

Shareholders beware – Section 424 and piercing the corporate veil!

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Introduction

When a director of a company conducts the business of the company, that director does not do so in his/her personal capacity. Instead, that director acts as an agent of the company, and is, for so long as the company continues to be regarded as having a separate legal personality, protected from incurring personal liability for, *inter-alia*, the company's debts. Be that as it may, when the level of mismanagement of the company's affairs becomes heedlessly gross or dishonest, then the fundamental attribute of separate legal personality should be retracted (as was stated in *Ebrahim and another v Airport Cold Storage (Pty) Ltd* 2008 (6) SA 585 ("**Ebrahim v ACS**").

The common law principle of piercing the corporate veil essentially gives courts the power to disregard the separate legal personality of the company and hold liable any person who is in control of, or a party to, reckless or fraudulent conduct occasioned on behalf of the company. Section 424(1) ("**the Section**") of the Companies Act 61 of 1973 ("**1973 Companies Act**") is a statutory expression of the aforesaid principle. This section remains extant in terms of item 9 of Schedule 5 of the Companies Act 71 of 2008 ("**the 2008 Companies Act**").

The Section provides that when it appears that any business of the company was or is being carried on recklessly, or with the intent to defraud creditors of the company (or any other person for that matter), the Court may, on application of, *inter-alia*, the liquidator, declare that any person who was knowingly a party to the carrying on of the business in the manner aforesaid, shall be personally responsible without limitation of liability for all or any of the debts or other liabilities of the company.

Recently, our Courts have, in the case of *Cooper and Another NNO v Myburgh and others* [2021] 2 All SA 114 ("*Cooper v Myburgh*"), further expanded on the legal precedent dealing with the Section. This article discusses the judgment recently handed down by the Honourable Justice Binns-Ward ("**Binns-Ward J**") in *Cooper v Myburgh*.

In *Cooper v Myburgh*, the applicants were co-liquidators seeking a declaration that the respondents be declared to be personally liable to pay the debts of DPMM Transport (Pty) Ltd ("**Transport**"), a company (in liquidation) that carried on business in the transport industry and whose assets included a fleet of trucks and trailers.

Transport was wholly owned by the Sean Billy Myburgh Trust ("**the Trust**") and Sean Billy Myburgh ("**Myburgh**"), who also happened to be the sole director of Transport, as well as DPMM Property Trucking (Pty) Ltd ("**Trucking**") and DPMM Hauliers (Pty) Ltd ("**Hauliers**") – the second and third respondents respectively.

In the face of financial difficulty, and despite the fact that Transport had creditors pressing for payment and threatening legal action, Myburgh, acting on behalf of each of the three aforementioned companies concerned, entered into two agreements. The first agreement provided for the sale of Transport's operational equipment to Trucking. The disposal of the goods was preceded by the adoption of a special resolution in terms of section 115 of the 2008 Companies by the Transport's shareholders, who also happen to be co-trustees of the Trust. The second agreement provided for the lease of the aforementioned goods by Trucking to Hauliers.

The issue to be decided by the Court was whether Myburgh's conduct, in his capacity as the director of Transport, falls to be categorised as reckless or fraudulent within the meaning of the Section.

Furthermore, and for the first time, the Court had to decide whether Transport's shareholders, in choosing to pass a special resolution in terms of section 115 of the Companies Act that – despite the company's precarious financial position – enabled Transport to dispose of all its assets, were party to the carrying on of Transport's business in a reckless or fraudulent manner.

Legal discussion

In *Ebrahim v ACS*, Cameron JA held that section 424(1) exacts a quid pro quo in terms of which the benefit of immunity from liability for a company's debts does not extend to the use of the company's formal identity to incur obligations recklessly, gross negligently or fraudulently. Binns-Ward J in *Cooper v Myburgh* concurred with this position – and noted that section 424(1) is not limited to the incurrence of obligations by the company, but also extends to the carrying on of the company's business in a way that prejudices creditors or disregards their interests. Indeed, participating in business necessarily involves taking entrepreneurial risks. However, the fundamental tenet of section 424(1) is to ensure that those involved in carrying on a company's business do not permit the company to continue to trade in circumstances where it is reasonably foreseeable that the company will be unable to pay its debts as and when they fall due (*Philotex (Pty) Ltd and another v Snyman and others* 1998 (2) SA 138 (SCA)).

Binns-Ward J's position was that the agreements Myburgh concluded were so palpably misconceived that any reasonable businessman applying his mind would recognise as much. For starters, Trucking did not carry on business at the time of conclusion of the agreements with Transport and Hauliers, and was not possessed of any assets. Thus, Trucking became indebted to Transport when the company's only means of satisfying that liability was the income stream it *might* generate from the lease agreement with Hauliers. Given the aforementioned state of affairs, Binns-Ward J concluded that the obvious and inevitable effect of the transactions was to keep Transport's creditors out of any prospect of recovery once Myburgh made the decision to liquidate Transport. Accordingly, he held that Myburgh's conduct constituted a clear case of reckless, if not fraudulent, conduct within the meaning of section 424(1). Binns-Ward J ordered that Myburgh be personally responsible, without any limitation of liability for all debts or other liabilities of the company as is provided by s424(1) of the 1973 Companies Act.

Turning to Transport's shareholders, Binns-Ward J considered *Currin and another v Van Zyl NO and another* [2019] ZAWCHC 96 (7 August 2019) as authority for the principle that the disposal by a company of its assets is a manifestation of the carrying on of its business ordinarily undertaken by its directors and employees as opposed to its shareholders. However, special resolutions made in terms of section 115 of the 2008 Companies Act create an exception to this general rule. In considering the liability of Myburgh and his father in their capacity as trustees, Binns-Ward J in *Cooper v Myburgh* noted how passing a special resolution in terms of s115, *qua* shareholders of Transport, enabled the disposal of the company's operational assets. Significantly, Binns-Ward J, held that shareholders who exercise the control reserved to them in terms of section 115 are obliged to have regard not only to their own interests but also to the effect of their decision on the company's ability to meet its obligations to third parties. Binns-Ward J held that Myburgh and his father failed to have due regard for the company's obligations, and that such failure amounted to an abuse of the limitation of personal liability for the company's obligations.

Although Binns-Ward J was of the view that the conduct of the co-trustees warranted their exposure to personal liability in terms of the Section, he held such exposure did not automatically make the assets of the Trust available to satisfy any order against the trustees to pay the debts of Transport. After all, one cannot ignore the implications of a validly established Trust. Accordingly, the claim for a declaratory order in terms of the Section against Myburgh and his father – in their capacity as co-trustees – did not succeed. Nevertheless, Binns-Ward J opined that liability of the co-trustees could have been established under the Section if the applicants alleged and proved that the Trust, insofar as it constitutes an example of the sort of “family trust” that was frowned upon for being an abuse of the trust form (*Land and Agricultural Bank of South Africa v Parker and others* 2005 (2) SA 77 (SCA)), was in fact a sham.

Ultimately, the judgment by Binns-Ward J is a clear warning to shareholders that, should they exercise the control reserved to them in terms of section 115, they are obliged to have regard not only to their own interests, but also to the effect of their decision on the company's ability to meet its obligations to third parties. After all, the Section does provide that “any person”, which would include a shareholder, who is in control of, or a party to, reckless or fraudulent conduct occasioned on behalf of the company may be held personally liable for the company's debts.

It is remarkable that the courts have, in both this matter and in the case of *Itzikowitz v ABSA Bank Ltd* 2016 (4) SA 432 (SCA), not considered the provisions of section 20(9) of the 2008 Companies Act. This section provides “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).” Clearly, this section codifies the ability to pierce the corporate veil.



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