVE: CONCLUSION AND RECOMMENDATIONS

The first part of the chapter gives a brief overview of the whole research. Recommendations are also provided to different stakeholders where there is need for change or development of the law. Lastly, at the end of the whole chapter, the researcher provided concluding remarks which sums up the entire work.

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1.12 Limitations of the study

In the course of this study, the researcher came across a number of limitations which *inter alia* are as follows:

It should be borne in mind that the present research is a doctrinal kind of research, as a result, reliance was made largely on the primary and secondary sources of legal information such as statutes, case law, textbooks and article journals *inter alia*. Therefore, this implies that when answering the research question stated above, the researcher did not have interaction with the companies that have undergone the process of piercing of the corporate veil, thus making it difficult to have first-hand conclusion on certain aspects.

Again, the topic that is examined in this research is so complex and challenging such that even the previously decided cases have not reconciled in this area of the law. Therefore, as a student, the researcher admits that there were some inherent limitations in the analysis and drawing of inferences and conclusions from the large number of legal materials which are not

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reconciled on main aspects that were considered in this research. This could however, have a positive effect as it opens the door for further inquiry by academics.

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INCORPORATION OF THE COMPANY AND THE CONSEQUENCES OF INCORPORATION

The chapter examines and discusses the procedure for incorporating a company and the consequences for such incorporation. For instance the status of separate legal personality endowed to the company by the law. The binding nature of the memorandum of incorporation which is the founding document of the company is also be discussed and analysed in this chapter for better understanding. The chapter discussion and submissions in this chapter are cemented by reference mainly to case law as authorities. At the end of the chapter a short conclusion to the chapter is provided. The next chapter focuses on the fiduciary duties and liabilities of the company directors as a continuation to this chapter.

2.1 Introduction

In simple terms, incorporation means the formation of a company by the company incorporators. The above stated definition is in line with the one provided by the Merriam-Webster dictionary which defines incorporation in relation to business to mean the formation of a corporation. The same dictionary also defines a corporation to mean 'a large business or organisation that under the law has the rights and duties of an individual and follows a specific process'.[76] From the legal perspective, it is true that a corporation has the rights and duties of its own distinct from that of its incorporators. Again, companies in law are incorporated to serve a specified purpose, for instance money lending. However, the research diverges a bit from the above dictionary definition that a corporation means a large business. This is not always accurate as demonstrated in the case of *Salomon v Salomon & Co Ltd*[77] which provides that a corporation can be one man business which is usually a small business. The size of the business is not that important, what matters for a business to qualify as a company is that all the requirements of incorporation must be complied with.[78]

Notably, the Act[79] describes the formation of a company as a right as opposed to a privilege. This is in line with the South African Constitution[80] which grants every person the right to freedom of association. At present, the incorporation of companies has been simplified and

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[76] Merriam-Webster dictionary available at *http://www.merriam-webster.com/dictionary/corporation* accessed on 31 August 2015.
[77] [1897] AC 22.
[78] *Ibid* at 30.
[79] Section 13 of the Act.
[80] Section 18 of Act 108 of 1996.

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made flexible by the Act in order to *inter alia* encourage formation of companies and economic expansion in South Africa.[81]

In commencing this chapter it should be borne in mind that the Act recognises two broad categories of companies that can be incorporated namely: the profit company and the non-profit company.[82] A profit company is a type of company which is formed as a profit generator for its shareholders.[83] On the other hand, a non-profit company, is a company formed for the purposes of public benefit or other aims stated in schedule 1 of the Act.[84] A profit company can be formed by one person or by an unlimited number of persons or a state organ, whereas, a non-profit company can be formed by a juristic person, an organ of the state, or three or more persons acting together.[85] The procedure for incorporating either a profit or a non-profit company is then the same. The researcher now proceeds to discuss the procedure for incorporating and registering a company.

2.2 Incorporation and the registration of the company

The first step in the incorporation of a company is that the memorandum of incorporation must be completed and signed by the incorporators of the company either in person or by proxy in the manner prescribed by the Act or unique to that company.[86] It is noteworthy that many writers consider the memorandum of incorporation as the company's constitution since it is the founding and the regulatory document of the company.[87]

After the memorandum has been completed and signed as aforementioned, the incorporators are then required to also file the notice of incorporation with the Commission for Companies and Intellectual Properties (the Commission).[88] The notice of incorporation must be accompanied by a copy of the memorandum together with the prescribed fee.[89] If there are any restrictions or prohibitions relating to the amendment of the memorandum as contemplated in section 15(2)(b)(c) the notice of incorporation must as such contain a clear statement drawing attention to such and their location.[90] Consequently, the letters "RF" (Ring Fenced) must appear immediately after the company's name.[91] This notifies the third parties dealing with the company about the existence of these special conditions in the memorandum and

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[81] Section 7(b)(ii).
[82] Section 8(1).
[83] Section 1.
[84] *Ibid.*
[85] Section 13 (1).
[86] Section 13(1)(a).
[87] See for instance, Cassim (note 14 above) 55.
[88] Section 13(1)(b).
[89] Section 13(2)(a)(b).
[90] Section 13(3) read with section 15.
[91] Section 11(3)(b).

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their location.[92] The sole purpose of serving Commission with the notice of incorporation is to notify the Commission about the incorporators' intention to incorporate a company for the purpose of having it registered.[93]

The Commission may accept the notice of incorporation and register the company[94] or reject the notice of incorporation and decline to register the company.[95] The Act grants the Commission both the discretionary and mandatory powers to reject the notice of incorporation in different circumstances.[96]

The mandatory powers to reject the notice of incorporation obliges the Commission to reject the notice of incorporation if, the minimum number of directors stated in the notice of incorporation are less than the minimum number stated in the Act or the memorandum of the company, or the Commission reasonably believes that any of the initial directors stated in the notice of incorporation are disqualified in terms of section 69(8) and the ones that remain do not reach the minimum required number of directors.[97] This implies that in these two circumstances the Commission completely lacks the capacity to exercise any discretion in deciding whether or not to accept the notice of incorporation and register the company.

Additionally, section 13(4)(a) grants the Commission the discretion to decide whether or not to reject the notice of incorporation and decline to register the company.[98] The Commission would exercise the discretionary powers if the notice of incorporation is not completely and properly completed or the documents accompanying it are incompletely or improperly completed.[99] From this section, it can be deduced that though the commission enjoys the discretion to reject the notice of incorporation, the exercise of the discretion is restricted to the two circumstances.[100]

If the Commission accepts the notice of incorporation and its accompanying documents, the Commission must within a reasonable period register the company.[101] The procedure for registering a company is stated in section 14 which provides as follows:

> (1) As soon as practicable after accepting a Notice of Incorporation in terms of section 13(1), or an application for the domestication of a foreign company in terms of section 13(5), the Commission must-
> (a) assign to the company a unique registration number; and
> (b) subject to subsection (2)-

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[92] Draft SAICA Companies Act Guide at 18, available at http://www.ahiwp.org.za/assets/dynamic/4/files/27/1315823275_draft-companies-act-guide.pdf accessed on 20 March 2016.
[93] Cassim (note 14 above) at 45.
[94] Section 14.
[95] Section 13(4).
[96] *Ibid.*
[97] Section 13(4)(b)(i)(ii).
[98] See M F Cassim, *Formation of Companies and The Company Constitution* in FHI Cassim, M.F Cassim Jooste Shev & J Yeast (eds), *Contemporary Company Law, (*2012) at 110.
[99] Section (13)(4)(a).
[100] See section 13(4)(a) which regulates the powers of the Commission.
[101] Section 14(1).

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(i) enter the prescribed information concerning the company in the companies register;
(ii) endorse the Notice of Incorporation, and, if applicable, the copy of the Memorandum of Incorporation filed with it, in the prescribed manner; and
(iii) issue and deliver to the company a registration certificate in the prescribed manner and form.

The registration certificate issued by the Commission serves as conclusive proof that a company has been duly incorporated and registered[102] and that all the requirements for incorporation as stated in the Act have been complied with.[103] However, unlike under the 1973 Act, the registration certificate does not serve as proof of exclusion of fraud in the formation of a company.[104] The certificate of incorporation serves as proof that a company has been duly incorporated. As from the date and time stated in the registration certificate the company becomes a juristic person as stated in section 19 of the Act that:

(1) From the date and time that the incorporation of a company is registered, as stated in its registration certificate, the company-
(a) is a juristic person, which exists continuously until its name is removed from the companies register in accordance with this Act;
(b) has all of the legal powers and capacity of an individual, except to the extent that-
(i) a juristic person is incapable of exercising any such power, or having any such capacity; or
(ii) the company's Memorandum of Incorporation provides otherwise.

Lastly, after the registration certificate has been issued by the commission which shows that the company has been duly incorporated and registered, the company is at liberty to commence its business. It should be noted that unlike in the 1973 Act, it is no longer a requirement that the Commission should issue the certificate of commencement.[105] This might have been intended to fulfil the objectives and aims of the Act which among others is to simplify the formation of companies and also to reduce the costs of company formation.[106]

2.3 Memorandum of incorporation of the company

A company is a body that comprises of its members or shareholders, as such there is need for regulations to guide its activities and those of its members or shareholders. The Act refers to the company's regulations as the memorandum of incorporation.[107] The memorandum of incorporation regulates the relationship between the members of the company *inter se*,

[102] This means that the company has been duly formed into a legal corporation and the Commission has entered it into the companies register after assigning a unique registration number.
[103] Section 14(4) see, also Cassim (note 14 above) 46.
[104] See *Registrar of Asiatics v Salajee* 1925 TPD 71 at 72 where Judge Stratford ruled that 'To say that a certificate is to be the conclusive proof of the facts to which it speaks is not the same thing as saying that the certificate cannot itself be attacked on the ground of fraud in its procurement'.
[105] Cassim (note 98 above) 102.
[106] See section 7 of the Act.
[107] Section 15 of the Act.

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relationship between the company and each of its shareholders and between the company and the directors or prescribed officers of the company or any other person serving the company.

The memorandum of incorporation is pivotal to the company's incorporation since, it is the founding document of the company and is being considered by some writers as the company's constitution.[108] The prime purpose of the memorandum is to set out the rights, duties and responsibilities of the shareholders, directors and others within and in relation to the company.[109] The memorandum of incorporation replaced both the memorandum of association and the articles of association under the 1973 Act. The form that the memorandum can take is not strictly defined. The memorandum can take either the manner prescribed by the Act or the unique form chosen by a company.[110] The main reason for the flexibility in the contents of the memorandum of incorporation is to enable the company to regulate its internal affairs in the manner that best suits the purpose of the company.[111]

The memorandum of incorporation bears the status of a contract, although it does not bear the characteristics of an ordinary contract. This is attributed to the fact that it is a contract created by the law and not voluntarily by the parties to it and it also binds persons who are not necessarily parties to it. No shareholder or member of the company shall resile from being bound by the provisions of the memorandum on the common law grounds such as mistake or undue influence. Again, this contract can be altered by way of a special resolution of the majority of shareholders despite the will of the minority shareholders and cannot be rectified on the grounds such as mistake.[112] Once altered the memorandum is binding on all members despite any questioning that might arise.

2.4 The binding effects of the company's memorandum of incorporation

The scope and the enforceability of the memorandum as a unique contract is a cause of concern to the courts and also academics even today. Even though the 2008 Act has made some significant shift in clarifying some of the aspects relating to the company's constitution, the said concerns remain inadequately addressed as demonstrated in the course of the chapter.

Section 15(6) which regulates the binding nature of the memorandum of incorporation is more or less similar to the provisions of section 65(2) of the 1973. However, the 2008 Act moved a step further by including more contracting parties within the provisions of the section. These sections respectively provide as follows:

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108 See for example, Cassim (note 14 above) 55.
109 *Supra.*
110 Section 15 of the Act.
111 Cassim (note 98 above) at 55.
112 See B Hannigan, *Company Law* (2009) 104.

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> A company's Memorandum of Incorporation and any rules of the company, are binding-
> (a) between the company and each shareholder;
> (b) between or among the shareholders of the company; and
> (c) between the company and-
> (i) each director or prescribed officer of the company; or
> (ii) any other person serving the company as a member of a committee of the board.
>
> The memorandum and articles shall bind the company and the members therefore, to the same extent as if they respectively had been signed by each member, to observe all the provisions of the memorandum and of the articles, subject to the provisions of this Act.

The researcher, in discussing the binding effects of section 15(6), makes great reference to the provisions of the old constitutive documents[113] in terms of the 1973 Act, this is due to the intertwined relationship which exist between the two provisions. Section 65(2) was said to be the only source from which the memorandum and articles of association derived their binding force and its extent, also the source which was relied on in determining who can enforce the provisions of the company's constitution.[114] Section 15(6) is similar to section 65(2) of the 1973 Act. Section 16(6) is considered as a contract section which derives its contractual nature from the Act and common law and not from the principles of law of contract.[115]

The contractual nature of the company's constitution is an extraordinary one.[116] This is attributed to the fact that, the parties to it are bound contractually not because they consent to be bound but merely because the Act regard them as bound by the constitution of the company.[117] Even though, Cassim[118] doubts the contractual status of the section 15(6) contract, due to the failure to use express term 'contract' by the legislature. Nwafor[119] however, posits that the use of words 'binding between' in the section is sufficient to indicate the existence of a statutory enforceable right and obligation in a similar way as an ordinary contract. Thus qualifying section 15(6) to be a unique statutory contract.[120]

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[113] The memorandum of association and the articles of incorporation.

[114] MS Blackman, RD Jooste & GK Everingham, Commentary on the Companies Act vol 1 (2002).
[115] *Bratton Seymour Service Co Ltd v Oxborough* [1992] BCLC 693 (CA) at 698.
[116] AO. Nwafor, The Unending Debate on the Contractual Effect of the Company's Constitution: A Comparative Perspective (2013) No 7, International Company and Commercial Law Review at 261.
[117] TCR Morajane, The Binding Effect of the Constitutive Documents of Companies: the 1978 and 2008 Companies Acts of South Africa [2010] PER 5 available at *www.saflii.org.za/za/journals/PER/2010/5.html* accessed on 8 February 2016.
[118] Cassim (note 98 above) 100.
[119] Nwafor (note 116 above) 264.
[120] This is because section 15(6) derives is contractual nature from the Act and common law and does not need to comply with the principles of a valid contract such as consensus on the contracting parties.

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However, the main challenge with section 15(6) is that it only lists the persons who are bound by the memorandum but fails to state the manner and the extent to which they are bound by the contract. Section 5(1) clearly stipulates that the Act must be interpreted and applied in a manner that gives effect to the provisions set out in section 7. More so, the courts when dealing with the matter brought before them in terms of the Act are required to develop the common law and also to improve the rights provided for in the Act.[121] It is on this basis that the common-law contractual binding effect of the memorandum apply to the legal nature of the section 15(6) contract.[122]

2.4.1 Binding effects between the company and each shareholder

Section 15(6)(a) clearly states that the memorandum is binding between the company and each shareholder. Despite the clear stipulation that the memorandum binds the company and each shareholder, there are certain questions that remain unanswered. These are the question of whether the memorandum of incorporation binds the shareholders only to the extent of the rights and the obligations imposed on the shareholders by the memorandum in their capacities as shareholders only[123] and the question of how shareholders enforce their rights against the company.[124]

In terms of the 1973 Act Portgieter J in *De Villiers v Jacobsdaal Salt Works (Michael and De Villiers) (Pty) Ltd*[125] held that shareholders are only bound by the company's constitution in their capacities as shareholders. He said:

> It is clear that the articles of association do not create a contract between the company and a member except in his capacity as a member. The articles constitute a contract between the members *inter se* and between the company and members but only in their capacity as a member.

The principle that the company constitution binds shareholders only in their capacities as members was also buttressed in the English case of *Hickman v Kent or Romney March Sheep Breeders' Association*[126] where the articles provided that any dispute which arises between the company and its members must be referred to arbitration. The company refused to register the sheep of the complainant who was also a member of the company. The complainant then took the matter to the court against the company. The company prayed that the matter must be referred to arbitration as stated in the articles and the company was granted its prayer based on the provisions of the articles of the company. Astbury J's held that:

> I think this much is clear, first, that no articles can constitute a contract between the company and a third person; secondly, that no right merely purporting to be given by an article to a person, whether a member or not, in a capacity other than that of a

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121 Section 158 (a), See also section 39 of the South African Constitution.
122 See P Delport, The *New Companies Act Manual* (2012) 11.See also Morajane (note 117 above) 181.
123 Not in any other capacity that a shareholder may have.
124 Cassim (note 98 above).
125 1959 3 SA 873 (O) at 876H-877A. See also *Wood v Odessa Waterworks Co* (1889) 42 ChD 636.
126 [1915] 1 Ch 881 at 900.

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> member, as, for instance, as solicitor, director, can be enforced against the company; and, thirdly, that articles regulating the rights and obligations of the members generally as such do create rights and obligations between them and the company respectively.

This implies that, the rights and/or obligations of shareholders must be connected to the shares that the shareholder holds in the company.[127] More so, in terms of the common law, in order for a shareholder to rely on a right conferred by the constitution of the company, the right must be granted to a shareholder by virtue of and in relation to the shares held in a company.[128] Based on the above discussion Cassim[129] submits that, section 15(6)(a) of the 2008 Companies Act must follow the common law position under the 1973 Act that the memorandum of incorporation binds each shareholder only in their capacities as such.

Milner J in *Rosslare (Pty) Ltd v Registrar of Companies*[130] answered the question which had received less attention in company law, the question of when a member of the company is bound by the constitutive documents of a company in that capacity as a member by pointing that:

> It seems clear, however, that what is meant by a contract with a member "in his capacity as such", is a contract between him and the company which is connected with the holding of shares and which confers rights which are part of the general regulations of the company applicable alike to all shareholders.

However, Milner J's analysis of the circumstances under which members are bound by the constitutive documents of the company is said to be wrong.[131] This is because it is not accurate to submit that members are contractually bound by the articles in their capacities as members only if the rights and obligations from the statutory contract concern their shareholdings and only if their shareholding confers general rights applicable to all shareholders alike.[132] This is because firstly, members of the company without share-capital have no shareholding but they are also bound by the constitutive documents of the company.[133] Secondly, rights cannot be granted in one's capacity as a shareholder if they are part of a general regulation which applies to all shareholders and companies have various classes of shares, with unique rights attached to them.[134]

In addition, the shareholders have the right to enforce the rights granted to them in terms of the memorandum in their capacity as such against the company.[135] Lord Wedderburn[136]

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127 *Rosslare (Pty) Ltd v Registrar of Companies* 1972 (2) SA 524 (D) at 528.
128 Cassim *et al* (note 98 above) 144.
129 *Ibid.*
130 *Rosslare's* case (note 127 above) at 528D-E.
131 Morajane (note 117 above) 181.
132 *Ibid.*
133 MS Blackman, RD Jooste and GK Everingham, Commentary on *Companies Act* (2002) at 4-151-3.
134 I*bid.*
135 *Pender v Lashington* (1877) 6 ChD 70 at 80.
136 KW Wedderburn, Shareholders Rights and the Rule in *Foss v Harbottle* (1957) Cambridge Law Journal 193 at 210- 215.

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observed that, as a general rule each shareholder has a right to have the affairs of the company conducted in accordance with the provisions of the memorandum of the company which is the governing document of the company.

Moreover, if the company acts in breach of the provisions of the constitution the shareholder has the right to bring an action to compel the company to observe the constitution's provisions. Davies,[137] however, posits that:

> This would not mean that every breach of the articles by a corporate officer would entitle each shareholder to sue the company for damages. Damages would be an available remedy only if the shareholder had personally suffered loss as a result of the breach.

Hence, a technical breach of procedural matters may not attract any judicial remedy. Such matters could be ratified by the resolution of the majority of shareholders in the shareholders meeting. Instituting legal action in such cases is not advisable as the court may award costs against the shareholder even though the shareholder is of the idea that he is exercising the granted right in terms of the company's constitution.[138] Davies' submission sounds more realistic than Wedderburn's illusory submission that each and every shareholder in their capacity as such can enforce every provisions of the memorandum.[139]

Lastly, it is crucial to also take note of the definition of the shareholder as provided for in the Act. The Act it defines the shareholder as the holder of shares issued by the company and has been entered as such in the certificated or uncertificated securities register.[140] On the other hand, a member is defined as a person who holds membership and specific rights in relation to a non-profit company.[141] Section 10(4) further provides that, with respect to a non-profit company that has voting members, a reference in this Act to 'a shareholder', 'the holders of a company's securities', 'holders of issued securities of that company' or 'a holder of voting rights entitled to vote' is a reference to the voting members of the non-profit company. It appears therefore, from the provisions of section 10(4) that a 'shareholder' as stated in section 15(6) refers to both shareholders of profit companies and members of non-profit companies. Hence, the rights flowing from the constitutive document of the company are granted and binding to both shareholders in profit companies and members in non-profit companies.[142]

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137 PL Davies & Gower *Gower & Davies' Principles of Modern Company Law* (2003) 65.
138 *Ibid.*
139 Wedderburn (note 136 above).
140 Section 1 of the Act.
141 *Ibid.*
142 Morajane (note 117 above) 182.

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2.4.2 Binding effects between or among shareholders

In terms of section 15(6)(b) the memorandum of incorporation is binding between shareholders *inter se.* This was illustrated in *Wood v Odessa Waterworks Co,*[143] where the plaintiff, a member of the company requested the court to set aside the implementation of the resolution not to pay dividends but to issue debentures. Sterling J stated that articles of association do not only constitute a contract between the company and shareholders but it also constitutes a contract between shareholders *inter se.* Thus illustrating that the constitutive documents of a company do not only bind the company and each shareholder rather it is binding among or between shareholders themselves.

Each shareholder is bound to the other shareholders in their capacities as such.[144] Shareholders have a right to enforce the memorandum of incorporation against each other with the involvement of the company.[145] In *Rayfield v Hands*[146] the articles provided that everyone who intends to transfer shares must first inform the directors who must take the shares equally between them at a fair value. The directors were notified by the plaintiff of his intention to transfer shares. However, the directors refused to take the shares. Vaisey J held that, the relationship in that matter was between the plaintiff as a member and the defendant also as a member and not as a director. Hence, the provision of the articles was applied in the matter based on the fact that the articles have a binding effect between members of the company *inter se.*

However, a direct action may also be instituted by the shareholder directly against another shareholder, without the involvement of the company if the action is based on a personal and individual right of a shareholder.[147] However, Lord Herschell in *Welton v Saffery*[148] stated that if the provisions of the articles does not affect the shareholder directly, such shareholder may not institute a direct action. Instead such shareholder may institute an indirect action with the involvement of the company against the other shareholder.[149]

However, in *Globe Fishing Industries Ltd v Coker*[150] Olatawura JSC of the Supreme Court of Nigeria noted that the issue of *locus standi* is the deceive factor for a member of a company to enforce the provisions of the memorandum of incorporation however, it is not easy to identify. Olatawura JSC adopted the opinion expressed in Pennington[151] that:

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143 (1189) 42 ChD 636.
144 *Ibid.*
145 *Rayfield v Hands* [1960] 1Ch 1.
146 *Ibid.*
147 Cassim (note 98 above) at 146.
148 [1897] AC 299 at 315.
149 LCB Gower, "The Contractual Effects of the Articles of Association" (1958) 21 Morden Law Review 401.
150 [1990] 7 NWLR (Pt 162) 265 at 280.
151 RR Pennington *Pennington's Company Law* (1979) 588.

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> The dividing line between personal and general interests is very hard to draw, and perhaps the most that can be said is that the court will incline to treat a provision in the Memorandum or Articles as conferring a personal right on a member only if he has interest in its observance distinct from the general interest which every member has in the company adhering to the terms of its constitution.

2.4.3 Binding effects between the company and the directors or the prescribed officers of the company

The 2008 Companies Act, unlike the 1973 Companies Act, brought about an important change in the application of the memorandum of incorporation by extending the ambits of the memorandum to also apply to directors who were previously considered as outsider, who are now considered as insiders.[152] In terms of the1973 Act outsiders were not bound by the provisions of the articles. This was illustrated in *Eley v Positive Life Assurance Co*[153] where a solicitor was not allowed to enforce the provisions of the articles after another person was appointed to replace him on the basis that, no contractual right existed him between him and the company since he was a mere outsider of the company with no rights in terms of the articles. Outsiders could enforce their rights against the company only through a separate contract not the articles.[154] In *Hickman v Kent or Romney Marsh Sheep Breeders Association,*[155] Astbury J held that:

> An outsider to whom rights purport to be given by the articles in his capacity as such outsider, whether he is or subsequently becomes a member, cannot sue on those articles treating them as contract between himself and the company to enforce those rights. Those rights are not part of the general regulations of the company applicable alike to all shareholders…and subsequent allotment of shares to an outsider in whose favour such an article is inserted does not enable him to sue the company on such an article.

However, Wedderburn J doubts the accuracy of the decision established in *Hickman v Kent or Romney Marsh Sheep Breeders Association*. Although he admits that the right of a member to sue the company lies solely on his capacity as a member and not as an outsider, he contends that:

> The proposition is that a member can compel the company not to depart from the contract with him under the articles, even if that means indirectly the enforcement of 'outsider' rights vested either in third parties or himself, so long as, but only so long as, he sues *qua* member and not *qua* 'outsider'.[156]

Gower and Davies[157] on the other hand posits that it is anomalous to consider directors as outsiders because the law in most cases treats directors as insiders. This is because company

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[152] Section 15(6)(c). See also A.O, Nwafor, The Unending Debate on the Contractual Effect of the Company's Constitution: A Comparative Perspective (2013) No 7, International Company and Commercial Law Review at 262.
[153] (1876) 1 Ex D 20 at 88. See also P Mantysaari, Comparative Corporate Governance: Shareholders as a Rule-maker (2006) at 108.
[154] B Hannigan, Company Law (2012) at 100.
[155] [1915] 1 Ch 881 at 897. See also *Globalink Telecommunications Ltd v Wilmbury Ltd* [2002] AII E.R (D) 158 para 30.
[156] Webberburn (note 136 above) 212-213.
[157] P Gower and S Worthington (ed) Gower and Davies: Principles of Modern Company Law (2008) 70.

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directors are the pillars of the company and some of the directors participate in the crucial activities of the company such as the drafting of the company's constitution.[158] Therefore, the 1973 Act had was mistaken to consider the directors as outsiders given the crucial role which directors play in companies.

However, the 2008 Act turned around the 1973 Act position, directors, prescribed officers together with any persons serving as members of the committee are now considered as insiders of the company. Therefore, board are contractually bound by the section 15(6)(c) contract to the company to observe the provisions of the constitution of the company.. This therefore, implies that directors in their capacity as such can enforce the provisions of the constitution of the company against the company and vice versa. This illustrates that a different decision was going to be reached if *Hickman v Kent or Romney Marsh Sheep Breeders Association* case was decided in terms of the provisions of the 2008 Act.

The 208 Act however, has some loopholes as it does not provide an explanatory meaning of the phrase 'in the exercise of their respective functions'.[159] The legislature is said to have intended the words to mean that the directors, prescribed officers or members of the committee of the board can enjoy rights and perform obligations flowing from the memorandum granted to them in their official capacities and not in their personal capacities.[160] Based on this it can therefore, be said that a right and/or an obligation is granted to the directors, prescribed officers or members of the committee in their official capacities, if the exercise of the right and /or performance of the obligation is linked to the positions they hold. For instance, if a director is also appointed as a legal adviser of the company, the functions connected to the legal work to the company is not related to his functions as a director. However, any rights and obligations linked to legal work in his capacity as a prescribed officer of the company will only be enforceable in his capacity as such not as a director.[161]

In short, the 2008 Act attempts to provide a clear scope as to who are the persons bound by the constitutive document of a company unlike the previous Act. The Act has brought new changes[162] and new challenges[163] which must be tested by the courts. It therefore, remains in the hands of the courts to find proper interpretation of the provisions of the constitution of the company. Nevertheless, the Act failed to address the extent to which the parties to the section 15(6) contract are bound by its provisions and the circumstances giving rise to them being bound.[164] Consequently, the section must be read together with section 161(1) which grants a

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158 Nwafor (note 152 above) 263.
159 Section 15(6)(c)(ii).
160 See Morajane (note 117 above) 186.
161 Section 15(6)(c)(i).
162 By treating the directors as insiders of the company in section 15(6)(c).
163 The Act failed to provide guidelines to the manner and the extent giving rise to be bound by section 15(6).
164 See also Nwafor (note 152 above) 271.

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holder of securities of a company the power to make an application to the court for the determinations of the rights that the holder is entitled in terms of the Act, or the company's constitution. A combination of both provisions suggests that a member of the company can enforce the provisions of a company's constitution only to the extent that grants him the rights in his capacity as a member or officer of the company.[165]

2.5 The separate legal personality of the company: the main consequence for incorporating a company

According to Pretorius,[166] a jurist person is a body or an association which is not a natural person but which the law grants the ability to acquire rights and incur liabilities of its own distinct from its members. In law the company is recognised as a juristic person which is distinct and separate from its shareholders and directors; and has the capacity to acquire rights and incur liability of its own.[167] The separate legal personality status of the company is the foundation upon which the entire company law is built.[168]

Section 19(1)(b) grants the company the capacity to acquire rights and incur responsibilities like individuals to the extent to which the company is able to exercise such rights. This is a clear indication to the fact that, if a juristic person is not able to exercise a particular right, such right will not apply to it. Section 19(1) which regulates the legal status of the companies provides that:

> From the date and time that the incorporation of a company is registered, as stated in its registration certificate, the company-
> (a) is a juristic person, which exists continuously until its name is removed from the companies register in accordance with this Act;
> (b) has all of the legal powers and capacity of an individual, except to the extent that-
> (i) a juristic person is incapable of exercising any such power, or having any such capacity; or
> (ii) the company's Memorandum of Incorporation provides otherwise.

In principle the company cannot be said to be a juristic person on its own. This is because companies are a mere association of its members, natural persons who compose the company. Hence, not realistically correct to consider the company as separate from its members. However, the research is only concerned about the law and not other economics of company composition. Therefore, the fact that companies do not have their own separate existence from that of its members does not take away the crucial principle of company law

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[165] Nwafor (*ibid*). See also Cassim (note 98 above) 137.
[166] JT Pretorius & P.A Delport (ed), *Companies in General, South African Company Law Through Cases* (1999) at 7.
[167] Section 19 of the Act.
[168] Cassim (note 98 above) 137.

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that a company is a distinct entity which is separate from its members, shareholders and directors.

The concept of separate legal personality of a company was founded in *Salomon v Salomon & Co Ltd*[169] where the House of Lords held that, Salomon cannot be held liable for the debts of the company because of the separate legal personality status of the company. Which entails that, shareholders of the company cannot be held liable for the debts and any liabilities of the company because two are distinct and separate persons.

The principle of separate legal personality of the company was confirmed in *Webb & Co Ltd v Northern Rifles*[170] where Gregorowskie the counsel for the defendant argued that a voluntary corporation is not an entity on its own but a mere association of its members. In that matter, Smith J said:

> An *universitas* is distinguished from a mere association of individuals by the fact that it is an entity distinct from the individuals forming it, that its capacity to acquire rights or incur obligations is distinct from that of its members.

The separate legal personality of a company originated in English law and has been fully incorporated into South African company law. For instance, in *Dadoo Ltd & Others v Krugersdorp Municipal Council* [171] the Appellate Division recognised the separate legal status of the company and held that the ownership of the property in question belonged to the company and not to its shareholders. The decision of the court was based on the contention that a company is indeed an entity which is distinct and separate from its members. As a result, the court held that there was no statute contravened since the statute did not prohibit companies to own immovable property but only prohibited the Asiatic persons. In that case, the court emphasised that ownership by the Dadoo Company did not violate any provisions of the Act, and does not imply ownership by its Asiatic shareholders, due to the separate legal personality of the company.

Innes CJ, in that matter elaborated further that:

> A registered company is a legal *persona* distinct from the members who compose it. In the words of Lord Macnaghten (*Salomon v Salomon & Co Ltd* 1897 AC at 51) "the company is at law a different person altogether from the subscribers to its memorandum".[172]

The separate personality status of the company is recently considered in the English case of *Prest v Petrodel Resources Ltd and Others*[173] where Lord Sumption stated that:

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169 *Salomon v Salomon & Co Ltd* [1897] AC 29 at 51.
170 1908 TS 462 at 464.
171 (1920) AD 530 at 550.
172 *Ibid.*
173 [2013] UKSC 34 para 8.

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> Subject to very limited exceptions, most of which are statutory, a company is a legal entity distinct from its shareholders. It has rights and liabilities of its own which are distinct from those of its shareholders. Its property is its own, and not that of its shareholders.

It is worth noting that the recognition of the separate legal personality of a company in the South African context[174] extends to and aligns with the provisions of the Bill of Rights contained in chapter two of the Constitution Act 108 of 1996. This is borne by section 8(4) of the Constitution which provides that, the rights contained in the Bill of Rights also apply to juristic persons. However, the extent of application of the rights depends on the nature of the rights and the juristic person receiving such right.[175]

For instance, in *Investigating Directorate: Serious Economic Offences v Hyundai Motor Distributors (Pty) Ltd ;In re Hyundai Motor Distributors (Pty) Ltd v Smit No*[176], the Constitutional Court heard the matter relating to the question of whether companies as juristic persons are they entitled to the right to privacy like any other individuals. In that matter, the Constitutional Court held that though the right to privacy is more crucial in relation to human beings, companies are also entitled to the right to privacy.

2.5.1 The separate legal personality of a company: the fountain for the other consequences for incorporating a company

The incorporation of a company as already highlighted above it comes with a number of consequences. These includes for instance the separate legal personality of a company which is the main consequence of incorporating a company. The separate legal personality of a company is considered to be the foundation of the entire company law because of its importance in company law.[177] Other consequences of company incorporation are undisputedly to flow from the separate legal personality status of the company. For demonstration, the *locus standi* of the company, which entails that the company has legal standing in a law suits. As it can sue and be sued in its own name. Limited liability of shareholders, and the capacity of the company to own property *inter alia* are all the attributes for company incorporation, flowing directly from the separate legal personality status of the company.

2.5.1.2 The contractual capacity of a company

Given the separate legal personality status of the company, a company has the capacity to contract in its own name with any person including its shareholders and directors.[178] This was

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[174] Contained in section 19(1) of the Act.
[175] Section 8(2) of the Constitution.
[176] 2001 (1) SA 545 (CC) at 551.
[177] Cassim (note 10 above) 29.
[178] *Farrar v Farrars Ltd* (1888) 40 ChD 395.

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also demonstrated in *Lee v Lee's Air Farming Ltd*[179] in that case the Privy Council relied on the decision established by the House of Lords in *Salomon v Salomon & Co Ltd*[180] and held as follows:

> Lee's company was a separate and distinct legal entity from him and that it was his employer. The contract between Lee and the company was a valid contract between two different legal persons, even if the company in making the contract acted through Lee. One cannot change this contract merely because of the difficulties one encounters in company law.[181]

Lord Reid in the same case also stated that:

> A person who holds practically all the shares in a company and is also appointed governing director with full power of government and control of the company's affairs may still, in his personal capacity, enter into a valid contract of service with the company and then become a worker in the employment of the company for the purposes of the Workers Compensation Act 1922 (now the Workers' Compensation Act 1956). The capacity of the company to make such a contract cannot be impugned because the governing director himself was the agent of the company in its negotiation.[182]

It was held by the Privy Council, on that premise that the deceased who was the sole shareholder and a director of his company was employed by his company as a chief pilot. The appellant was therefore, allowed to claim compensation for her deceased husband in terms of the New Zealand Workmen's Compensation Act of 1922.[183]

2.5.1.3 Limited liability

Limited liability is the concept of company law which entails that shareholders can not liable for the liabilities of the company. The shareholders immunity to be liable for the debts and liabilities of a company because of the separate legal personality status of a company. The concept of limited liability simply entails that, due to the separate legal personality of a company, shareholders of the company are not liable for the debts and any liabilities of the company. This is because the debts and liabilities of the company are incurred by the company itself and do not extend to the shareholders of the company.[184]

Since a company is liable for its debts this also means that, creditors of a company cannot recover their claims from the shareholders of the company because a company and its shareholders are two separate persons. This therefore, means that if the company fails to

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179 1961 NZLR 325.
180 [1897] AC 29.
181 *Ibid* at 327.
182 *ibid.*
183 *Lee* case (note 179 above) 336.
184 *Ibid.*

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satisfy its debts to its creditors, the creditors of the company do not have recourse to the private assets owned by the shareholders of the company.[185]

However, the only liability that the shareholders of the company can incur is limited only to their share capital.[186] Share capital of the company simply refers to the funds contributed by the shareholder when subscribing for the shares of the company which must be invested by the company in its business.

The concept of shareholders limited liability is also strengthened by the Act which excludes the shareholders of the company from being liable for company's debts merely by reason of being shareholders except to the extent that the Act or memorandum states otherwise.[187]

The concept of limited liability was established in *Salomon v Salomon & Co Ltd*[188] where the House of Lords held that, even though Salomon was the owner of almost all the shares of the company, he still enjoyed limited liability, as such, he cannot be held liable for the debts of the company. The decision of the court was based on the fact that, a company is an entity distinct from its incorporators, shareholders and directors.[189] The concept of limited liability also applies to one-man business in the same manner as it applies to all other companies. In that case, Lord Macnaghten[190] held that:

> Among the principal reasons which induces persons to form private companies… are the desire to avoid the risk of bankruptcy…by means of a private company trade can be carried on with limited liability and without exposing the persons interested in it in the event of failure to the harsh provisions of bankruptcy law.

The principle that the debts of the company are limited only to the company and do not extend to the shareholders was strengthened by Lord Herschell[191] in the same case where he said:

> In a popular sense, a company may in every case be said to carry on business for and on behalf of its shareholders; but this certainly does not in point of law constitute the relation of principal and agent between them or render the shareholders liable to indemnify the company against the debts which it incurs.

However, despite the fact that shareholders enjoy the privilege of not being liable for the debts and obligations of the company, shareholders can assume liability for the debts and obligations of the company voluntarily by forming a personal liability company. A personal liability company holds the past and present shareholders together with directors jointly and severally liable for the debts and liabilities of the company for the debts that were incurred by the company during

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185 RC Beuthin, Beuthin's Company Law (2000) at 5.
186 JL Van Dorsten, *South African Business Entities: A Practical Guide* (1991) at 81.
187 See section 19(2).
188 *Salomon v Salomon & Co Ltd* [1897] AC 29 at 51.
189 *Ibid* at 51.
190 *Ibid* at 52.
191 *Salomon's* case (note 188 above) 43.

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the their existence in the company's affairs. As such, where the shareholders chose to shoulder the liabilities of the company, they will lose the rights of limited liability.[193]

The privilege of limited liability bestowed on the shareholders has been subjected to abuse in many cases by those shareholders who possess the controlling powers in respect of the company's affairs. Which is so detrimental to company law. Therefore, as a measure to prevent such abuse, an exception to the principle of limited liability was established. This is known as the principle of piercing of the corporate veil. The principle of piercing the corporate veil enables the courts to look behind the veil of incorporation in order to disregard the separate legal personality of the company and affix liability to the rightful individuals where there is unconscionable abuse of the juristic *persona* of the company.[194] However, this forms the subject of discussion later in this work.[195]

The main aim of limited liability is to protect the rights and interests of shareholders against those of the creditors of the company.[196] Thus, shareholders enjoy protection for being liable for the debts and liabilities of the company. This was illustrated in *Airport Cold Storage (Pty) Ltd v Ebrahim*[197] the court held that, in principle the company's debts belong only to the company itself consequently company shareholders cannot be held liable for the debts of the company.

In addition, the concept of limited liability has economic advantages. This is because, since liabilities of the company are only limited to the company, shareholders become willing to invest more bearing in mind that they cannot be held liable for the debts of the company in times of economic distress. This therefore, leads to the growth of companies which result in economic expansion of the country.[198]

Since the debts and liabilities of the company belong to the company itself, so do the profits of the company.[199] Shareholders do not have any entitlement to the profits of the company due to the separate legal personality status of a company. If a shareholder utilises the profits of a company for personal benefits, such a shareholder will be held liable to account for all the profits utilised. This was demonstrated in the case of *S v De Jager*[200] where the Appellate Division Court found the accused liable to the company for using the company's profits for his own personal benefits despite the fact that the other shareholder consented to the use.

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192 Section 19(3).
193 *JH Rayner (Mincing Lane) Ltd v Department of Trade and Industry* 1990 (2) AC 418 (HL).
194 Section 20(9).
195 See chapter four of this research in general.
196 *Ibid.*
197 2008 (2) SA 303 (C) para 6.
198 R Cassim (note 98 above) 35.
199 *Hughes v Ridley* 2010 (1) SA 381 (KZP) para 22.
200 1965 (2) SA 616 (A).

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Prohibition for use personal use of company profits applies to all companies even the companies with a single shareholder.

The court in that matter further highlighted that, the use of the company's profits by shareholders for their own personal benefits and not that of the company infringes certain crucial principles of company law. For instance the separate legal personality of the company which entails that the company is a separate legal person as such it is entitled to own its own profits and not its shareholders.[201] The court added further that shareholders or directors may not be permitted to violate such an important principles of company law despite what is contained in the provisions of the memorandum of incorporation of a company.[202] This is because the separate legal personality of the company is an important concept of company law as such it deserves great protection by the courts. Shareholders are however, entitled to the profits of the company only when declared dividends by the company.

2.5.1.4 Perpetual succession of a company

Companies enjoy perpetual succession.[203] Once the company is incorporated and registered in compliance with the provisions of the Act, such a company continues to exist until such time it is removed from the companies register.[204] As it has already been shown that the company is an entity distinct from its shareholders and directors and as such it is capable of having its own rights and liabilities.[205]

Consequently, any changes in shareholding composition either as a result of death of a shareholder or transfer of shares does not have any effect on the company's status unlike a partnership which is affected by the change in shareholders' composition.[206] Henceforth, this clearly indicates that company's existence does not depend on and is not affected by change in the membership of the company.

Perpetual existence of the company despite the change in shareholders' composition was buttressed by Colman J in *Stern v Vesta Industries (Pty) Ltd & Another*[207] where he stated that a company is a legal person and it remains as such despite the change in its shareholding and controlling minds. Perpetual succession of the company was also confirmed by Smith J in *Webb & Co Ltd v Northern Rifles* where he stated that, "a company continues to exist though

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201 *Ibid* at 625.
202 *Ibid.*
203 Section 19(1). See also *Webb &Co Ltd v Northern Rifles* 1908 TS 462 at 463.
204 Section 19(1)(a). See also J.L Van Dorsten (note 186 above) at 79.
205 *Salomon* case (note 191 above).
206 Van Dorsten (note 186 above).
207 1976 (1) SA 81 (W) at 85.

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the individual members comprising it change...it has what is sometimes termed perpetual succession".[208]

A similar approach was adopted earlier in the Australian case of *In re Noel Tedman Pty Ltd*[209] where the simultaneous death of all the shareholders of the company did not mark the end of the existence of a company. The court held that the company continued to exists despite the death of its shareholders because it is a person separate from the shareholders.

2.5.1.5 Ownership of the assets and the property of a company

Despite the controversial characteristic of the company as being a separate legal person and an association of its shareholders, the assets and property of the company undisputedly belong only to the company and not to the shareholders.[210] This is simple because the law has accepted that the company is a person separate and distinct from its shareholders and directors. Differently put, the shareholders are not in any way the owners of the company's property and assets, instead the property and the assets of the company belong only to the company itself. The company's capacity to acquire and own property in its own name is said by Smith J in *Webb & Co Ltd v Northern Riffles*, to be one of the crucial rights appertaining to the company's status of separate legal personality.[211] The fact that the company can own its own assets and property indicates that, the company is a separate person from its shareholders and directors. If the company was not a person on its own the law would not have granted it the right and capacity to own any property and assets.

In the prominent South African case of *Dadoo Ltd & Others v Krugersdorp Municipal Council,*[212] the Appellate Division heard before it the issue of whether ownership of property by the Dadoo Company constituted ownership of such property by its Asiatic shareholders. This was triggered by the fact that the Transvaal statute prohibited Indians from owning immovable property. Dadoo Ltd was formed by two Indians who purchased immovable property from Krugersdorp municipal. The defendant in that matter contended that there had been contravention of the statute which prohibited Indians from owning immovable property. However, the Appellate Division held that there was no contravention of the statute in any manner since the legislation did not prohibit companies from owing immovable property but only the Indian persons. The non-violation of the said statute was based on the fact that the immovable property in question was not owned by shareholders of the Dadoo Company instead it was owned exclusively by the company, separate from its shareholders. Given the

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[208] 1908 TS 462 at 465.
[209] [1967] QdR 561.
[210] *Dadoo Ltd Others v Krugersdorp Municipal Council* (1920) AD 530 at 550 -551. See also D French, S Mayson & C Ryan (note 39 above) 122.
[211] *Webb* case (note 203 above) at 465.
[212] *Dadoo* case (note 210 above).

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fact that the company in law is deemed as a person separate and distinct from its shareholders. Innes CJ held that:

> Taking the intention then to be the prohibition of ownership of fixed property by Asiatics and the prohibition of the acquisition and the occupation of mining rights by the coloured people, I come to inquire whether the transaction complained of is a contravention of the statute. In other words, whether ownership by Dadoo Ltd, is in substance ownership by its Asiatic shareholders. Clearly in law it is not. A registered company is a legal *persona* distinct from the members who compose it.[213]

As companies are juristic persons separate from its shareholders, they are the legal and beneficial owners of their property and assets.[214] As a result shareholders of the company cannot be considered as the beneficiary owners of the company's property despite the fact that they hold shares in the company.[215] Since shareholders do not have ownership in the assets and property of the company, they are also deemed to lack insurable interest in company's assets and property.[216]

In the *Macaura v Northern Assurance Co Ltd*[217] the appellant sold his timber to Irish Canadian Saw Mills Ltd in which he owned nearly all the shares. The appellant insured the timber company by the policy effected in his name against damage by fire. When the timber was damaged by fire the insurance company refused to pay on the basis that the insurer lacked insurable interests in the asset insured. The House of Lord ruled in favour of the defendant company that indeed the insurance company was not bound to pay because the shareholders even if they own most or even all of the shares held by the company, they do not have ownership in the company's assets as such they cannot insure company's assets in their own names, as they lack insurable interest in the assets insured. Lord Sumner stated that:

> My Lords, this appeal relates to an insurance on goods against loss by fire. It is clear that, the appellant had no insurable interests in the timber described. It is not his. It belongs to the Irish Canadian Saw Mills Ltd of Skibbereen Co Cork. His relation was to the company, not to its goods, and after the fire he was directly prejudiced by the paucity of the company's assets, not by the fire.[218]

In addition, in *Stellenbosch Farmers Winery Ltd v Distillers Corporation (SA) Ltd*[219] the provisions of section 166 of the Liquor Act prohibited brewers from having direct or indirect financial interests in the business of any licenced brewery. Hoexter ACJ held that, the fact that shareholders are entitled to the residue of the company upon its winding up makes the

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213 *Ibid* 550.
214 *JJ Harrison (Properties) Ltd v Harrison* [2002] 1 BCLC 162 at 25.
215 *Ayton Ltd v Popely* [2005] EWHC 810 (Ch).
216 *Macaura v Northern Assurance Company Ltd* [1925] AC 619 HL.
217 *Ibid.*
218 *Ibid* at 673.
219 1962 (1) SA 458 (A) at 469.

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shareholders to have financial interests in the success or failure of the company. However, such does not grant them proprietary interests in the assets of the company.[220]

It should be noted that, as elaborated in *Stellenbosch Farmers Winery Ltd v Distillers Corporation (SA) Ltd,* financial interest is not the same as the proprietary interest and the two do not go hand in glove. Instead financial interests are those interests tied to the rewards of the company such as dividends. Thereby, indicating that even though shareholders have financial interests in the success or failure of the business of the company they do not in law have proprietary interest in the assets of the company.

2.5.1.6 The capacity of the shareholders to seek relief for the wrong done to the company

Shareholders in law are not agents of the company. The position is the same even if the company is a 'one-man business'.[221] Only authorised persons are allowed to act or contract on behalf and in the name of a company. This is provided for in section 66(1) of the Act which grants the directors of a company the powers to manage the affairs of the company. According to the section[222] only directors have the capacity to manage the affairs the company. Membership to a company does not grant the shareholders the right to act in the name of and on behalf of a company.

In cases where wrong is done against the company, it is only the company through its representatives that can institute legal proceedings against the wrongdoer.[223] In *Francis George Hill Family Trust v South African Reserve Bank,*[224] Hoexter JA confirmed the *locus standi* of a company and held that:

> It is trite that a company with limited liability is an independent legal person and separate from its shareholders or directors. In general, therefore, when a wrong is alleged to have been done to a company the proper plaintiff to sue the wrongdoer is the company itself.

Hence, it follows that, if the company enters into a contract, shareholders do not have the capacity or any right to institute any legal actions to enforce the contract. Thus, the company should in its own name and capacity institute action for the enforcement of such contract.[225]

Given the separate legal personality of a company which grants the company the capacity to sue in its own name. Consequently, this also implies that, a company on the other hand can

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220 *Ibid* at 472.
221 *Salomon* case (note 188 above) 42-43.
222 Section 66(1).
223 *Moir v Wallersteiner and Others* (No 2) [1975] 1 ALL ER (CA) at 857.
224 1992 (3) SA 91 at 97.
225 *Wiseman v Ace Table Soccer (Pty) Ltd* 1991 (4) SA 171 (W) at 175.

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also be sued in its own name. This was demonstrated in *Lipschitz v Wolpert & Abrahams*[226] where Holmes JA stated that, "a company is a creature whose existence is provided for by statute. It is a legal entity, separate from its shareholders and directors…It can sue and be sued".

However, even though the company has all the right and capacity to sue and or to be sued in its own name, it lacks existence of its own which can enable it to engage in conducts which are inherently human in nature such as the ability to physically appear in court as a party to a law suit.[227] Is the reason why the law assigns the relevant persons such as directors and or prescribed officers of a company to act in the name of and on behalf of a company.[228] The appointed individuals act as the agents and trustees of the company; which is not able to act on its own due to the lack of the ability to engage in activities which are inherently human. Nonetheless, lack of ability by a company to act on its own does not take away the separate legal personality status of the company which is the corner stone of company law.

2.6 Chapter conclusion

The procedure and the requirements for incorporating a company are clearly stated in the Act.[229] Therefore, the incorporators should strictly abide with those provisions when incorporating a company, so to ensure success in the incorporation of a company. This is attributed to the fact that, failure to comply with those requirements will result in the Commission declining to register the company.[230]

The memorandum of incorporation is the main document in the incorporation of the company and has been considered by many academics as the constitution of the company.[231] This is due to the fact that the memorandum of incorporation is the sole founding and governing document of the company which sets out the rights and the liabilities of any person dealing with the company.

Furthermore, section 15(6) has brought great changes in the South African company law with regard to the binding effects of a company's memorandum. The Act in section 15(6)(c) considers directors as insiders and bound by the company's constitution as opposed to the 1973 Act which anomaly regarded directors as outsider. Again, section 15(6) due to its binding effects has been considered by many scholars as a unique statutory contract, which does not

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226 1977 (2) SA 732 (A) at 740.
227 Cassim (note 14 above) 17.
228 *Ibid.*
229 See section 13 and 14.
230 See section 13(4) which grants the Commission discretionary and mandatory powers to reject the notice of incorporation.
231 For instance Cassim (note 14 above) 22.

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need to comply with the requirements of a valid contract but it derives its contractual nature from common law and the Act.

It is also important to note that the outstanding consequence of incorporating the company is the separate legal personality of a company which is acquired by the company from the date and time of its registration.[232] From the above discussion, it cannot be disputed that the separate legal personality of a company is the heart of the entire company law and that it is the fountain for all the other attributes of incorporating a company.

However, despite the importance of separate legal personality of a company it has been prone to abuse by the controlling minds of the company who commit unjust acts and hide behind the separate legal personality of the company as a way of dodging liability when faced by the arm of the law. Hence, in cases of abuse of the juristic personality of a company, the courts disregard the separate legal personality of the company.[233] The disregarding of the separate legal personality of a company is covered in the succeeding chapters of this work.[234] In the next chapter, the researcher discusses the fiduciary duties and liability of company directors.

[232] Section 19(1).
[233] See for instance section 20(9)(a) which grants the courts the discretion to disregard the separate legal personality of a company in cases where there is 'unconscionable abuse' of the corporate structure.
[234] See chapter four of this research in general.

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CHAPTER THREE

FIDUCIARY DUTIES AND LIABILITIES OF COMPANY DIRECTORS

The chapter examines the fiduciary duties of directors. The discussion commences with the discussion of the common law position in this area of the law and extends to the innovations introduced by the Companies Act of 2008. It is important to note that a breach of fiduciary duties by directors give rise to the imposition of liabilities on directors in two ways, namely the imposition of personal liability without the piercing of the corporate veil, and the imposition of liability through the piercing of the veil of incorporation. Where the breach of duty constitutes a wrong against the company, the director is held personally accountable to the company without the veil of incorporation being pierced. However, where the breach of duty gives rise to a wrong against an outsider, the court could pierce the corporate veil in order to reach the director hiding behind the veil and impose liability on the director. The present chapter focuses on the fiduciary duties of directors and the breach of duties owed to the company as they relate to the wrong against the company, which does not lead to the piercing of the corporate veil.

3.1 Introduction

The duties of directors in general are divided into two broad categories. These are the fiduciary duties and the duty of care, skill and diligence.[235] Fiduciary duties require the director of the company *inter alia* to exercise the powers granted to the director in his capacity as such in good faith and for a proper purpose and also in the best interests of the company. These duties arise due to the fiduciary relationship which exists between directors and the company. Directors are regarded as the fiduciaries of the company because they are entrusted with the company's assets and the running of the affairs of the company.[236] The duty of care, skill and diligence requires the directors to display the standard of a reasonable man when performing their duties. Simply put, the duty of care, skill and diligence requires the directors of the company to act in a way in which a reasonable man, in the shoes of the concerned director, would have acted in a given situation. However, the researcher in this work focuses only on the examination of the fiduciary duties of directors.

It should be noted that, prior to the enactment of the Companies Act 71 of 2008 the fiduciary duties of directors were regulated solely by common law. The company directors were required

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[235]Section 76(2) and section 76(3). See also *South Africa: Duties and Responsibilities of Company Directors* at available http://www.mondaq.com/southafrica/x/35736/Contract+Law/Duties+and+Responsibilities+of+Company+Directors accessed 31 August 2015.

[236] FHI Cassim 'The Duties and the Liability of Directors' in M.F Cassim, R Jooste, J Shev & J Yeast (eds) *Contemporary Company law* (2012) 507.

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to act in utmost good faith putting the best interests of the company first. The Act has now codified these common law duties of directors.[237] Thus, the fiduciary duties of directors are now regulated by the provisions of the Act together with the common Law.

Since the fiduciary duties of directors are now regulated by two bodies of law, it is reasonable to expect that both cannot always be in harmony on every issue. Consequently, where there are inconsistencies between the common law and the Act on the duties of directors, the Act will always take precedence over the common law.[238] A recourse to common law is done only in those cases where the Act does not address a particular duty of directors.[239] This is attributed to the fact that, if the Act does not address a particular duty of directors, such does not imply that the concerned duty no longer exists. Instead such common law duty will remain applicable and regulated solely by the common law.

More so, there is a close relationship between the common law and statutory duties of directors.[240] This is due to the fact that, statutory duties of directors originate directly from common law. Thus, for one to have a good understanding of the statutory duties of directors, one must first understand the common law duties of directors.

The codification of the duties of directors in the Act is of vital importance in the South African company law because it raises the standards of corporation and the directorial behaviour.[241] Again, it enable the directors to clearly understand their fiduciary duties to the company, and makes the applicable rules accessible to all. Again, the provisions of section 66 should not be ignored when discussing the fiduciary duties of directors. The section grants the directors the managerial powers over the affairs of the company, by providing as follows:

> The business and affairs of a company must be managed by or under the direction of its board, which has the authority to exercise all of the powers and perform any of the functions of the company, except to the extent that this Act or the company's Memorandum of Incorporation provides otherwise.

It is clear from the wording of the section that the Act confers mandatory powers over the company's affairs on the directors. This is indicated by the usage of the word 'must' in the section. Thus, one can say that this is the reason why it is a prerequisite that every company to be incorporated should satisfy the minimum number of directors stated in the Act, who are to manage the company. Though the section grants the directors all the powers to manage the business of the company, such powers are not absolute. The section further provides that, such powers are subject to provisions of the memorandum of incorporation or the Act which

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[237] See for instance section 76 of the Act.
[238] Werksmans Attorneys *'Claims against Directors in Terms of the Companies Act 2008'* available at http://www.werksmans.com/wp-content/uploads/2013/04/Directors-liaibility1.pdf (accessed 31 August 2015).
[239] *Ibid.*
[240] Cassim (note 236 above) 507.
[241] *Ibid.*

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may provide otherwise. Resulting from the management powers are therefore, the standards laid down by the law which the directors should observe in the exercise of those powers.

3.2 The fiduciary duties of directors

The term fiduciary refers to trust and confidence.[242] A fiduciary is a person who undertakes to act on behalf of and in the interests of another person in the exercise of power which affects the interests of another person.[243] Since directors undertake to act on behalf of and in the best interests of the company, and are entrusted with the assets of the company, their position qualify them to be regarded as fiduciaries. Hence the law, has imposed fiduciary duties on directors so as to ensure that directors do not abuse the trust and confidence reposed on them by the company. The fiduciary duties are compulsory to all company directors and no director may be relieved of any of these duties in any manner.[244]

3.2.1 To whom do directors owe the fiduciary duties

It is the trite law that the directors owe the fiduciary duties to the company and the company alone. No other person is owed the fiduciary duties by the directors, not even the shareholders of the company. However, there are challenges as to what constitutes the company in defining the fiduciary duties of the directors. The general principle of the law is that the company is a separate legal person from the shareholders. Nonetheless, in limited cases the company has been deemed to be an association of its shareholders. Therefore, it is paramount to look into the question of what constitutes the company in relation to the fiduciary duties of directors.

Section 1 of the 2008 Act defines the company as a juristic person with legal personality distinct and separate from that of its shareholders and directors. Therefore, the company and its shareholders are two separate and distinct entities.[245] On that premise, it is easy to support the common law position that directors owe their fiduciary duties only to the company.

Mongalo[246] is however, of the view that the expression 'best interests of the company' has always been translated to denote the interests of present and future shareholders of the company. Thus, according to Mongalo's view, since the law requires directors to act in good faith and in the best interests of the company, it simply requires the directors to serve the interests of shareholders who compose an artificial person, the company.

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[242] AO. Nwafor & C K Okoli, 'The Corporate Opportunity Doctrine- An Inflexible or Flexible Rule' *(2013) Vol.9 No. 2, Corporate Board: Role, Duties & Composition* 22.
[243] AO. Nwafor 'Director's Fiduciary Duties – In Whose Benefit?' *(2002) Vol 7 No 1, Modus International Law & Business Quarterly* 1.
[244] *Barlows Manufacturing Co Ltd v R N Barrie (Pty) Ltd* 1990 (4) SA 608 (C).
[245] *Salomon v Salomon & Co Ltd* [1897] AC 22.
[246] T Mongalo *Corporate Law and Corporate Governance: A Global Picture of Undertakings in South Africa* (2003) 161.

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Cassim[247] also posits that in the light of section 76(3)(b), which regulates the fiduciary duties of directors to act in the best interests of the company, the term company in that context is a synonym for shareholder and that 'shareholder' refers to shareholders collectively. This suggests that, the fiduciary duties of directors are owed to the shareholders as a collective body. This submission could be correct in the narrow sense where the company is considered as an association of its shareholders. However, it is not always the case that directors owe fiduciary duties to shareholders collectively.[248] In fact, there are certain cases in which directors have been held to owe the fiduciary duties to shareholders on individual basis. For instance, where a separate contract exists which obliges the director to act in the best interests of the shareholder.[249]

At common law, the position is that directors owe their fiduciary duties to the company alone and not to the shareholders individually.[250] This implies that no fiduciary duty is owed by the directors to the shareholders of the company. As a result shareholders do not have a right to question the exercise of the director's duty.[251] The principle that directors owe their fiduciary duties to the company alone and not to any persons including the shareholders was also buttressed in *Bramford v Bramford,*[252] where the court held that no fiduciary duty is owed by the directors of the company to the shareholders.

Again in *Percival v Wright,*[253] Swinfen-Eady J stretched the point that directors owe their duty of loyalty only to the company and not to individual shareholders, though such depends on the facts of each case. Swinfen-Eady J added that, fiduciary relationship which binds directors to perform fiduciary duties to the company only exists between the company and the directors. No fiduciary relationship exists between the directors of the company and the individual shareholders. Thus, directors are not under any duty to perform fiduciary duties to company shareholders as a general rule.[254]

In *In re Horsley and Weight Ltd,*[255] the court considered the question of whether directors of the company have any fiduciary duties towards the creditors of the company. In that matter, Buckley LJ held that no fiduciary duty is owed by the company directors to the creditors of the

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[247] Cassim (note 14 above) 82.
[248] See for example *Brunninghausen v Glavanics* (1999) 46 NSWLR 338 NSW where the court held that Brunninghausen, the director had a fiduciary duty to inform Glavanics, the shareholder in the company about the sale of the company.
[249] *Ibid.*
[250] *Percival v Wright* [1902] 2 Ch 401.
[251] *Ibid.*
[252] [1970] Ch 212 at 238 where Harman LJ held that the fiduciary duty of directors is owed to the company and not the shareholders as such if a director commits a wrong against the company it is only the company that can condone such an act at the general meeting.
[253] *Percival* case (note 250 above).
[254] However this principle has been considered as the general rule which can be subjected to some exceptions for instance, where a shareholder is vulnerable. See for instance *Peskin v Anderson* [2001] BCLC 372.
[255] [1982] 3 WLR 431.

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company.[256] However, it was established, in *Winkworth v Edward Baron Development Co Ltd & Ors,*[257] that the company through its directors has a duty to protect the interests of its present and future creditors. This therefore, brings out the fact that even though creditors are outsiders, which are not directly served by the company, the protection of their interests is of paramount importance because they stand in a special relationship with the company.

Furthermore, in *Liquidator of West Mercia Safety Wear Ltd v Dodd & Anor,*[258] the court held that directors of an insolvent company must take into account the interests of creditors of the company when performing the fiduciary duties that they owe the company. However, it must be borne in mind that even though directors in performing their fiduciary duties are expected to take into consideration the interests of creditors, such expectation does not erode the general principle of law that directors owe no fiduciary duty to company creditors. However, due to the special standing that exists between the company and its creditors, the directors of the company are not supposed to neglect the interests of the company creditors in the performance of their duties.

As already been explained above, even if the company is regarded in law as a separate legal person, the separate legal status of the company is a mere fictitious concept of law. In true sense, the company is an association of its shareholders. Consequently, the interests attributed to the company are certainly the collective interests of shareholders who have formed the company to serve their interests and whose interest must be served by the directors. Thus the conclusion drawn in this research is that, indeed directors owe their fiduciary duties to the company, which refers to the interests of shareholders as a collective body.

3.2.2 Duty to act in the best interests of the company

The duty to act in the best interests of the company is a common law fiduciary duty of directors which has found express codification in the Act.[259] This duty requires that, directors when performing their fiduciary duties should always prioritise the best interests of the company and not to act in a manner which will prejudice the interests of the company. This entails that, interests of the company should always be put first by the directors in the performance of their fiduciary duties.

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[256] *Ibid* at 442.
[257] [1987] 1 All ER 118.
[258] (1988) 4BCC 30. See also *Lonrho Ltd v Shell Petroleum Co Ltd* [1980] 1 WLR 627 where Diplock LJ held that the duty of directors to act in the best interests of the company also includes serving the interests of the creditors of the company.
[259] Section 76(3)(b) of the Act provides that: subject to subsection (4) and (5), a director of a company, when acting in that capacity, must exercise the powers and perform the functions of the director-(b) in the best interests of the company.

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This duty, like the other fiduciary duties of directors, arises due to the fiduciary relationship which exists between the directors and the company.[260] The duty to act in the best interests of the company is compulsory to all company directors as a result no director may be relieved of this duty in any manner.[261] The present researcher is of the view that, the duty to act in the best interests of the company can be said to be the foundation of all the fiduciary duties of directors. This is ascribed to the fact that, if the director aims to act in the best interests of the company, there is high possibility to fulfil the other fiduciary duties imposed on him. Such as avoiding conflict of interest and the duty not to utilise corporate opportunities. This is because sabotaging the opportunities of the company certainly does not serve the best interests of the company.

The fiduciary duty that directors are supposed to prioritise the interests of the company, was applied in *In Re W & M Roith Ltd.*[262] In that case, the director contracted with the company to grant pension to his wife after his death. The court declared that the contract is not binding on the company because it did not serve the company's interests but that of Mrs Roith.

Furthermore, the duty to act in the best interests of the company was acknowledged by Cartwright J in *Peso Silver Mines Ltd (NPL) v Cropper*[263] where he held that:

> When Dickson, at Dr A's suggestion, offered his claim to the appellant it was the duty of the respondent as the director to take part in the decision of the board as to whether that offer should be accepted or rejected. At that point he stood in a fiduciary relationship to the appellant. There are affirmative findings of the fact that he and his co-directors acted in good faith, solely in the interests of the appellant and with sound business reasons in rejecting the offer.

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In addition, directors in performing their duties in utmost good faith and in the best interests of the company should take into account the long term considerations and not only the short-term ones.[264] This implies that directors are not only expected to act in a manner that will increase dividends at the expense of the future growth of the company.[265] This is due to the fact that the duty to act in the best interests of the company is owed both to the present and future shareholders as a collective body.[266] Therefore, the interests of present shareholders must not be advanced at the expense of the interests of future shareholders.[267]

Section 76(4)(a) has been introduced as a statutory defence where it is alleged that the director breached the duty to act *bona fide* and in the best interests of the company. The section

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[260] Cilliers *and Benade* (note 38 above) 139.
[261] *Barlows Manufacturing Co Ltd v R N Barrie (Pty) Ltd* 1990 (4) SA 608 (C).
[262] [1967] 1 WLR 432.
[263] (1966) 58 DLR 2d 1 (Supreme Court of Canada).
[264] LCB Gower 'Corporate Control: The Battle for the Berkeley' (1954-55) *Vol. 668 No.1176, Harvard Law Report* 1184.
[265] Cassim (note 236 above) 516.
[266] *Ibid.*
[267] *Ibid.*

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stipulates the standards which should be satisfied by the directors in performing the fiduciary duties in a manner which serves the best interests of the company. The section provides that:

> In respect of any particular matter arising in the exercise of the powers or the performance of the functions of director, a particular director of a company-
> (a) will have satisfied the obligations of subsection (3)(b) and (c) if-
> (i) the director has taken reasonably diligent steps to become informed about the matter;
> (ii) either- (aa) the director had no material personal financial interest in the subject matter of the decision, and had no reasonable basis to know that any related person had a personal financial interest in the matter; or
> (bb) the director complied with the requirements of section 75 with respect to any interest contemplated in subparagraph (aa); and
> (iii) the director made a decision, or supported the decision of a committee or the board, with regard to that matter, and the director had a rational basis for believing, and did believe, that the decision was in the best interests of the company.

The above provision of the Act is said to introduce the business judgment rule into the South African company law.[268] According to the section, the director will be relieved of any liability for the breach of the duty to act in the best interests of the company if; the director has taken reasonably diligent steps for him to be informed about the matter at hand, have no material financial interests in the matter or disclosed such interests or had no basis to know that any related person had financial interests in the matter concerned and had rational basis for believing the decision taken was in the best interests of the company.

The business judgment rule entails that whatever the decision the director of the company takes with the *bona fide* belief that it is in the best interests of the company but leads to undesirable results would not lead to imposition of personal liability upon the director.[269] This principle was applied in *Coronation Syndicate Ltd v Lilienfeld & New Fortuna Co Ltd*,[270] where Salomon J held that:

> But the directors are in a fiduciary position, and it is their duty to do what they consider will best serve the interests of shareholders. If therefore, they have bound themselves by contract to do a certain thing and therefore have *bona fide* come to the conclusion that it is not in the interests of the shareholders that they should carry out the undertaking, I do not think that the court would be justified in interfering with their discretion and compelling them to do what they honesty believe would be detrimental to the interests of the shareholders.

This decision buttresses the view that it lies within the discretion of the director of the company to decide that a particular transaction is in the best interests of the company.

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[268] W Geach 'Statutory, Common Law and Other Duties of Directors' available at *http://www.chartsec.co.za/documents/speakerPres/WalterGeach/GeachStatutoryCommonLawAndOtherDutiesOfDirectors.pdf* (accessed 16 March 2016).

[269] *Ibid.*

[270] 1903 TS 489 at 497.

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3.2.3 Duty to act in good faith and for a proper purpose

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Both common law[271] and statutory provisions[272] require directors to act in good faith and to exercise the powers of the directors for a proper purpose. This simply means that the directors are supposed to exercise their powers for the reasons which the powers are granted to them. Directors are prohibited to use the powers granted to them for an extraneous purpose.[273] The director is also not allowed to exercise the powers granted to him for an improper purpose even though the director reasonably believes that the act is in the best interests of the company.[274]

If the directors exercise the powers granted to them for a reason other than the one for which the powers are granted to them, such an act will be voidable unless ratified by shareholders.[275]

Turner LJ in *In Re Cameron's Coal Brook Steam Coal & Swansea & Lougher Railway Co Bennett*[276] gave reasons why directors should always exercise the powers granted to them in their capacity as the director for a proper purpose. He stated as follows:

> Powers given to them for one purpose cannot, in my opinion, be used by them for another and different purpose. To permit such proceedings on the part of directors of companies would be to sanction not the use but the abuse of their powers. It would be to give effect and validity to an illegal exercise of the legal power.

The fiduciary duty of directors to exercise their powers for proper purpose is said to have drawn the attention of the courts largely as a result of the directors using their powers for purposes other than the ones for which they are granted to them.[277] To elaborate on this, Cilliers referred to the case of *Punt v Symons & Co Ltd*[278] where the directors issued shares with the intentions to amend the articles of association so as to protect their positions , by making shareholders who have voting rights to lose their rights to vote. Reference was also made to the case of *Piercy v S Mills & Co,*[279] where the directors issued shares with the intention to hinder the appointment of more directors which was going to make the current directors minority directors. In both cases, the court decided that directors improperly exercised their powers and all the allotted shares were set aside.

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271 See for instance, *Punt v Symons & Co Ltd* [1903] 2 Ch 506.
272 See section 76(3)(a) of the Act which stipulates that: subject to subsection (4) and (5), a director of a company, when acting in that capacity, must exercise the powers and perform the functions of director- (a) in good faith and for a proper purpose.
273 *In re Cameron's Coalbrook Steam Coal, and Swansea and Lougher Railway Co, Bennett* (1954) 5 De G M & G 284 at 298.
274 Section 76(4)(a) which excludes the business judgment rule from applying in respect of the duty to act in good faith and for a proper purpose.
275 French, Mayson & Ryan (note 39 above) 481.
276 *In re Cameron's* case (note 273 above).
277 See Cilliers & *Benade* (note 38 above) 145.
278 [1903] 2 Ch 506.
279 [1920] 1 Ch 77.

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To determine whether the director exercised the powers granted to him as the director for an extraneous purpose, the court must consider the state of mind and the motive for exercising the powers in such a manner by the director. These elements were indicated by Viscount Finlay in *Hindle v John Cotton Ltd,*[280] where he said:

> Where the question is one of abuse of powers, the state of mind of those who acted, and the motive on which they acted, are all important, and you may go into the question of what their intention was, collecting from the surrounding circumstances all the materials which genuinely throw light upon that question of state of mind of the directors so as to show whether they were honestly acting in discharging of their powers in the interests of the company or were from some by-motive, possibly of personal advantage, or for any other reasons.

Lord Wilberforce in *Howard Smith Ltd v Ampol Petroleum Ltd*[281] held that a subjective test should be applied in determining whether the director exercised the powers for an improper or extraneous purpose. This therefore, implies that the matter must be considered from the director's point of view.

Application of the subjective test seems appropriate in matters involving the question of whether directors exercised the powers for an improper purpose. This is based on the fact that it is the paramount duty of directors to act in the best interests of the company, therefore, whatever conduct they engage in or decision that the director takes, should presumably be in the best interests of the company. This is due to the fact that it is within the judgement of the director and not of the courts that the director is acting in the best interests of the company.

In addition, directors of the company must at all material times ensure that they act within the ambits of the powers granted to them,[282] so as to ensure that they direct their powers to the rightful purpose. This simply entails that, the directors are not allowed to act beyond the scope of their powers when performing their duties. If the director act on behalf of the company, which is not authorised either in terms of the company's constitution or the Act, the director will be acting beyond the scope of his powers and may be found liable for the breach of the fiduciary duty to the company.[283] *In re Cameron's Coalbrook Steam Coal, and Swansea and Laugher Railway Co, Bennett's case*[284] Turner LJ stated that, directors must act within the scope of the powers granted to them so as to avoid abuse of their legal powers.

However, in the case of *R v Jona* [285] the director who took the monies of the company for personal use was charged with theft. The director was discharged after he adduced evidence

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[280] (1919) 56 SLR 625 at 630-631.
[281] [1974] AC 821 at 832.
[282] *In re George Newman & Co* [1895] 1 Ch 674.
[283] See *R v Milne and Erleigh* (5) 1950 (4) SA 604 (W) where the court found the directors guilty of theft for making payments to themselves which they were not authorised to make and which they lacked *bona fide* belief that they were authorised to do so.
[284] *In re Cameron's* case (note 273 above).
[285] 1961 (2) SA 301 (W).

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that he acted under a reasonable belief that he was authorised to do so since he was the sole shareholder in the private company that he directed.

Directors who breach the fiduciary duty to act within the scope of their powers to the company usually incur liability on individual basis. Thus, the directors cannot incur joint liability if the other directors act *ultra vires* except the director authorised the other director to act ultra vires.[286] This simply implies that the director cannot be liable for the wrongful acts committed by the fellow director unless he acquiesces in it.[287]

The duty of directors to act within the scope of their powers was also considered in *Howard Smith Ltd v Ampol Petroleum Ltd,*[288] where Lord Wilberforce held that it is not feasible to set out plainly the ambits within which the directors should act because directors are faced with different situations in their respective companies. He stated that:

> To define in advance exact limits beyond which directors must not pass is, in their lordship's view, impossible. This clearly cannot be done by enumeration, since the variety of the situations facing directors of different types of company in different situations cannot be anticipated.

In a nutshell, the duty to act in good faith and for a proper purpose by the director is of fundamental importance in company law. This is attributed to the fact that it serves a crucial role, such as the prevention of abuse of powers by the directors. This is because, if the directors are permitted to use their powers as directors for whatever purpose, there is great risk of abuse of the powers, given their human nature.

3.2.4 Duty to avoid conflict of interests

It should be borne in mind that directors occupy a crucial position in the company. As a result, they might have some direct or indirect personal interest in their involvement with the company. Therefore, to avoid conflict of interests which might arise in situations where the director has interests in the matter in which the company is involved, the law forbids directors from putting themselves in a position where there is real or potential conflict of interests.[289]

Like many other fiduciary duties of directors, the duty to avoid conflict of interests, arises from the fiduciary relationship which exists between the company and the directors.[290] The director who puts his interests ahead of the interests of the company will be liable to the company for

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[286] *Barlow v The Friend PP Co Ltd* 1909 ORC 110.
[287] *Land Credit Company of Ireland v Lord Fermoy* (1870) 5 Ch App 763. See also *Cargil v Bower* (1878) 10 ChD 502.
[288] *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821 at 835.
[289] See *Aberdeen Rly Co v Blaikie Bros* (1854) 1 Macq 461 at 471-472 which suggests that this duty is very strict such that the court will not even consider the fairness of the contract between the director and the company.
[290] M. Havenga 'Competing with the Company - When Does a Director breach Her Fiduciary Obligation' 1995 Vol 4 No 3, *South African Mercantile Law Journal* 435.

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a breach of this fiduciary duty.[291] The duty to avoid conflict of interests is also a common law duty. However, this common law duty is not yet explicitly codified in the Act, but it can be inferred from the provision of section 76(2)(a), which prohibits the directors from using their positions to benefit other person other than the company or knowingly cause harm to the company or the subsidiary company. The section stipulates that:

> A director of a company must-
> (a) not use the position of director, or any information obtained while acting in the capacity of a director-
> (i) to gain an advantage for the director, or for another person other than the company or a wholly-owned subsidiary of the company; or
> (ii) to knowingly cause harm to the company or a subsidiary of the company.

A close look at this duty to avoid conflict of interests has reveals that the duty imposes dual obligations upon directors, namely; that the directors must not put themselves in a position where their interests conflict with their fiduciary duties to the company and, that they should not use their positions as directors to acquire benefits for themselves.[292] The second part of this fiduciary duty has been expressly codified in the Act and shall be discussed as a separate duty later in this chapter.[293]

The duty to avoid conflict of interests plays a crucial role in company law because it compels the directors to perform their fiduciary duties honestly, without endeavouring to pursue their own interests which might be prejudicial to the company. Cilliers[294] supports the prohibition on directors to acquire benefits for themselves as of paramount importance as it curbs conflict of interests which are likely to exist. In *Parker v McKenna,*[295] Lord Cairns LC pronounced that the directors have a fiduciary duty to ensure that they guard their interests from conflicting with the interests of the company. He held that:

> Now the rule of this court, as I understand it, as to agents, is not a technical or arbitrary rule. It is a rule founded upon the highest and truest principles of morality. No man can in this court, acting as an agent, be allowed to put himself into a position in which his interest and his duty will be in conflict.

The duty to avoid conflict of interests was deliberated upon in *Robinson v Randfontein Estates Gold Mining Co Ltd.*[296] In that case, the court held that Robinson acted in breach of his fiduciary duty to avoid conflict of interests by acquiring the benefit for himself which he as the director, was supposed to have acquire for the company. He was therefore, ordered by the court to

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[291] Cilliers & *Benade* (note 38 above) 141.
[292] *Cyberscene Ltd & Others v i-kiosk Internet and Information (Pty) Ltd* 2000 (3) SA 806 (C) at 809-810.
[293] See section 76(2)(a) which provides that, 'A director of a company must- (a) not use the position of director, or any information obtained while acting in the capacity of a director- (i) to gain an advantage for the director, or for another person other than the company or a wholly-owned subsidiary of the company'.
[294] Cilliers & Benade (note 38 above) 142.
[295] (1874) 10 Ch App 96.
[296] 1921 AD 168.

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return to the company all the benefits that he had made from such acquisition. Innes CJ held that:

> Where one man stands to another in a position of confidence involving a duty to protect the interests of that other, he is not allowed to place himself in a position where his interests conflict with his duty... As was pointed out in *The Aberdeen Railway Company v Blaikie Bros (1 Macqueen 474),* the doctrine is to be found in the civil law (Digest 18.1 34.7), and must of necessity form part of every civilised system of jurisprudence. It prevents an agent from properly entering into any transaction which would cause his interests and his duty to clash. If employed to buy, he cannot sell his own property; if employed to sell, he cannot buy his own property; nor can he make any profit from his agency save the agreed remuneration; all such profit belongs not to him, but to his principal.[297]

This duty was also demonstrated in *Industrial Development Consultants Ltd v Cooley,*[298] where the defendant who was appointed by the plaintiff company to obtain design and supervision contracts from the Eastern Gas Board for the plaintiff company breached in his duty to avoid conflict of interests. In that case, the Eastern Gas Board did not want to deal with the plaintiff company but wanted to deal with the defendant personally. The defendant then resigned and accepted work from the Eastern Gas Board. The defendant was ordered to account to the plaintiff company for all the benefits acquired by him in his employment by the Eastern Gas Board on the basis that he breached his fiduciary duty to the plaintiff company to guard his interest from clashing with the company's interests. Roskill J held that:

> They say that his duty required him to obtain that business for and only for the plaintiffs. Put in another way, the plaintiffs say he allowed his duty and interests to conflict... As a result, he became in gross breach of what the plaintiffs claim to have been his fiduciary duty to them, thus rendering himself accountable to them for the profits resulting from that breach of fiduciary duty which the plaintiffs claim at all material times he was under. Therefore, I feel compelled to the conclusion that...he was guilty of putting himself into the position in which his duty to his employers, the plaintiffs and his own private interests conflicted and conflicted grievously... It is an overriding principle of equity that a man must not be allowed to put himself in a position in which his fiduciary duty and his interests conflict...On the other hand, if the defendant is not required to account he will have made a large profit as a result of having deliberately put himself into a position in which his duty to the plaintiffs who were employing him and his personal interests conflicted.[299]

Notwithstanding the above prohibition imposed on company directors, company directors are not prohibited to serve as directors of more than one company, including the competing companies.[300] Apparently, what is of paramount importance is that directors must at all material times avoid conflict of interests which might arise between the companies that they are serving and also ensure that they do not disclose any confidential information of one company to the

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[297] *Ibid* at 177-178.
[298] [1972] 2 All ER 162.
[299] *Ibid* at 168 and 174.
[300] See *Bell v Lever Brothers Ltd* [1932] AC 161 at 195, where Lord Blanesburgh held 'that a director of one company was at liberty to become a director also of a rival company'.

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other. Thus, directors serving rival companies are under an obligation to maintain confidentiality and to avoid conflict of interests between the two companies.

This was buttressed in *London and Mashonaland Exploration Company Ltd v New Mashonaland Exploration Company Ltd,*[301] the parties in that case were competitors, directed by the same director. The plaintiff company brought a motion to the court requesting for an order to restrain the defendant company from making an announcement that Lord Mayo, who was the director of both companies, is its director and to restrain Lord Mayo from authorising such announcement and to act as the director of the defendant company. Chitty J held:

> Even assuming that Lord Mayo had been duly elected chairman and director of the plaintiff company, there was nothing in the articles which required him to give any part of his time, much less the whole of his time, to the business of the company, or which prohibited him from acting as a director of another company; neither was there any contract express or implied to give his personal services to the plaintiff company and to no other company. No case had been made out that Lord Mayo was about to disclose to the defendant company any information that had been obtained confidentially in his character of chairman.

In another case of *Scottish Co-operative Wholesale Society Ltd v Meyer and Another,*[302] the defendant company nominated three directors in accordance with its articles. These directors were at the same time directors of the plaintiff company. The duties of these directors to the textile company was to sell the issued shares of the company at the best possible price, whereas to the plaintiff company they were supposed to obtain new shares for the company at the possible lowest price. When the plaintiff company formed Rayon department in competition with the textile company, their duty to the textile company were expanded to promoting the business of the company, to act in good faith, to ensure that the confidential information is not disclosed to the competitors, and not to take any position with the competitor if such would prejudice the interest of the textile company. On the other hand, they had the same duty to the co-operative society, the plaintiff company. Hence, the three directors were faced with a situation in which they failed to uphold their duties to the textile company as nominee directors but managed to uphold the duties they owed to the plaintiff company. Lord Denning held:

> It is plain that in the circumstances, the three gentlemen could not do their duty to both companies, and they did not do so. They put their duty to the society above their duty to the company in this sense, at least, that they did nothing to defend the interests of the company against the conduct of the society. They probably thought that 'as nominees' of the co-operative society their first duty was to the co-operative society. In this they were wrong. By subordinating the interests of the textile company to those of the co-operative society, they conducted the affairs of the textile company in a manner oppressive to the other shareholders.[303]

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301 [1891] WN 165.
302 [1958] 3 All ER 66.
303 *Ibid* at 88.

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The above case illustrates that directors should always avoid positions which will result in clash of interests. This is because if directors are permitted to place themselves in a position where other interests clash with their fiduciary duties, given their human nature, they cannot serve two masters at the same time equally.[304] Thus, to avoid such bias and unfairness to one master, the law prohibits the directors from placing themselves in a situation which will result in or is likely to result in their fiduciary duties clashing with their interests.

3.2.5 Duty not to utilise corporate information and opportunity

The fiduciary duty of directors not to utilise corporate opportunities or information accessibly to directors in their capacity as such for their own benefit, is a common law duty which has been expressly codified in the Act.[305] This duty is said to be an arm of the duty to avoid conflict of interests as already highlighted above.[306] This duty prohibits directors from usurping the corporate opportunities or using the corporate information to enrich themselves or any other person other than the company or knowingly cause harm to the company.[307]

The prohibition on directors to utilise confidential information or to sabotage corporate opportunities for the profit of another person other than the company was illustrated in *Cyberscene Ltd and Others v i-Kiosk Internet and Information (Pty) Ltd.*[308] In that case, the respondents resigned from their employment by the first applicant in April 1999 and formed a company, the first respondent, which was involved in the i-Kiosk concepts and projects. The applicant's case was that the respondents, whilst employed by the first applicant, acted in breach of their fiduciary duty towards the applicant by stealing some confidential information to which they had accessed in their respective positions as directors of the first applicant. They then made use of the confidential information to the detriment of the first applicant and for the benefit of the first respondent.

After deliberating on the facts of the case Hlophe DJP held that:

> The liability for breach of such duty is not delictual, but sui generis. Clearly a director acts in breach of his fiduciary duty where he sabotages the company's contractual opportunities for his own advantage, or where he uses confidential information to advance the interests of a rival concern or his own business to the prejudice of those of the company. In *casu* Armstrong, the only director of the first respondent, on 8 April 1999, some eight days before he resigned, visited the city of Tygerberg canvassing for business opportunities. Thus he acted in a manner which placed himself in a situation of conflict of interests and duty in relation to Cyberscene… This conduct was clearly unlawful as the respondents have placed themselves in a situation of conflict of interest and duty with Cyberscene. The respondents have set up a business in direct competition with Cyberscene and they have also replicated

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304 See *Bray v Ford* [1896] AC 44 (HL) at 52.
305 See section 76(2)(a)(i)(ii) of the Act.
306 *Cyberscene* case (note 292 above).
307 Section 76(2)(a)(i)(ii). See also *Cyberscene* (note 292 above) 820 where Hlophe DJP held that; 'it has also been held that a director has a duty not to misappropriate corporate opportunities'.
308 2000 (3) SA 806 (C).

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> the entire business of Cyberscene using its assets, goodwill, trading name and impropriety information. This was done particularly with the use of…and using Cyberscene's information contained in Cyberscene's marketing brochures… as well as information contained in Cyberscene's business plan. There can be no doubt, in my view, that the information contained in [the marketing brochures and information pack] is confidential. Thus clearly respondents should not be permitted to make any gain from their springboard.[309]

The above case illustrates that, in addition to the duty not to improperly utilise company's confidential information, the director also has a duty not to sabotage the company's business opportunities.

This duty was also demonstrated in *Magnus Diamond Mining Syndicate v Macdonald & Hawthorne,*[310] where the directors, who were the defendants in that case purchased the diamondiferous in competition with the company after they have obtained information about diamondiferous in their capacities as directors of the plaintiff company. The court ordered the defendants to transfer the diamondiferous and pay the company all the profits they had made. The judgment of the court was based on the finding that, the directors acted in breach of the duty not to utilise confidential information and not usurp corporate advantages arising in their capacity as directors to benefit any other person other than the company.

Again, in *Robinson v Randfontein Estates Gold Mining Co Ltd*[311] it was buttressed that directors have a fiduciary duty to the company not to utilise corporate opportunity to benefit any other person other than the company itself. In that case, the director of the plaintiff company bought property for himself in circumstances in which it was his duty to acquire the property for the company. He later sold the property to the company at a higher price. The court held that the company was entitled to claim from the director all the profit made by the director out of the transaction. The court further held that, the action was neither one for breach of contract nor for damages arising from delict. Instead the claim arose because the director breached his fiduciary duty to the company not to sabotage corporate opportunities. The court held that:

> Where one man stands to another in a position of confidence involving a duty to protect the interests of that other, he is not allowed to make secret profits at the other's expense… nor can he make any profit from his agency save the agreed remuneration; all such profit belongs not to him, but to his principal.[312]

In *Volvo (Southern Africa) (Pty) Ltd v Yssel,*[313] the court also considered the duty of directors not to sabotage corporate opportunities. In that case, the appellant, the Volvo Company sued the respondent to disgorge all the profits made by him in breach of his fiduciary duty. In its judgment, the court referred to the principle that was established in *Robison v Randfontein*

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[309] *Ibid* at 820-821.
[310] 1909 ORC 65.
[311] 1921 AD 168.
[312] *Ibid* at 177.
[313] 2009 (6) SA 531 SCA.

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Estates Gold Mining Co Ltd,[314] where the Appellate Division held that, directors given their fiduciary relationship with the company, are not allowed to benefit from the corporate opportunities arising in their capacity as fiduciaries to the company. The court then held that Yssel was in a position of trust when he engaged himself in receiving extra commission at the expense of the company, he was not entitled to act in such a manner as it amounts to a breach of his fiduciary duty. Hence, he was ordered by the court to disgorge to the appellant company all the secret commissions that he had made.

It should be noted further that, the fiduciary duty of directors not to utilise their position as fiduciaries to the company to benefit any other person other than the company, applies even in cases where the company is not able to acquire the said opportunity. This was highlighted by Lord Russell in *Regal (Hastings) Ltd v Gulliver*[315] where he held:

> One final observation I desire to make. In his judgment Lord Greene MR stated that a decision adverse to the directors in the present case involved the proposition that, if directors *bona fide* decide not to invest their company's funds in some proposed investment, a director who thereafter embarks his own money therein is accountable for any profits which he may derive therefrom.

Lord Porter in the same matter further held that:

> Directors, no doubt, are not trustees, but they occupy a fiduciary position towards the company whose board they form. Their liability in this respect does not depend upon breach of duty but upon the proposition that a director must not make a profit out of property acquired by reason of his relationship to the company of which he is director. It matters not that he could not have acquired the property for the company itself-the profit which he makes is the company's even though the property by means of which he made it was not and could not have been acquired on its behalf.[316]

James LJ in *Parker v MacKenna*[317] held that the directors duty not make secret profits for themselves without the knowledge of the company, is a strict rule which does not need to be proven otherwise. He held that:

> I do not think it is necessary, but it appears to me very important, that we should concur in laying down again and again the general principle that in this court no agent in the course of his agency, in the matter of his agency, can be allowed to make any profit without the knowledge and consent of his principal; that that rule is an inflexible rule, and must be applied inexorably by this court, which is not entitled, in my judgment, to receive evidence, or suggestion, or argument as to whether the principal did or did not suffer any injury in fact by reason of the dealing of the agent; for the safety of mankind requires that no agent shall be able to put his principal to the danger of such an inquiry as that.

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[314] *Robison* case (note 311 above) 177.
[315] [1942] 1 All ER 378 at 391.
[316] *Ibid* at 198.
[317] (1874) 10 Ch App 96 at 124.

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However, in *Phillips v Fieldstone Africa (Pty) Ltd*[318] the court recognised that there is a narrow exception to the fiduciary duty which prohibits directors from profiting from the corporate opportunities and confidential information of the company. In that case, Hehe JA held:

> The rule that prohibits a person in a position of trust from making a secret profit is a strict one which allows little room for exceptions. It extends not only to actual conflict of interests but also to those which are real sensible possibility. The defence open to a fiduciary who breaches his trust are very limited, only the free consent of the principal after full disclosure will suffice.

The above decision implies that, the director who utilised corporate opportunity for his own benefit or advantage will be exonerated of breach of duty only if the said director has made disclosure of interest and the company consented to the use of corporate opportunity for the director's advantage. However, this does not erode the general legal principle that directors are not supposed to utilise any corporate benefits for any other person's benefit except only for the company's benefit. Therefore, at this point, the researcher proceeds to discuss the duty of directors to disclose interest, which is a statutory defence for the breach of fiduciary duties of directors.

3.2.6 Duty to disclose interest

Directors occupy an important position in corporate governance as business persons it is difficult for them to avoid dealings with the companies they are directing. Such is likely to give rise to their interests conflicting with their fiduciary duties to the company. However, the law strives to strike a balance between the interest of the directors and freedom of association with their fiduciary duties to the company. Directors are thus relieved from liability for the breach of duty where they have made honest and full disclosure of interests to the breach of the duty.

It should be noted that one of the fundamental keys to the success of the companies is transparency on the management board. This is due to the fact that companies are fictitious creatures of the statutes as such their success depend solely on the competence and transparency of the directors. Directors as agents and trustees of the company should perform their duties with absolute transparency. Thus, they should disclose any interests that they may have in the transaction involving the company.

This implies that if the director whose interest conflicts with his fiduciary duties to the company has made full and honest disclosure of such to the board of directors he would be exonerated from liability to the company. The power of the company to exonerate the director from liability for a breach of duty where a prior disclosure of interests is made was acknowledged by Lord

[318] 2004 (3) SA 465 (SCA).

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Upjohn in *Boulting v Association of Cinematography, Television & Allied Technicians*[319] where he noted that:

> The person entitled to the benefit of the rule may relax it, provided he is… *sui iuris* and fully understands not only what he is doing but what his legal rights are, and that he is in part surrendering them. Thus, the company may in its articles of association permit directors to be interested in contracts with the company. It may go further, and articles may validly permit directors to be present at board meeting and even to vote when proposed contracts in which they are interested are being discussed; provided of course, that they make full disclosure of their interests.

At present, the fiduciary duty of directors to disclose interest in South Africa is regulated by section 75 of the Act. The section provides that if the director has direct or indirect financial interest in the matter or contract in which the company is involved or has material interest, the director is under an obligation to disclose such interest to the shareholders or the board of directors of the company as the case may be.[320] According to Bhengu,[321] the duty of the directors to disclose interest is necessary in the South African company law due to multiple cases where directors withheld material information to the prejudice of the company.

In addition to the requirement that the directors must disclose any personal financial interest that they have in the matter or agreement in which the company is involved, the disclosing director is supposed to recuse himself from the meeting and deliberations of the company in which the matter is discussed after disclosing interest.[322] Recusal precaution ensures that the deliberation and voting by the board is done fairly and free from influence by the interested director.[323]

It should also be noted that the director is not only obliged to disclose only personal financial interest, but also the personal financial interest of any related person that the director is aware of.[324] According to the Act, related persons do not only refer to natural persons but also includes juristic persons which the director or related person is connected with.[325] As a result, in respect of the duty of disclosure, the director has a duty to disclose direct and indirect financial interests regardless of the materiality of the interest. Direct interests being those interests of the director and indirect interests relates to the interest of a related person as defined in the Act.

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319 (1881) 2 QB 606 at 636.
320 Section 75(4) of the Act.
321 N Bhengu *Directors and Officers Cautioned against Disregard of the Provisions relating to the Disclosure of Personal Financial Interests set out in Section 75 of the Companies Act 208* available at *http://www.werksmans.com/wp-content/uploads/2014/07/041263-WERKSMANS-final-legal-brief-DIRECT.pdf* (accessed 13 March 2016).
322 Section 75(5)(d)(e).
323 AO. Nwafor 'Transparency in Corporate Governance: Extent of Directors Duty to Declare Interest in Company's Transactions' (2015) *Vol. 11 No. 1, Corporate Board: Role, Duties & Composition* 144.
324 Section 75(5) of the Act.
325 Section 75(1)(b) of the Act.

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Before dwelling further on this discussion, it is worthy to take into account the definition of personal financial interest as provided in section 1 of the Act. The section defines personal financial interest as 'a direct material interest of the person, of a financial, monetary or economic nature, or to which a monetary value may be attributed'.

The statutory requirement that directors should disclose both direct and indirect personal financial interest in the matter in which the company has material interest in is similar to the United Kingdom Companies Act that:

> If a director of a company is in any way, directly or indirectly, interested in a proposed transaction or arrangement with the company, he must declare the nature and extent of that interest to the other directors.[326]

In fulfilling the duty of disclosure of personal financial interest, the disclosing director should set out the nature and the extent of the personal financial interest, or of the related person, that exists in the matter in which the company has material interests. Additionally, the material circumstances relating to the director or the related person need to be also disclosed. The Act provides that:

> If a director of a company acquires a personal financial interest in an agreement or other matter in which the company has a material interest, or knows that a related person has acquired a personal financial interest in the matter, after the agreement or other matter has been approved by the company, the director must promptly disclose to the board, or to the shareholders in the case of a company contemplated in subsection (3), the nature and extent of that interest, and the material circumstances relating to the director or related person's acquisition of that interest.[327]

As a guide to the fulfilment of the duty to disclose interest, the Act also provides for the procedure which the directors must follow when disclosing financial interest. In terms of the Act, the directors should disclose personal financial interest in writing and prior to the matter being considered by the board. This is provided in section 75(4) of the Act as follows:

> At any time, a director may disclose any personal financial interest in advance, by delivering to the board, or shareholders in the case of a company contemplated in subsection (3), a notice in writing setting out the nature and extent of that interest, to be used generally for the purposes of this section until changed or withdrawn by further written notice from that director.[328]

It should also be noted that the duty to disclose personal financial interest applies both in respect of the contracts or transactions which the company has material interest but not yet considered by the board (proposed matter)[329] and those agreements that the company is

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[326] Section 177 of the United Kingdom Companies Act 2006.
[327] Section 76(5) & (6) of the Act.
[328] Section 75(4).
[329] Section 75(5).

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already involved (existing matters).[330] In such cases the director must promptly disclose any personal financial interest that exists in the agreement.[331]

In some jurisdictions, for instance, the United Kingdom, the duty to disclose interests is somehow preposterous in the sense that even sole directors are obliged to disclose interest that they have in respect of the affairs of the company. This was demonstrated in *Neptune (Vehicle Washing Equipment) Ltd v Fitzgerald*[332] by Lightman J who stated that sole directors are not exempted from the duty to disclose interests as provided in section 317 of the United Kingdom Companies Act of 1985 where he said:

> The sole director may hold a meeting attended by himself alone or he may hold a meeting attended by someone else, normally the company secretary. When holding the meeting on his own, he must still make the declaration to himself and have the statutory pause for thought, though it may be that the declaration does not have to be out loud, and he must record that he made the declaration in the minutes. The court may well find it difficult to accept that the declaration has been made if it is not so recorded. If the meeting is attended by anyone else, the declaration must be made out loud and in the hearing of those attending, and should be recorded... In either situation the language of the section must be given full effect: there must be a declaration of interest.

Disclosure in such circumstances as noted by Lightman J ensures the existence of records of interest for future use where the transaction becomes subject to scrutiny. Such record will provide vital information as to the existence of any interest and its disclosure which indicates accountability on the part of the director and shareholders protection against self-dealing by the director.

However, this is not the position in South Africa. The 2008 Companies Act exempts sole directors who are sole shareholders of the company from the duty to disclose any direct or indirect financial interest that the director might have in the contracts in which the company is involved.[333] However, where the sole director does not hold all the issued securities of the company, the director is required by the Act to disclose interest to the shareholders of the company at the shareholders general meeting prior to entering or determining any matter that the director or the related person have financial interests.[334]

However, section 75(2)(b) overlooked the vital factor that the company is a juristic person which exists separate from its directors and shareholders and survives the director even if the

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330 Section 76(6).
331 *Ibid.*
332 [1995] 3 All ER 811 at 818.
333 Section 75(2)(b).
334 Section 75(3) which provides that if a person is the only director of a company, but does not hold all of the beneficial interests of all the issued securities of the company, that person may not- (a) approve or enter into any agreement in which the person or a related person has a personal financial interest: or (b) as a director, determine any other matter in which the person or a related person has a personal financial interest, unless the agreement or determination is approved by an ordinary resolution of the shareholders after the director has disclosed the nature and extent of that interest to the shareholders.

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director is the sole holder of all company's issued shares. Again, many Companies Acts allow private companies to be run by a single director.[335] Therefore, it is justified to say that a sole director constitutes a board of directors. Hence, this implies that any disclosure of interests required by the law from the directors to make to the board of directors, should also apply to a sole director. Thus in doing so, the law ensures the protection of the separate existence of the company.

Section 75(2) creates further exception to the fiduciary duty of directors to disclose interest. In the following instances:

> (i) in respect of a decision that may generally affect- (aa) all of the directors of the company in their capacity as directors; or (bb) a class of persons, despite the fact that the director is one member of that class of persons, unless the only members of the class are the director or persons related or inter-related to the director; or (ii) in respect of a proposal to remove that director from office as contemplated in section 71; or (b) to a company or its director, if one person- (i) holds all of the beneficial interests of all of the issued securities of the company; and (ii) is the only director of that company.

Nwafor[336] however, on the other angle posits that, where disclosure cannot be made to the board of directors due to the existence of interest, such disclosure should be made to the shareholders at the general meeting. According to him shareholders are an important arm of the company which can act in situations where directors are not capable of acting.

Furthermore, the directors are exempted from the fiduciary duty to disclose personal financial interest of the related person if; the director lacks knowledge that a related person has personal financial interest in the matter or contract in which the company is involved. However, the director is deemed to have knowledge of personal financial interest of the related person where the director is in the position in which he reasonably ought to have actual knowledge, to have investigated the matter to an extent that would have provided him with actual knowledge or have taken the measures which if taken would reasonably provide the director with the actual knowledge about the matter.[337] Therefore, this implies that if interest to be disclose is an indirect interest, for the duty to disclose to be invoked against the director, it should be proved that the director has the knowledge of the existence of such interest.

Wunsh J in *JeNo & Others v Mitsui Co Ltd & Others*[338] held that the director is deemed to have knowledge that something is going on if he suspects that something is going on but deliberately ignores it. This implies that the director will be held liable for a breach of duty to disclose

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[335] See, for instance, section 66(2)(a) of the South African Companies Act of 2008 and section 154(1) of the UK Companies Act.
[336] AO. Nwafor (note 323 above).
[337] Section 1 of the Act.
[338] [1996] 3 All SA 353 (W) 401.

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personal financial interest of a related person if he deliberately shut his eyes to the existing interests or decides not to investigate the matter.[339]

Imputed knowledge was descried by Jeremy Cousin QC in *Valentine v Bangla TV Ltd*[340] as knowledge inferred from the surrounding circumstances. The basis for wilful blindness or inferred knowledge was described by Williams[341] though from the criminal law perspective as:

> In either event there is someone with actual knowledge. To the requirement of actual knowledge there is one strictly limited exception. Men readily regard their suspicions as unworthy of them when it is to their advantage to do so. To meet this, the rule is that if a party has his suspicion aroused but the deliberately omits to make further enquires, because he wishes to remain in ignorance, he is deemed to have knowledge.

Failure by the director to fulfil the fiduciary duty to disclose financial interest does not go without any legal consequences attached to it. The transaction or agreement approved by the board without proper disclosure as stipulated in section 75 is voidable at the instance of the company unless ratified by an ordinary resolution of shareholders or declared valid by the court.[342] The court may declare an existing transaction or agreement valid even if the director failed to disclose or made disclosure not in satisfaction of section 75 if an application is made by an interested person to the court.[343] An interested person simply refers to any person who has direct financial or economic interest in the matter.[344]

The status of the contract entered into by the company where the director failed to make prior disclosure of financial interests to the board was deliberated upon by Lord Pearson in *Hely-Hutchinson v Brayhead.*[345] He held that:

> If a director makes or is interested in a contract with the company, but fails duly to declare his interest, what happens? Is it void, or it is voidable at the option of the company, or it is still binding on both parties, or what? … I think that the answer must be supplied by the general law, and the answer is that the contract is voidable at the option of the company, so that the company has a choice whether to affirm or avoid the contract, but the contract must be either totally affirmed or totally avoided and the right of voidance will be lost if such time elapses or such event occur as to prevent rescission of the contract.

Furthermore, the director who fails to disclose interests may be faced with a civil or criminal charge. For instance, if the company suffers loss or damages as a result of non-disclosure, the company or any interested person may claim damages from the director who defaulted on the

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339 See for example *R v Jorgensen* [1995] 4 SC 55 (SCC), where the court termed such act of the director as wilful blindness.
340 [2009] EWHC (Ch) 632 para 53.
341 G Williams 'Criminal Law: The General Part' (2003) 157.
342 Section 75(7) of the Act.
343 Section 75(8) of the Act.
344 Section 1 of the Act.
345 [1967] 3 All ER 98 at 109.

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duty to disclose financial interests. If the director is found guilty he will be compelled to disgorge all the profits made by him in breach of the fiduciary duty to disclose interest.[346]

In *Gardiner and Another v S*[347] the court considered the question of whether breach of duty to disclose financial interest by the director amounts to a criminal offence. In that case the appellants were the directors of the LeisureNet International Company but also held shares in the Dalmore Company. The LeisureNet Company and Dalmore Company entered into a contract. The appellants failed to make prior disclosure that they have interest in Dalmore Company. The appellants admitted before the court that their conduct amounted to a breach of their fiduciary duty to disclose interest. Heher JA on appeal[348] quoted the decision of Coetzee J in *S v Burstein*[349] where it was held that:

> The question whether non-disclosure is a criminal offence is not an easy one. As pointed out by Hunt in SA Criminal Law and Procedure Vol 2 at 716, silence may well constitute civil fraud without constituting criminal fraud. The distinguishing feature lies mainly in the presence or absence of the necessary intention to defraud. There are very few cases of criminal non-disclosure.

The Supreme Court of Appeal found the accused guilty of fraud on the ground that they deliberately and fraudulently withheld material information from the board of directors which they were obliged to disclose.

In a nutshell, the duty to disclose interest serves as a statutory relief to the directors from a breach of their fiduciary duties. This is attributed to the fact that, if the director makes an honest and full disclosure of any direct or indirect financial interest in the contracts in which the company has interest, such director would be exonerated from any liability where his interest and his fiduciary duties conflict. In other words, section 75 provision relaxes the common law duty which prohibits directors to benefit from corporate opportunities or to allow their interest to conflict with those of the company. Therefore, it is clear that, the Act now allows directors to benefit from corporate opportunities where there is full and frank disclosure of interest by the director. Hence, serving as an exception to the general provisions on the fiduciary duties of directors.

This was strengthened by Lord Wilberforce in *Hey-Hutchinson v Brayhead*[350] where he held that:

> It seems to me what that means is this, that if a statutory disclosure is made, then a director's contracts with a company are exempted from the normal consequences which would follow under the general law where one person who is in a fiduciary position enters into a contract with a person to whom he owes the fiduciary duty; and

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346 Section 77(2)(a) of the Act.
347 2011 (4) SA 79 (SCA).
348 *Ibid* para 30.
349 1978 (4) SA 602 (T) at 604G-605B.
350 [1967] 3 All ER 98 at 106.

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there is also the second consequence that the person in the fiduciary position does not have to account for any profit.

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3.3 Chapter conclusion

This chapter shows that the directors are in a special standing with the company. Hence, they are considered as fiduciaries to the company. As such directors are expected to perform fiduciary duties to the company without any bias and compromise which might prejudice the interests of the company. Thus, a director who fails in his fiduciary duties to the company will be faced by a number of legal consequences. He will be obliged to account to the company for all the profits made by him arising from his breach of the fiduciary duties to the company.

It is also undisputed that directors owe their fiduciary duties solely to the company, which in the context of company law, is an entity separate and distinct from its shareholders and directors. An important fictitious concept of law, which grants the companies the separate legal personality which is the foundation of the entire company law. However, there are certain circumstances as highlighted above where directors are expected to take into account the interests of individual shareholders, even though a company is deemed to be a collective body of its shareholders. Again, in *In re Horsley & Weight Ltd,* the court held that, directors when performing their fiduciary duties should take into considering also the interests of creditors, though considered as outsiders.

In addition, it is brought out in this chapter that the Act has modified and simplified the fiduciary duties of directors in various ways. For instance, section 75 introduces a statutory defence for a breach of duty of disclosure by directors. Unlike under common law the duty of disclosure is no longer absolute because the director alleged of a breach can be relived of liability if it is proven that he had made a frank and full disclosure of personal or related person's financial interests that he has knowledge of prior to the alleged breach. The disclosing director is required to disclose the nature and extent of the extent of the financial interests that exists in the existing or proposed matters of the company. Noted again, is that the accused director may not easily escaped liability on the allegation that he lacked knowledge of existence of financial interests because the director may be deemed to have had knowledge as defined in section 1 of the Act.

The next chapter focuses on the cases in which the director defaults on the performance of his duties to the prejudice of the outsider, which could lead to the piercing of the corporate veil in order to impose liability on the defaulting director.

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THE LIFTING OF THE CORPORATE VEIL

This chapter discusses the piercing of the corporate veil, an enigma exception to the fundamental principle of corporate entity, which entails that the company is a separate legal person distinct from its shareholders and directors. The chapter examines what constitutes unconscionable abuse of the juristic personality of the company as a separate legal entity as a ground for the piercing of the corporate veil in terms of section 20(9) of the Companies Act 71 of 2008. In other words, the chapter investigates the circumstances under which the corporate veil may be pierced by the courts. The investigation is triggered by the fact that, even though the Act expressly provides that the legal personality of a company may be disregarded where there is unconscionable abuse of the juristic personality of a company, it is however, not certain as to what constitutes 'unconscionable abuse'. Given this challenge, the question that arises is: was the legislature supposed to have provided a definition of what constitutes unconscionable abuse?

4.1 Introduction

As previously discussed in chapter two of this work, once a company is incorporated and registered in accordance with the provisions of sections 13 and 14 of the Act, metaphorically a veil is formed between the company and the incorporators. This veil bestows on the company legal personality status which is distinct from that of its incorporators, shareholders and directors. Thus section 19(1)(a)(b) provides as follows:

> (1)From the date and time that the incorporation of a company is registered, as stated in its registration certificate, the company-
> (a)is a juristic person, which exists continuously until its name is removed from the companies register in accordance with this Act;
> (b) has all of the legal powers and capacity of an individual, except to the extent that-
> (i) a juristic person is incapable of exercising any such power, or having any such capacity; or
> (ii) the company's Memorandum of Incorporation provides otherwise.

Due to the separate legal personality status of the company, shareholders and directors of the company are treated as separate from the company, hence, protected from being liable for the debts and liabilities of the company. This is known in law as the doctrine of limited liability which emanates from the separate legal personality of the company. This legal principle is provided for in section 19(2) of the Act. The sub-section grants the incorporators, shareholders and directors immunity from the debts and liabilities of the company, in the following words:

> A person is not, solely by reason of being an incorporator, shareholder or director of a company, liable for any liabilities or obligations of the, company except to the extent that this Act or the company's Memorandum of Incorporation provides otherwise.

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The above provision entails that unless provided otherwise by the Act or the company's memorandum of incorporation, shareholders, directors and incorporators of the company are immune from being liable for the debts and liabilities of the company. This is one of the fundamental consequences of the separate legal personality of a company.

However, despite the importance of the principle of separate legal personality of the company in company law, the corporate personality has been abused by the controlling minds of the companies in many instances. Hence, as a measure to guard against the abuse of the corporate structure, the legislature[351] and the courts[352] have allowed an exception to the principle of separate legal personality of the company. This exception is applicable where there is unconscionable abuse of the corporate structure by directors or any person involved in the management of the company. The exception to the principle of corporate entity is known in law as the doctrine of piercing the corporate veil. The doctrine of piercing of the corporate veil allows for the disregarding of the corporate veil in certain justified circumstances so as to affix the liability that is seemingly to be that of the company to the rightful individuals.

4.2 Piercing the corporate veil

There is a high level of uncertainty and challenges in company law with regard to the doctrine of piercing of the corporate veil. In *Ex parte Gore & Others NNO*[353] the court stated that there is no clearly defined principles in regard to circumstances in which the courts will pierce the corporate veil. Also in *Cape Pacific Ltd v Lubner Controlling Investments*[354] Smalberger JA held that the courts are far from being settled with regard to the grounds on which the corporate veil may be pierced, as such each matter must be decided based on its own facts.

Again, in 2002 Scott JA in *Hulse-Reutter & Others v Godde*[355] reiterated that:

> The circumstances in which a court will disregard the distinction between a corporate entity and those who control it are far from settled. Much will depend on a close analysis of the facts of each case, considerations of policy and judgement.

The confusion with regard to the piercing of the corporate veil is the same even in the United Kingdom as demonstrated by Lord Neuberger in *VTB Capital plc v Nutritek International Corp*[356] where he held that:

> The notion that there is no principled basis upon which it can be said that one can pierce the veil of incorporation receives some support from the fact that the precise

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351 Section 20(9) of the 2008 Act.
352 See for instance, *Ebrahim v Airports Cold Storage (Pty) Ltd* [2009] 1 All SA 330 (SCA) para 15, where it was held that, 'it is an opposite truism that close corporations and companies are imbued with identity only by virtue of statute. In this sense their separate existence remains a figment of law, liable to be curtailed or withdrawn when the objects of their creation are abused or thwarted'.
353 [2013] 2 All SA 437 (WCC) at 445.
354 1995 (2) All SA 543 (A) at 802-803.
355 [2002] 2 All SA 211 (A) para 20.
356 [2013] 2 AC 337 para 123.

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nature, basis and meaning of the principle are all somewhat obscured, as are the precise nature of the circumstances in which the principle can apply.

In the United States of America, in *Allied Capital Corp v GC-Sun Holdings LP*[357] the Delaware Court of Chancery held that the doctrine of piercing of the corporate veil has been, 'rightfully criticized for its ambiguity and randomness and its application yields few predictable results'. Cardozo J in *Berkley v Third Avenue Railway*[358] also described the piercing of the corporate veil "as enveloped in the mists of metaphors".

In addition, Easterbrook and Fischel,[359] the American writers also commented on the obscure nature of the piercing of the corporate veil as follows:

> "Piercing" seems to happen freakishly. Like lightening, it is rare, severe, and unprincipled. There is a consensus that the whole area of limited liability, and conversely of piercing the corporate veil, is among the most confusing in corporate law.

The question of when the courts may pierce the corporate veil has also been described by Cassim[360] as the most undecided and controversial question in company law. This is due to the fact that the instances of piercing the corporate veil are problematic since the courts do not follow a consistent principle in deciding whether or not to pierce the corporate veil.[361]

Today, the common law principle of piercing the corporate veil has been codified in section 20(9) of the Act, which provides that:

> If, on application by an interested person or in any proceedings in which a company is involved, a court finds that the incorporation of the company, any use of the company, or any act by or on behalf of the company, constitutes an unconscionable abuse of the juristic personality of the company as a separate entity, the court may –
>
> (a) declare that the company is to be deemed not to be a juristic person in respect of any right, obligation or liability of the company or of a shareholder of the company or, in the case of a non-profit company, a member of the company, or of another person specified in the declaration; and
> (b) make any further order the court considers appropriate to give effect to a declaration contemplated in paragraph (a).

Section 20(9), which is the centre of this work, is an insertion to the 2008 Companies Act by section 13 of Act 3 of 2011. This section grants the courts a wide discretion to disregard the separate legal personality of the company by piercing the corporate veil where there is unconscionable abuse of the juristic personality of the company, in order to reach the perpetrators of the abuse. Put differently, section 20(9) grants the courts the discretion to brush

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357 A 2d 1020 (Del Ch 2006) at 1042-1043.
358 244 NY 84 (1926) at 94.See also *In re Polly Peck International Plc* (1996) 2 All ER 433 at 447,where the court held that piercing of the veil of incorporation 'is a vivid but imprecise metaphor'
359 FH. Easter & D.R Fischel 'Limited Liability and the Corporation' (1985) *Vol. 52 No.89 University of Chicago Law Review* 89.
360 Cassim (note 10 above) 39.
361 *Ibid* 44.

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aside the dichotomy which exists between the company and its shareholders and directors and treat the entities as one in order to affix liabilities appearing to be that of the company to the rightful individuals who unconscionably abuse of the juristic personality of the company. In simple terms, piercing of the corporate veil allows the courts to reach the controlling minds of the company who abuse the corporate personality and shield behind the corporate veil.

The section, the section grants the courts a wide discretion to decide whether or not to disregard the separate legal status of a corporation.[362] To substantiate on that, Cassim[363] posits that even if all the requirements of section 20(9) which allow the courts to disregard the separate legal personality of the company are fulfilled, the courts bear no obligation to pierce the corporate veil, instead the courts are at liberty to decide not to pierce the veil of incorporation but make any further order that the courts consider appropriate.[364]

However, despite the overwhelming welcome that section 20(9) has received, the section carries a number of challenges and questions which have not been answered. The main challenge is the question of what constitutes "unconscionable abuse" of the juristic personality of the company, which is the heart of this study. Put differently, in what circumstances will the courts pierce the corporate veil? This is because the Act does not define or provide guidelines as to what constitutes unconscionable abuse of the separate legal personality of a company as a ground for the piercing of the corporate veil. Such failure by the legislature, brings some disappointments and pains to the courts in determining the circumstances under which the corporate veil may be pierced. Challenges for absence of clearly defined grounds for piercing the corporate veil on the part of the legislature, has been highlighted by Lord Diplock in *Dimbleby and Sons Ltd v National Union of Journalists*[365] where he held that:

> The 'corporate veil' in the case of companies incorporated under the Companies Act is drawn by statute and it can be pierced by some other statute if such other statute so provides; but in view of its *raison d'etre* and its consistent recognition by the courts since [*Salomon*], one would expect that any parliamentary intention to pierce the corporate veil would be expressed in clear and unequivocal language.

The question that can be raised in this context is: would it be desirable for the Act to stipulate the circumstances that constitute unconscionable abuse of the juristic personality? Such stipulation or guidelines would certainly result in rigidity in the application of that provision. This would make it easier for persons abusing the corporate entity to escape the piercing of the corporate veil even if the facts of the case so favours, merely on the ground that the facts do not fall within the stipulated category. More so, given the peculiarities of individual cases, the legislature might have intentionally left the door open so as to grant the courts the discretion

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[362] Section 20(9) uses the words 'the courts may' which is an indication that it is within the discretion of the court to decide whether or not to pierce the corporate veil in all circumstances but not mandatory.
[363] Cassim (note 10 above) 310.
[364] See also section 20(9)(b).
[365] [1984] 1 WLR 427 at 435.

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to decide each matter based on its facts. Thus allowing flexibility in the application of the section in different cases. Again, if the circumstances which amounts to unconscionable abuse of the juristic personality of a company were specifically stated, the controllers will abuse the juristic personality of a company in a skilful manner by making sure that they avoid those stated circumstances. Furthermore, in trying to encapsulate all the possible circumstances amount to unconscionable abuse, the section will turn to be very bulky. And there would be need for continuous amendment of the Act so as to include new developments in company law.

As a summation to the submission that the omission by the legislature should be applauded to a greater extent and not dismissed as a complete failure as it allow the courts to deal with different cases based on the same provision, Nwafor[366] posits that:

> The Act, which contains a copious definitions of various terms and phrases of similar nature in section 1, inexplicably failed to define the term 'unconscionable abuse'. This failure by the parliament to assign a definite meaning to that term could construed as an acceptance by the law makers of the absence of any general acceptable conditions for disregarding the corporate personality of the company. By so doing, the parliament have learnt statutory force rather than resolving the existing judicial conundrum…

The approach by the legislature to leave the courts with discretion to decide what constitutes unconscionable abuse of the juristic personality of a company, indicate that the legislature resects the important principle of separation of powers between the three arms of the government. In that manner the legislature did not want to intrude into the judicial powers; to resolve matters based on the application of the law that has been made by the legislature.

Besides the controversy arising from the definition of 'unconscionable abuse' is the question of whether the section substitutes or complements the common law position on the piercing of the corporate veil? The courts seem to have accepted that section 20(9) complements the common law position on veil piercing.[367] Another challenge is the question of whether piercing of the corporate veil is a remedy of last resort like the position at common law. All these challenges will be addressed in the course of this work.

It is salient to note that the courts will not easily disregard the separate legal personality of the company where there is mere abuse of the juristic personality. For the abuse of the corporate structure to warrant the piercing of the corporate veil, it must be unconscionable.[368] This implies that there must be compelling reason for the courts to pierce the corporate veil. This was buttressed in *Cape Pacific Ltd v* Lubner *Controlling Investments (Pty) Ltd,*[369] where the then Appellate Division emphasised that the courts should strive to uphold the separate legal

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366 AO. Nwafor 'Piercing the Corporate veil: An Incursion into the Judicial Conundrum' (2015) *Vol. 11 No. 3, Corporate Board: Role, Duties & Composition* 137.
367 See for instance, *Ex parte Gore & Others NNO* [2013] 2All SA 437 (WCC) 452.
368 Section 20(9) of the Act.
369 1995 (2) All SA 543 (A).

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personality of the company and only pierce the veil of incorporation where there are compelling factors calling for the piercing of the corporate veil. In that case, Smalberger JA emphasised that:

> It is undoubtedly a salutary principle that our courts should not lightly disregard a company's separate personality, but should strive to give effect to give effect and uphold it. To do otherwise would negate or undermine the policy and principles that underpin the concept of separate corporate personality and the legal consequences that attach to it. But where fraud, dishonesty or other improper conduct (and I confine myself to such situations) are found to be present, other considerations will come into play. The need to preserve the separate corporate identify would in such circumstances have to be balanced against policy considerations which arise in favour of piercing the corporate veil (cf Domanski: 'Piercing The Corporate Veil-A New Direction: 1986 *SALJ* 224). And a court would then be entitled to look to substance rather than form in order to arrive at the true facts, and if there has been a misuse of corporate personality, to disregard it and attribute liability where it should rightly lie. Each case would obviously have to be considered on its own merits[370]

4.3 Meaning of piercing of the corporate veil

Before delving further into the topic of piercing of the corporate veil, one should, in order to avoid confusion, look closely into the actual meaning of lifting or piercing the corporate veil. The terms 'piercing' or 'lifting' the corporate veil have been used in most cases interchangeably to refer to the disregarding of the corporate veil by the courts. The two terms have been described by Young J in *Pioneer Concrete Services Ltd v Yelnah Pty Ltd*[371] as an act of looking behind the separate legal personality of the company by the courts in order to reach the actual controllers of the company.

In *Atlas Maritime Co SA v Avalon Maritime Ltd, The Coral Rose No 1*[372] Staughton J held that:

> To pierce the corporate veil is an expression that I would reserve for treating the rights or liabilities or activities of a company as the rights or liabilities or activities of its shareholders. To lift the corporate veil or look behind it, on the other hand, should mean to have regard to the shareholding in a company [in other words, to its controllers] for some legal purpose.

However, Binns-Ward J in *Ex parte Gore No and Others NNO*[373] argues that whether to pierce or lift the corporate veil must be determined by the courts based on the facts of each case. This is more or less similar to the submission of Nwafor[374] who posits that, the phrase to be employed by the courts when disregarding the separate entity of the company in order to reach the controlling minds of the company does not in actual facts matter. He states that:

> It seems that it does not really matter which metaphor is employed by the court in describing a particular judicial act, so long as it is realized that what is being done is

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370 *Ibid* at 553.
371 [1986] 5 NSWLR 254 (SCNSW) at 264.
372 [1991] 4 All ER 769 CA at 776.
373 [2013] 2 All SA 437 (WCC) at 440-441.
374 See also *Yukongline Ltd of Korea v Rendsburg Investments Corporation of Liberia* (No2) [1998] 1 WLR 294 at 305 where Toulson J observed that, "it may not matter what language is used as long as the principle is clear".

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> to disregard the separate entity of the company and to get at the real persons whose conducts are the subject matter of judicial inquiry.[375]

Despite a number of explanations provided by different academics and the courts, the current researcher though concurs with the above explanations, nonetheless, favours the submission of Lord Sumption of the Supreme Court of the United Kingdom in *Prest v Petrodel Resources Limited and Others*[376] that:

> "Piercing the corporate veil" is an expression rather than indiscriminately used to describe a number of different things. Properly speaking, it means disregarding the separate personality of the company. There is a range of situations in which the law attributes the acts or property of a company to those who control it, without disregarding its separate legal personality. But when we speak of piercing the corporate veil, we are not (or should not be) speaking of any of these situations, but only of those cases which are true exceptions to the rule in *Salomon v Salomon and Co Ltd* [1897] AC 22, i.e. where a person who owns and controls a company is said in certain circumstances to be identified with it in law by virtue of that ownership and control.

Nwafor[377] however, provides a different and interesting argument that where the court disregards the separate legal personality of the company and treats it as a single entity with its controllers such should rather be seen as the recognition of the company as a separate entity as opposed to ignoring the separate structure of the company.

4.4 The effects of piercing the corporate veil

It should also be noted that, piercing of the corporate veil is done only in regard to a particular right, duty or transaction. It does not imply non-recognition of the company's legal personality in general.[378] Thus, if the court decides to disregard the separate legal personality of the company, it does not imply that the company is deemed not to exist at all, rather, the court will be disregarding the separate status of the company only in respect of the transaction in dispute. The company's separate legal personality status generally remains unaffected.[379]

Again, piercing of the corporate veil has the sole effect of shifting focus from the form of the company as an entity to its true substance as an association of persons. This means that focus is shifted from the company as separate legal person to the individuals who compose and/or control the company.[380] When the corporate veil is pierced, the directors of the company are left exposed to the outsiders. As such directors can be held personally liable for the conduct that constitutes unconscionable abuse of the juristic personality of the corporate entity. In other words, veil piercing allows the courts to peep behind the corporate veil and reach the controlling minds of the company and impose liability appearing to be that of the company on

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375 Nwafor (note 366 above) 140.
376 [2013] UKSC 34 para 16.
377 Nwafor (note 366 above) 140.
378 Nwafor (*ibid*). See also *Ben Hashem v Ali Shayif* [2008] EWHC 2380 (Fam) para 682.
379 *Lategan & Another NNO v Boyes and Another* 1980 (4) SA 191 (T) at 201.
380 RC Beuthin & SM Luiz, *Beuthin's Basic Company Law* 12. See also *Cape Pacific* case (note 369 above) 802.

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the controlling minds of the company where there is unconscionable abuse of the separate legal personality of the company.

However, the crux of this work is to answer the question of what constitutes unconscionable abuse of the juristic personality of the company as the ground for piercing the corporate veil in terms of section 20(9) of the Act. The courts even at present have not succeeded in defining with certainty the circumstances under which the corporate veil may be pierced despite the fact that the courts have on certain instances undoubtedly pierced the corporate veil. These include cases where there is evidence of fraud, dishonest or improper conduct in relation to the use of the corporate personality.[381] Even though the courts have accepted to pierce the corporate veil, they are still in pain in coming up with clearly defined categories in which the courts should pierce the veil of incorporation.[382] Therefore, the researcher intends to build up the pieces under which the courts have pierced the corporate veil, which in the light of section 20(9) amounts to unconscionable abuse of the juristic personality of the company as a separate legal person.

4.5 Circumstances which constitutes unconscionable abuse of the juristic personality of a company

According to section 20(9) of the 2008 Act, the courts will disregard the separate legal personality of the company where there is unconscionable abuse of the juristic personality of the company as a separate legal entity. However, the term 'unconscionable abuse' is not defined anywhere in the Act and there are no directions nor guidelines as to the circumstances that would constitute unconscionable abuse of the juristic personality of the company as a separate entity. Such failure by the legislature raises many questions and uncertainties in the application and interpretation of the provision. Such failure by the legislature to provide directions and guidelines as to what constitutes 'unconscionable abuse' may negatively affect the application of that provision.

In its ordinary sense, the phrase unconscionable abuse has been defined to mean unscrupulous misuse of the juristic personality of the company as a separate entity.[383] In *Ex parte Gore & Others NNO*[384] the Western Cape High Court per Binns-Ward J, is the first case to apply section 20(9) of the Act. Even though the case focuses on the piercing of the corporate veil in group of companies, it is of fundamental importance to the doctrine of veil piercing in general as it addresses challenges posed by section 20(9) which *inter alia* are the questions of what constitutes unconscionable abuse of the juristic personality of the company, whether

[381] See Cassim (note 236 above) 802.
[382] Beuthin (note 380 above).
[383] W T Zindonga 'Piercing of the Corporate Veil in Terms of Gore: Section 20(9) of the New Companies Act 71 of 2008' unpublished MA dissertation, University of Cape Town, 2015, 42.
[384] *Gore* case (note 373 above) 452.

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the section supplements or complements common law. For instance, in that case, it was held that:

> The term "unconscionable abuse of the juristic personality of a company" postulates conduct in relation to the formation and use of companies diverse enough to cover all the descriptive terms like "sham", "device", "stratagem" and the like used in that connection in the earlier cases.

Binns-Ward J in *Gore's* case further posits that the term 'gross abuse' as stated in section 65 of the Close Corporations Act has more extreme meaning than the term 'unconscionable abuse' stated in section 20(9) of the 2008 Act. This implies that for the corporate veil to be pierced under section 20(9), a lower standard of abuse must be proved as compared to the standard of abuse required for the corporate veil of a close corporation to be pierced under section 65 of the Close Corporations Act.[385]

Cassim[386] in his article which focuses on the case of *Gore* warns that unconscionable abuse must not be confused with unconscionable injustice as was stated by Flemming J in *Botha v Van Niekerk en `n Ander*[387] where the court held that the veil of incorporation will be pierced by the courts where the plaintiff suffered unconscionable injustice. But rather, according to Cassim, unconscionable abuse refers to the conduct giving rise to the remedy of piercing the corporate veil.[388]

The interpretation of section 20(9) indicates that there is no difference between the common law principles of piercing the corporate veil and section 20(9). The courts at common law disregarded the corporate veil in a number of circumstances that shall be discussed below. Thus, the term 'unconscionable abuse' can be said to be a catch-all term for all the common law circumstances for piercing of the corporate veil.

4.5.1 The use of separate legal personality of the company to evade an existing obligation

Use of the company's separate legal personality to evade an existing contractual obligation is a ground for the courts to pierce the corporate veil.[389] This ground for piercing the corporate veil has been raised mostly in respect of restraint of trade agreements where one of the parties to the contract tends to use the company's separate legal personality to evade an existing obligation. Thus if the corporate personality is used to escape existing contractual obligations, the courts will not hesitate to pierce the corporate veil.

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385 Cassim (note 236 above) 312.
386 *Ibid* at 316.
387 1983 (3) SA 513 (W) para 33.
388 Cassim (note 236 above) 317.
389 Cassim (note 10 above) 44.

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In *Gilford Motor Co Ltd v Horne & Another*[390] where the defendant was a party to a restraint of trade agreement which prohibited him from engaging in any business similar to that of his previous employer, the plaintiff company, for a period of five years. After resignation but before the expiry of the restraint period, the defendant incorporated the company in competition with the plaintiff company as a mechanism to enable him escape the existing contractual obligation that he owed to the plaintiff company in terms of the restraint of trade agreement. The plaintiff sought an injunction against the first defendant not to entice and solicit its regular customers, in accordance with the provisions of the restraint of trade contract. The court ruled in favour of the plaintiff and refused to recognise the separate legal personality of the respondent company on the ground that the defendant company was incorporated as a mere device and stratagem to mask the defendant from the contractual obligation that existed between the parties. Lord Hanworth MR in reaching his judgment held that:

> I am quite satisfied that this company was formed as a device, a stratagem, in order to mask the effective carrying on of a business of Mr E.B Horne. The purpose of it was to try to enable him, under what is a cloak or a sham, to engage in business which, on contemplation of the agreement which had been sent to him just about seven days before the company was incorporated, was a business in respect of which he had a fear that the plaintiffs might intervene & object.[391]

Lawrence LJ agreed with Farwell J of the court *a quo* that the evidence adduced by the plaintiff justifies the conclusion that, the defendant company was a mere cloak or sham for the purpose of enabling the defendant to commit a breach of his covenant against solicitation and which justifies the piercing of the corporate veil.[392]

Again, in *Le' bergo Fashions CC v Lee & Another*[393], a similar decision was reached, in that case, the first respondent entered into a restraint of trade agreement with the applicant, whereby she agreed not to engage directly or indirectly in any manner in the business similar to that of the applicant, the buyer of her business as an ongoing concern. The applicant approached the court seeking to impose the restraint of trade agreement against the second respondent and the company formed by the first respondent, in the same manner as the contract was imposed on the first respondent. The applicant contended before the court that the first respondent should not be allowed to evade contractual obligations by hiding behind the corporate structure of the second respondent.

In reaching the judgment, Hoffman AJ[394] observed that:

> It also seems clear that a company can be a façade even though it was not originally incorporated with any deceptive intentions, what counts is whether it is being used as a façade at the time of the relevant transaction. Thus if the company, otherwise

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390 [1933] All ER 109.
391 *Ibid* at 114.
392 *Gilford Motors Co Ltd v Horne & Another* [1933] All ER 109 at 120.
393 1998 (2) SA 608 (C).
394 *Ibid* at 614.

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> legitimately established and operated, is misused in a particular instance to perpetrate fraud, or for a dishonest or improper purpose, there is no reason in principle or logic why its separate personality cannot be disregarded in relation to the transaction in question.

In that matter, the court disregarded the separate legal personality of the second respondent company on the ground that it was used for improper purpose to enable the first respondent to escape an existing contractual obligation. Hoffman AJ held that:

> I am of the view that the facts relied upon by the applicant and enumerated above are sufficient to sustain the argument that the first respondent is guilty of improper conduct in using her company, the second respondent, as a façade behind which she has engaged in business in breach of the restraint of trade undertaking. I am satisfied that whether it be on the basis of veil piercing, or on the basis of interference in contractual relation, the second respondent must be interdicted in this matter.[395]

The above case illustrates clearly that interposition of the separate legal personality of the company as shield for dodging an existing contractual obligation is a ground which justifies the piercing of the corporate veil by the courts. Thus it can be said that it constitutes unconscionable abuse of the juristic personality of the company in terms of section 20(9) of the Act.

Jones v Lipman[396] is another example of case law where the court pierced the corporate veil where the company's separate legal personality was used as a device to evade an existing contractual obligation. In that case, the defendant formed the company so as to enable him to escape specific performance in terms of the contract of sale that he had entered into with the plaintiff. The court, per Russell J, held that even though the *merx* had been sold by the defendant to the company formed by him, he was still bound to perform in terms of the contract. Hence, the separate legal personality of the defendant's company was disregarded by the court and treated the defendants as one entity on the ground that, the defendant company was a mere mask to enable the first defendant to evade specific performance in terms of the existing contract.

In *Die Dros (Pty) Ltd v Telefon Beverages CC*[397] the court also elaborated that use of the separate legal personality of the company to avoid a contractual obligation is a ground for piercing the corporate veil. In this matter, the court held that, the separate legal personality of the company will undoubtedly be disregarded where the person who is subject to the restraint of trade contract uses the separate existence status of the company as a shield to engage in activities prohibited by the restraint of trade contract.[398]

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[395] *Le bergo Fashions CC v Lee & Another* 1998 (2) SA 608 at 614 & 616.
[396] [1962] 1 All ER 442 at 444-445.
[397] 2003 (4) SA 207 (C).
[398] *Ibid* para 24.

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In addition, it should be considered that directors in law stand in a fiduciary relationship with the company as a result they owe the company a number of fiduciary duties which cannot be escaped by the director. Therefore, the directors cannot not be allowed to evade the fiduciary duty that they owe to the company under any circumstances. For instance, the director is prohibited to evade the fiduciary duty that he owe to the company by interposing another company and hiding behind it.[399] Put differently, the director is not permitted to use the separate legal personality of another company as a shield to escape the fiduciary duties owed to the company after accepting appointment.

This was demonstrated in *Robinson v Randfontein Estates Gold Mining Co Ltd* [400] where the Appellate Division refused to recognise the separate legal personality of the subsidiary company which the plaintiff intended to use as a shield to evade the fiduciary duty that he owed to the holding company. In that matter, the court treated both the subsidiary company and the holding company as a single entity, thereby disregarding the separate existence of the subsidiary company on the basis that, the subsidiary company was interposed by the plaintiff in order to enable him to escape the fiduciary duties to the holding company. Disregarding the separate legal personality of the subsidiary company by the court in that matter was done in order not to allow Robinson to evade the fiduciary duties to the holding company.

However, in the *Prest v Petrodel Ltd and Others*,[401] Lord Sumption classified such grounds for piercing of the corporate veil under what he termed the "evasion principle". He submits that, the court may disregard the separate legal personality of the company if there is a legal right against the person in control of the company and the company is deliberately interposed in order that, the separate legal personality of the company should defeat the enforcement of that right against the controlling party. Thus, in such cases, the court may then pierce the corporate veil in order to ensure the enforceability of the alleged right. It should be noted that, piercing of the corporate veil in such cases is only done for the purpose of depriving the company or its controller of the advantage they would have obtained by reason of the company's separate legal personality.

It should be borne in mind that when the courts pierce the veil of incorporation on this ground the motive of forming the company is not considered. This was illustrated in the *Cape Pacific Ltd v Lubner Controlling Investments*[402] where the Appeal Court held that "it does not matter prior to the piercing of the corporate veil whether the company was formed with bad intention or good intention but was later improperly used". This implies that the courts will pierce the

[399] Cassim (note 10 above) 43.
[400] 1921 AD 168.
[401] [2013] UKSC 34 para 28.
[402] 1995 (4) SA 790 (A) at 804.

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corporate veil where the separate legal personality of the company has been used to avoid an existing contractual obligation despite the *bona fide* intentions of its formation.

4.5.2 The company as a sham or mere façade

If the company is used to appear to be something else which in actual fact is not for the purposes of deceiving third parties the court will pierce the corporate veil in order to reach the actual actors. For instance, if the company is made to appear to possess certain legal rights and obligations which in actual fact it does not have.[403]

The assertion that the use of a company as a sham constitutes unconscionable abuse of the separate legal personality of such juristic person was affirmed in *Hitch v Stone (Inspector of Taxes)*[404] where the court held that the separate legal personality of a juristic person may be disregarded if a juristic person is a sham. The question that follows from this decision is; what constitutes a 'sham'.[405] Lord Diplock in *Snook v London and West Riding Investment Ltd*[406] addressed this question by stating as follows:

> As regards the contention of the plaintiff that the transactions between himself, Auto Finance and the defendants were a "sham," it is, I think, necessary to consider what, if any, legal concept is involved in the use of this popular and pejorative word. I apprehend that, if it has any meaning in law, it means acts done or documents executed by the parties to the "sham" which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations (if any) which the parties intend to create.

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A sham could be in a form of conduct or written agreement.[407] However, what matters most is the intention of the parties to deceive a third party or the court. This was demonstrated in *Nilesh Hirji Pankhania v Kalavanti Narendra Chandegra*[408] by Lord Justice Patten, though the matter related to a sham trust and not a company, held as follows:

> [I]t must be shown both that the parties to the trust deed (in this case, the claimant and the defendant) never intended to create a trust and that they intended to give that false impression to the third parties or to the court.

Drawing from the decision in *Snook v London & West Riding Investments*[409] Arden LJ in *Stone v Hitch*[410] held that in determining whether the company is used as a sham, the facts of the case should be scrutinised. Therefore, in doing so, the following factors must be applied. For

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[403] See for instance *Donald v Baldwyn* [1953] NZLR 313 at 321, where Adam J held that a sham exists where the parties say one thing while really intend another.
[404] [2001] EWCA CiV 63.
[405] *Nilesh Hirji Pankhania v Kalavanti Narendra Chandegra* [2012] EWCA CiV 1438 para 20.
[406] [1967] 2 QB 786 at 802.
[407] See for instance *Haljiloucas v Crean* (1987) 284 EG 927 at 929, where Purchas LJ held that a written agreement qualifies as a sham if it incorporates clauses which neither of the parties intends to be bound by them, which is obviously a smokescreen to shed the true intentions of the parties.
[408] [2012] EWCA CiV 1438 para 20.
[409] *Snook case* (note 406 above).
[410] *Stone v Hitch* [2001] EWCA CiV 63 para 64.

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instance, if it is a document which is subject to dispute, the court may also examine extrinsic evidence that might be available and of necessity. In such cases, the court must not only confine itself to the questioned document.[411] Secondly, for the parties to be found guilty as aforementioned, they must have had the intention to create legal rights and obligations diverse from the one that the juristic person actually possesses and to give false impression about such rights and obligations. Therefore, to determine the intention of the parties the court must apply the subjective test.[412] Thirdly, the fact that a document is not a commercial one or artificial does not avert it from being a sham.[413] Moreover, if the parties later on deviate from the agreement that they have reached that does not imply that they lack the required intention.[414] Instead, the contract will be considered as it is still existing and valid even though the parties to it have decided to cancel it. Lastly, it must be proven that the parties to a sham possessed common intention to deceive third parties or court about the rights and obligations that they falsely created about the juristic person involved which are not similar to the one that a trust or juristic person actually has.[415] Hence, this is in line with the decision reached by Lord Justice Patten that since there are no allegations raised or evidence that Ms Ker and Optima had common intention to deceive a third party about the terms and the impact of the tenancy agreement therefore, the agreement does not qualify as a sham.[416]

Again, in the case of *Hulse-Reutter & Others v Godde*[417] Scott JA held that the appellants acted through Goldleaf Company is common cause that they intended to hide their identities as Harken's "godmothers". Therefore, the fact that there was some truth concealed by the appellants makes it justified for the court to grant the relief sought, that is, to pierce the corporate veil because the company in question qualified as a sham.[418] This line of decision was also adopted by Lord Keith in *Woolfson v Strathclyde Regional Council*[419] who observed that it is appropriate to pierce the corporate veil only where special circumstances exist indicating that the company is a mere façade or sham concealing the true facts.

In *Trustor AB v Smallbone (No 2)*[420], the defendant used the company as a vehicle to enable him to receive money from the plaintiff. The submission made on behalf of the plaintiff was that the authorities allow the piercing of the corporate veil in three overlapping circumstances and these are: where the company is used as a sham or façade, where the company is involved in some form of impropriety and where the interests of justice so require. Sir Andrew Morritt VC

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411 *Ibid* at para 65.
412 *Ibid* para 66.
413 *Ibid* para 67.
414 *Ibid* para 68.
415 *Ibid* para 69.
416 *Nilesh* case (note 408 above) para 22.
417 [2002] 2 All SA 211 (A) at 218.
418 *Ibid*.
419 1978 SC (HL) 90 at 536.
420 [2001] 1 WLR 1177.

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came to the conclusion that the authorities, however, allow the piercing of the corporate veil only in the first two circumstances provided that the impropriety is coupled with the use of the corporate structure to conceal or avoid liability. The Vice-Chancellor rejected the last circumstance that the veil of incorporation may be pierced if the interests of justice so require on the ruling established in *Adams v Cape Industries*[421] where it was held as follows:

> The court was entitled to 'pierce the corporate veil' and recognise the receipt of the company as that of the individual(s) in control of it if the company was used as a device or façade to conceal the true facts, thereby avoiding or concealing any liability of those individual(s).

The above decision is similar to the one reached in the House of Lords in *Woolfson v Strathclyde Regional Council*[422] where Lord Keith held that:

> The court is not free to disregard the principle of *Salomon v A Salomon & Co Ltd* [1897] AC 22 merely because it considers that justice so requires. Our law, for better or worse, recognises the creation of subsidiary companies, which though in one sense the creatures of their parent companies, will nevertheless under the general law fall to be treated as separate legal entities with all the rights and liabilities which would normally attach to the separate legal entities.

Lord Sumption in *Prest v Petrodel Resources Limited and Others*[423] however, contended that there are challenges in identifying relevant wrongdoing and that the use of the terms 'facade' or 'sham' raises multiple questions which cannot be answered satisfactorily. He further argues that there are two distinct principles which lie behind these two protean terms and these are the concealment principle and evasion principle. He attempt to distinguish these two principles by stating as follows:

> The concealment principle is legally banal and does not involve piercing the corporate veil at all. It is that the interposition of a company or perhaps several companies so as to conceal the identity of the real actors …In these cases the court is not disregarding the "facade", but only looking behind it to discover the facts which the corporate structure is concealing. The invasion principle is different. It is that the court may disregard the corporate veil…

More so, in the leading South African case of *Ex parte Gore,* it was held that the reports submitted to the court were evident enough that the disregard by the King Brothers of the separate corporate personalities of the companies in the King Group was so extensive to justify the conclusion that the Group was a sham.[424] Hence, the plaintiff's prayer was granted on this basis.

Also in *Amlin (SA) Pty Ltd v Van Kooij* [425] fraud, agency, evasion, abuse of the corporate form, and the creation of a mere facade to conceal the true state of affairs or as a means or device

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[421] [1991] 1 All ER 929 para 23.
[422] 1978 SC (HL) 90 at 536.
[423] *Prest* case (note 401 above) para 28.
[424] *Ex parte Gore & Others NNO* [2013] 2 All SA 437 (WCC) para 15.
[425] 2008 (2) SA 558 at 568.

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to conceal wrongdoing or to avoid obligations, were all submitted as justifiable grounds for piercing the veil.

Lord Sumption in *Prest's* case,[426] identified such circumstances for piercing of the corporate veil as the concealment principle. The concealment principle relates to those situations in which the company or companies are interposed in a transaction so as to mask the true principals to the transaction. Put different, the parties attempt to employ a façade to disguise their activities. However, Lord Sumption does not consider the concealment principle as constituting factor which may lead to the piercing of the corporate veil. Accordingly, the courts will simply unveil the true facts which the corporate structure is designed to conceal.

4.5.3 The use of separate legal personality of the company to commit fraud

Defining fraud has never been easy for the courts[427] but has in many cases been considered as a ground for piercing the corporate veil. In *Daniels v Daniels*[428] the court defined fraud as the violation of fair dealing or unconscionable conduct or abuse of power between the trustee and the shareholders in the company management. To determine whether a particular company is intended to be used to defraud any third party, inference has to be drawn from the manner in which the company conducts its business. Maugham J in the case of *In Re William C Leitch Brothers Ltd*[429] held that intention to defraud can be extrapolated in the following circumstances:

> If a company continues to carry on business and to incur debts at a time when there is to the knowledge of the directors no reasonable prospect of the creditors ever receiving payment of those debts, it is, in general, a proper inference that the company is carrying on business with intent to defraud.

Denning LJ in his famous *dictum* in *Lazarus Estates Ltd v Beasley*[430] with regard to the use of the separate legal personality of the company to commit fraud as the ground for piercing the corporate veil said:

> No court in this land will allow a person to keep an advantage which he has obtained by fraud. No judgment of a court, no order of a minister, can be allowed to stand if it has been obtained by fraud. Fraud unravels everything. The court is careful not to find fraud unless it is distinctly pleaded and proved; but once it is proved, it vitiates judgment, contract and all transactions whatsoever.

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426 *Prest* case (note 401 above) para 28.
427 See for instance *R v Grantham* (1984) 79 Cr App R 86 at 90 where Lord Lane held that; "No distinction is to be drawn... between the state of mind of one who does an act because he desires it to produce a particular evil consequence, and the state of mind of one who does the act knowing full well that it is likely to produce the consequence although it may not be the object he was seeking to achieve by doing the act".
428 [1978] 2 All ER 89 (ChD).
429 [1932] 2 Ch 71 at 77.
430 [1956] 1 QB 702 at 712.

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The piercing of the corporate veil on the ground of fraud is also confirmed in *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd and Others*[431] where Smalberger JA held that:

> The principle of a company's separate juristic personality was first asserted in the House of Lords in *Aron Salomon v A Salomon and Company Limited* [1897] AC 22. There already it appears to have been recognised that proof of fraud or dishonesty might justify the separate corporate personality of a company being disregarded… And over the years it has come to be accepted that fraud, dishonesty or improper conduct could provide grounds for piercing the corporate veil.[432]

Moreover Smalberger JA commenting on the judgment reached by Corbett CJ in *The Shipping Corporation of India Ltd v Evdomon Corporation and Another*[433] where the court disregarded the separate legal personality of the company on the ground of fraud, held that:

> It seems to me that, generally, it is of cardinal importance to keep distinct the property rights of a company and those of its shareholders, even though the latter is a single entity, and that the only permissible deviation from this rule known to our law occurs in those (in practice) rare cases where the circumstances justify 'piercing' or 'lifting' the corporate veil…I do not find it necessary to consider, or attempt to define, the circumstances under which the Court will pierce the corporate veil. Suffice it to say that they would generally have to include an element of fraud or other improper conduct in the establishment or use of the company or the conduct of its affairs.

Furthermore, Smalberger JA in demonstrating that the use of the corporate structure to commit fraud justifies the disregarding of the separate legal personality of the company further said:

> Two matters arising from the quoted passage merit further comment. First, reference is made to "those (in practice) rare cases where the circumstances justify 'piercing' or 'lifting' the corporate veil" it is undoubtedly a salutary principle that our courts should not lightly disregard a company's separate personality, but should strive to give effect to and uphold it... But where fraud, dishonesty or other improper conduct are found to be present, other considerations will come into play.[434]

It should be borne in mind that when the courts pierce the corporate veil on the ground of fraud, it is not necessary that the company should have been incorporated in deceit and was not intended to function genuinely as the company.[435] Thus if the company is legitimately formed but is misused in a particular instance to perpetrate fraud or any improper purpose, there is no justification in law why its separate legal personality should not be disregarded in relation to that misuse.

Menzies J in *Hardie v Hanson*[436] emphasised that for an act of the company to qualify as fraud it must be interfused with factors like misrepresentation. He held that:

> Even if the chances of payment of all creditors in full were so remote that it belonged to the realms of hope rather than belief, it seems to me that the fault, grievous though

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[431] [1995] 2 All SA 543 (A).
[432] *Ibid* at 552.
[433] 1994 (1) SA 550 (A) 566C-F.
[434] *Cape Pacific Ltd v Lubner Controlling Investment (Pty) Ltd* 1995 (4) SA 790 (A) at 553.
[435] *Ibid*.
[436] (1960) 105 CLR 451 (HC) at 467.

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it may be, falls short of fraud unless it is coupled with something else, such as misrepresentation of the position or an intention to use the goods purchased on credit for the purposes of dishonest gain, which gives it a fraudulent character.

4.5.4 Other improper use of the company's separate legal personality

The veil of incorporation may be pierced if there are improprieties involving the use of the company's separate legal personality, for instance, to conceal liability. This was buttressed by Munby J in the case of *Ben Hashen v Ali Shayif*[437] referred to in *Linsen International Ltd & Others v Michael Howard QC & Others*[438] where it was held that there must be some impropriety that the corporate structure is involved before the corporate veil can be pierced. Munby J further emphasised that mere involvement of the company in certain impropriety does not grant the courts the power to pierce the corporate veil. Instead, the impropriety in which the company is involved must be linked to the use of the company structure to avoid or conceal liability.[439]

Furthermore, Sir Andrew Moritt VC in *Trustor AB v Smallbone (No 2)*[440] concurs with the decision of Munby J above that the impropriety to suffice for the piercing of the corporate veil must have been used to avoid or conceal liability. He said:

> Companies are often involved in improprieties. Indeed there was some suggestion to that effect in *Salomon v A Salomon & Co Ltd* [1897] AC 22. But it would make undue inroads into the principle of *Salomon's* case if an impropriety not linked to the use of the company structure to avoid or conceal liability for that impropriety was enough.

In addition, Munby J also emphasised that it is not enough to only prove that the company's structure was involved in some impropriety as a façade to avoid liability. Instead, it must also be shown that the perpetrator had control over the company in question. It is noteworthy that the company can qualify as a façade though it was incorporated with the *bona fide* intention if it is later on involved in some *mala fide* conducts.[441]

The case *of Ex parte Gore NO and others NNO*[442] is another case where the court pierced the corporate veil in the group of companies on the ground of improper use of the corporate personality. In that case, the king brothers did not maintain the separate legal personality of each company in the group in their dealings. It was stated in that case that:

> It is a factor that is evident in cases in which the "circumstances [indicated that] a corporate group is operating in such a manner as to make each individual entity

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437 [2008] EWHC 2380 (fam) para 161.
438 [2011] EWHC 2339 (comm).
439 *Ben Hashen* case (note 440 above) para 162.
440 [2001] 1 WLR 1177 para 22.
441 *Ben Hashen* case (note 440 above) para 164. See also *Linsen International Ltd* case (note 441 above) para 15.
442 [2013] 2 All SA 437 (WCC).

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> indistinguishable, and therefore it is proper to pierce the corporate veil to treat the parent company as liable for the acts of the subsidiary".

In that case, Binns-Ward J in reaching his decision also stated that:

> The relevant improprieties involved in the current case involved the controllers of the companies treating the group in a way that drew no proper distinction between the separate personalities of the constituent members and in using the investors' funds in a manner inconsistent with what had been represented. The first mentioned category of impropriety, in my view, constituted an unconscionable abuse by the controllers of the juristic personalities of the relevant subsidiary companies as separate entities and brought the case within the ambit of the statutory provision.[443]

The above decision might have fuelled by Cassim's submission that conducting the business of group of companies with scant regard to their separate legal personality constitutes gross abuse of the corporate structure of the companies concerned, thus justifying the piercing of the corporate veil.[444]

Furthermore, the abuse of the company's separate legal personality to commit some impropriety as a ground for piercing the corporate veil was strengthen by the court of first instance in *Prest v Petrodel Ltd & Others*[445] where Moylan J acknowledged that no general principle allows for the piercing of the corporate veil, except in exceptional circumstances such as improper abuse of the company, Lord Sumption in the Supreme Court alluded to that decision where he said:

> The distinctive feature of the judge's approach was that he concluded that there was no general principle of law which entitled him to reach the companies' assets by piercing the corporate veil. This was because the authorities showed that the separate legal personality of the company could not be disregarded unless it was being abused for a purpose that was in some relevant respect improper. He held that there was no relevant impropriety. He nevertheless concluded that in applications for financial relief ancillary to a divorce a wider jurisdiction to pierce the corporate veil was available under section 24 of the Matrimonial Causes Act.

Many considerations under which the corporate veil was pierced by the courts reflect that, the courts pierce the corporate veil mostly to prevent the abuse of the corporate personality of the companies.[446] Abuse is not only limited to that form of abuse which may cause the company to incur liability in the first instance, instead, it may also include abuse of the separate legal personality of the company to frustrate the enforcement of the law.[447] For instance by a way of interposing a company, to avoid existing obligation.

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[443] *Ibid* at 452.
[444] Cassim (note 10 above) 61-62.
[445] [2013] UKSC 34 para 6. See also the leading judgment of the majority deliver by Rimer LJ where he held among others that, the practice developed by the Family Division was beyond the jurisdiction of the court unless the corporate personality of the company was being abused for a purpose which was in some relevant respect improper (para 7).
[446] *Ibid* para 34.
[447] *Ibid*.

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4.5.5 Policy considerations

The decision of the courts to pierce the corporate veil is a policy consideration, which requires the courts to strike a balance between the importance of protecting and giving effect to the separate legal personality of the company, the corner stone of company law against, disregarding it. It was held in the case of *Gore* by Binns-Ward J that:

> In my view the determination to disregard the distinctness provided in terms of a company's separate legal personality appears in each case to reflect a policy based decision resultant upon a weighing by the court of the importance of giving effect to the legal concept of juristic personality, acknowledging the material practical and legal considerations that underpin the legal fiction, on the one hand, as against the adverse moral and economic effects of countenancing an unconscionable abuse of the concept by the founders, shareholders, or controllers of a company, on the other.[448]

Put in simple terms, the court in *Gore's* case above meant that in determining whether or not to pierce the corporate veil, the courts must balance between the importance of giving effect to the separate legal personality of the company against the adverse moral and economic effects of tolerating unconscionable abuse of the juristic personality of the company.

The need to preserve the separate legal personality of the company against its piercing was also demonstrated in *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd*[449] where Smalberger JA held that:

> But where fraud, dishonesty or other improper conduct... is found to be present, other considerations will come into play. The need to preserve the separate corporate identity would in such circumstances have to be balanced against policy considerations which arise in favour of piercing the corporate veil.

The balancing approached laid down by the Appellate Division in *Cape Pacific Ltd v Lubner* is modelled on the United States case of *Glazer v Commission on Ethics of Public Employee*[450] where the Supreme Court of Louisiana stated that the policies behind the recognition of the separate corporate existence must be balanced against the policies justifying the piercing of the corporate veil.[451] The balancing approach emphasises the importance of the company's separate legal personality and requires the courts to balance the need to preserve the company's separate legal personality against policy considerations which are in favour of piercing the corporate veil in the given circumstances.

Therefore, it is of great importance that the courts in exercising their discretion to pierce the corporate veil in terms of section 20(9) of the Act should apply the balancing approach as

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[448] *Gore* case (note 427 above) 450.
[449] 1995 (4) SA 790 (A) at 803.
[450] So 2d 752 (La 1983).
[451] *Ibid* at 757.

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stated in *Gore*[452] and *Cape Pacific*[453] carefully before piercing the corporate veil and deeming the company not to be a juristic person.

In summing up, the courts have shown that they will not easily pierce the corporate veil merely because the interests of justice so require. This contention was adopted by Slade LJ in *Adams v Cape Industries plc,*[454] where he held that:

> The court is not free to disregard the principle of *Salomon v A Salomon & Co Ltd* [1897] AC 22 merely because it considers that justice so requires. Our law, for better or worse recognises the creation of subsidiary companies, which though in one sense the creation of their parent companies, will nevertheless under the general law fall to be treated as separate legal entities with all the rights and liabilities which would normally attach to separate legal entities.

In *Ben Hashen v Al Shayif*[455] Munby J formulated six principles which should be taken into consideration by the courts in deciding the matters of piercing of the corporate veil. They include; that ownership and control of the company are not sufficient to justify the piercing of the corporate veil, the courts will not pierce the corporate veil merely because the interests of justice so require, that the veil of incorporation may only be pierced only if the are some improprieties in which the company is involved. To justify the piercing of the corporate veil control of the company by the wrongdoers must be connected with the impropriety in which the company is involved.

4.6 The piercing the corporate veil as the remedy of last resort

At common law, piercing the corporate veil is a drastic remedy that must be resorted to sparingly and as a very last resort in circumstances where justice will not otherwise be done. This was demonstrated by both the Supreme Court of Appeal and the Cape Court respectively in *Hulse-Reutter and Others v Godde*[456] and *Amlin (SA) Pty Ltd v Van Kooij*[457] where the court took a firm decision that piercing of the corporate veil should only be used as the remedy of last resort. However, in *Cape Pacific v Lubner Controlling Investments (Pty) Ltd and Others* the Appellate Court held that availability of an alternative remedy to the plaintiff does not hinder the piercing of the veil where policy considerations favour the piercing of the veil. Smalberger J held that:

> In principle I see no reason why piercing of the corporate veil should necessarily be precluded if another remedy exists. As a general rule, if a person has more than one legal remedy at his disposal he can select any one of them; he is not obliged to pursue one rather than another (although there may be instances where once he has made an election he will be bound by it). If the facts of a particular case otherwise justify the piercing of the corporate veil, the existence of another remedy, or failure

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452 *Gore* case (note 427 above) para 29.
453 *Cape Pacific* case (note 437 above) 803.
454 [1990] Ch 433 at 536. See also *Trustor AB v Smallbone (No 2)* [2001] EWHC 703 (Ch).
455 [2009] 1 FLR 115 para 159 – 164.
456 2001 (4) SA 1336 (SCA).
457 2008 (2) SA 558 (C).

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> to pursue what would have been an available remedy, should not in principle serve as an absolute bar to a court granting consequential relief. The existence of another remedy, or the failure to pursue one that was available may be a relevant factor when policy considerations come into play, but it cannot be of overriding importance.[458] ...In the circumstances the appellant's failure to pursue its remedy under the doctrine of notice does not in my view operate as a bar to the relief it seeks... That it can do so is a logical consequence of piercing the corporate veil and disregard the separate juristic personality of LCI and GLI. To hold otherwise would be to negate the very reason for piercing the veil.

Taking into account the provisions of section 20(9) it appears that the courts will disregard the corporate veil where there is unconscionable abuse of the juristic personality of the company even if the plaintiff has alternative remedy, provided the court is satisfied that the given facts constitute unconscionable abuse. Therefore, this indicates that for the corporate veil to be pierced, it is not a requirement that the claimant does not have an alternative remedy. The fact that the separate legal personality of a company may be disregarded even if the claimant has an alternative remedy leads one to infer that the Act unlike common law does not consider the separate legal personality of a company as sacrosanct.

Furthermore, in *Ex parte Gore's* case it was highlighted that the decision established in *Hulse-Reutter v Godde*[459] has been misinterpreted to mean that the separate legal personality of a company will only be disregarded if the claimant does not have an alternative remedy. Instead, the decision implies that availability of an alternative remedy to the plaintiff may be a relevant consideration but does not bar the piercing of the veil if the facts so justify its piercing.

The Western Cape High Court further held that the availability of section 20(9) militates against the traditional acceptance that piercing of the corporate veil should be relied on only in the absence of an alternative remedy.[460] Binns-Ward J held as follows:

> The newly introduced statutory provision affords a firm, albert very flexibly operate, I think, to erode the foundation of the philosophy that piercing the corporate veil should be approached with an a' *priori* difference. By expressly establishing its availability simply when the facts of a case justify it, the provision detracts from the notion that the remedy should be regarded as exceptional, or "drastic".[461]

Hence, this indicates that in `the new dispensation of section 20(9) piercing of the corporate veil is no longer a remedy of last resort has the case under the common law. This is attributed to the fact that, the courts may pierce the corporate veil even in cases where the claimant has an alternative remedy at his disposal, what is of essence is that there must be unconscionable abuse of the juristic personality of the company.

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[458] *Ibid* at 555-556.
[459] *Hulse-Reutter* case (note 459 above).
[460] *Ex parte Gore* case (note 427 above) para 34.
[461] *Ibid* para 34.

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4.7 Chapter conclusion

From the above discussions, it is clear that despite the endless attempts made to bring out what constitutes "unconscionable abuse" by the courts and scholars the term 'unconscionable abuse' remains unclear. It has been brought out in this chapter that the term 'unconscionable abuse' is a legislative derivate from the various terms used by the courts at common law to justify the disregarding of the separate legal personality of the corporate entity. Just as those terms used at common law, the term is confounding. So shall this legislative innovation remain confounding until a specific meaning is assigned to it by the parliament. Nonetheless, it has been submitted that the term 'unconscionable abuse' is diverse enough to cover all the descriptive terms such as sham, device and many other terms used at common law to justify the piercing of the corporate veil.[462]

However, in order to ease the pain faced by the courts in determining the circumstances in which the corporate veil may be pierced, each case has been decided based on its own facts.[463] The courts should, refrain from trying to categorise the circumstances that constitutes unconscionable abuse. This is attributed to the fact that those categorise identified by the courts are overlapping and confusing. Again, if categorising approach is to be followed such is likely to result in the rigid application of the doctrine of piercing of the corporate veil.

Lastly, the fact that the separate legal personality of a company can be disregarded even if the plaintiff has an alternative remedy, might be an indication of diversion from the tradition that the separate legal personality of a company is a sacrosanct principle. Instead the Act grants the courts discretion to disregard separate legal personality of a company where there is 'unconscionable abuse'. Nothing is stipulated in the section or any conditions imposed to protect the separate legal personality of the company in all circumstances.



[462] *Ex parte Gore* case (note 427 above) 450.
[463] *Ibid* at 444 where Lord Binns-Ward J held that the South Africa, Australian and English jurisprudence has indicated that the courts vary considerably to pierce or look behind the veil of incorporation depending on the facts of each. See also *Cape Pacific* case (note 440 above) where Smalberger JA held that our law is far from being settled in respect of the circumstances under which the corporate veil maybe pierced hence, each matter must be decided based on its facts.

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CONCLUSIONS AND RECOMMENDATIONS

This research traced, examined, analysed and compared in depth the circumstances which constitute unconscionable abuse of the juristic personality of a company as a broad ground for disregarding the separate legal personality of a company in terms of section 20(9) of the Act. After scrutinising primary and secondary sources of the law in this area, a number of conclusions and recommendations were derived.

5.1 Conclusions to the preceding chapters

Piercing of the corporate veil is a common law principle which has been codified and developed by section 20(9) of the Act. This is a great development in the South African company law since the doctrine of piercing of the corporate veil can now be easily accessible by everyone. However, during this research, the researcher discovered that there are serious challenges associated with this section. The main challenge being that, even though the section clearly grants the courts wide discretion to disregard the separate legal personality of a company where there is unconscionable abuse of the juristic personality of a company, the section does not give any hints as to which conduct amounts to unconscionable abuse. Such failure *prima facie* may result in serious challenges in the application and interpretation of the section by the courts. For instance, the same section can be interpreted and applied differently by different judges based on their different understanding of the section, thus resulting in diversity in the application of the same law. This would be undesirable as the law should be applied uniformly in all circumstances.

Since, section 20(9) merely codifies and develops the common law provisions for piercing of the corporate veil this therefore, might justify the conclusion that the section complements the common law position. Again, it has been indicated that where the section is not applicable to the facts of a case, the common law provision will take over. Hence, the fact that the two provisions work hand in hand cements the submission that the common law and section 20(9) are complementary and not substitutes. Put differently, the section does not mark an end to the common law provisions of piercing of the corporate veil. What the section does, is to capture all those common law grounds which justify the piercing of the corporate veil in one broad category. Accordingly the term 'unconscionable abuse' can be said to be a catch-all term for the common law circumstances for piercing of the corporate veil.

It also came out from this research that the section 20(9) remedy for disregarding the separate legal personality of a company can no longer be regarded as a remedy of last resort as it was the position at common law. What can be drawn is that the section grants the courts a very wide discretion to disregard the separate legal personality where there is unconscionable

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abuse. This submission is demonstrated by the fact that the separate personality of a company can be disregarded at any time where there is evidence of unconscionable abuse of the juristic personality of a company. Once such evidence is adduced before the court the discretion is then that of the court to decide whether or not to pierce the corporate personality of a company based on the adduced evidence. The courts bear no duty to investigate if there are any remedies available to the plaintiff prior to piercing the corporate veil. What is of importance is that there must be unconscionable abuse of the corporate structure. Moreover, the fact the court may initiate the disregarding of the corporate personality of a company *mero motu* also is a sign that, the corporate veil may be disregarded anytime where there is unconscionable abuse of the corporate structure regardless of the fact that the plaintiff has another remedy available at his disposal.

5.2. Recommendations

After the intense examination of the law, the researcher makes the following recommendations to the courts and the legislature for the improvement the law in the aspects that have been examined in this research work. However, these recommendations are not legally binding they are mere recommendations by the researcher based on her findings after conducting this research work.

5.2.1 Recommendations to the courts

It is a difficult task for the courts or any other person to deduce with certainty what constitutes unconscionable abuse of the juristic personality of a company as a separate legal person. Rather, the term 'unconscionable abuse' is a legislative derivate from the various terms used by the courts at common law to justify the piercing of the separate legal personality of the corporate entity. Subsequently, it is diverse enough to cover all those metaphors such as sham, device and many other terms used at common law to justify the piercing of the corporate veil. This is attributed to the fact that section 20(9) came into effect as a supplementary tool and not substitutive tool to the common law position of piercing of the corporate veil. Just like those terms used at common law, the term unconscionable abuse is so confounding, since the Act does not assign it any definition or meaning. In order to resolve this problem, it is recommended that each case should be considered based on its peculiar facts.

In addition, the fact that the courts have been granted wide discretion to pierce the corporate veil, this does not imply that the courts can easily do so. This is due to the importance of the separate legal personality of a company in company law. As such, the courts should strive to protect and uphold this important principle of company law, thus, to achieve this, the courts should apply the balancing approach. This approach requires that, before the courts disregard

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the separate legal personality of a company a balance should be struck between the policy considerations favouring the piercing the corporate veil *vis-à-vis* those favouring its protection.

Furthermore, it has been demonstrated that the categorising approach for the circumstances under which the corporate veil may be pierced used at common law are challenging as most of them do not have clear boundaries but are overlapping. This makes it difficult for the courts to identify the category into which the facts of a particular case fit. To resolve this problem thus, the courts should do away with categorising the circumstances which may constitute unconscionable abuse as was the position at common. Therefore, each matter should be decided based on its unique facts with the universal application of the section. The other challenge with the categorising approach is that it narrows the application of the section. This is based on the fact that, if the facts of a case do not fall within a particular category but constitutes another form of unconscionable abuse which is not covered in the stipulated categories, the courts might not be able to disregard the separate legal personality of a company in such circumstances. Since there would be no category providing authority for such.

Again, simplicity and clarity should be the goal of the courts in disregarding the separate legal personality of a company. Hence, it is of paramount importance for the courts to do away with the metaphors used at common law to justify the piercing of the corporate veil. This implies that, the court in deciding the cases of piercing of the corporate veil should use terms which carry literal meaning and not metaphoric meaning.

5.2.2 Recommendations to the legislature

It is common cause that section 20(9) of the Act expresses the legislative intention to grant the courts the discretion to disregard the separate legal personality of a company where there is unconscionable abuse of the juristic personality of a company. This intention of the legislature is put in a way that the section is left broad enough to accommodate whatever can arise thus leaving the discretion to the courts to interpret the section as cases are presented before them.

It has been argued by others that the legislature left a gap by not providing in the definition clause as to what constitutes unconscionable abuse. Would it be desirable if the legislature defined what constitutes unconscionable abuse? Should the section be amended in order to provide clear meaning of the conduct which amount to unconscionable abuse? These questions clouded the mind of the researcher in answering the challenges associated with section 20(9).

However, if legislature had provided a definition of what constitutes unconscionable abuse of the juristic personality of a company certainly such was going to result in the inflexibility in the application of the section. This is due to the fact that, for the separate legal personality of a company to be disregarded, the facts of the case should perfectly fit into the definition given

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by the legislature. If the facts do not fit within a stipulated category but proves some other form of unconscionable abuse which justifies the piercing of the corporate veil the courts in such circumstances would not have the discretion to so pierce the corporate veil. This would limit the applicability of the section and thus, allow the violators of the section to go free whereas the law requires that violators of the law should not benefit from their bad acts but be punished accordingly.

Again, given the current technological era, things are changing very rapidly every day. This implies that if the legislature had stated the circumstances which amount to unconscionable abuse such would soon be outdated. As a result calling upon the legislature to continuously amend the Act in attempt to catch up with the rapid change in technology, would be impossible given that the process of amending a statute takes a long time.

The conclusion drawn from the above observations therefore, is that it is wise for the legislature to have left room for the courts to decide what constitutes unconscionable abuse of the juristic person of a company. Again, given the disadvantages for stipulating what constitutes unconscionable abuse of the corporate structure it is therefore, judicious to recommend that, section 20(9) should not be amended but be left the way it is. This is because its wording allows the section to be applied in various circumstance thus, allowing flexibility in its application.

In addition, the legislature cannot be said to have made an unwise decision by not stipulating what constitutes unconscionable abuse of a company's separate legal personality as a juristic person. Instead, the inference that should be drawn is that the legislature respects the important principle of separation of powers between the spheres of the state. In so doing, the legislature did not want to intrude into the judicial powers, thus, leaving it to the courts to decide the judicial conundrum of what constitutes unconscionable abuse.

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5.3 Concluding remarks

The term 'unconscionable abuse' should be considered as a legislative derivate from the various terms used by the courts at common law to justify the piercing of the separate legal personality of a company. As such it is diverse enough to cover all those metaphors such as sham, device and many other terms used at common law to justify the piercing of the corporate veil. Since, the section is worded in a way which enables flexibility in the application of the section to different cases, for that reason the researcher recommends that the section should not be amended in any way. Nonetheless, to resolve the said challenges, each case should be dealt with based on its unique facts.

In addition, since the section is still new and in so far as its application by courts is concerned has only be applied in one case that is the case of *Gore*. Therefore, before any amendment

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can be suggested, it is wise for the section to be given enough time to be tested through application and see the actual challenges which might arise and it is then that an amendment may be considered. But as things stands now, the researcher is of the view that section 20(9) does not warrant an amendment, as it is wide enough to allow broad application of the section.

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