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20 000 WORDS RESEARCH PAPER

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I, Simphiwe Peaceful Phungula, do hereby declare that unless specifically indicated to the contrary in this text, this dissertation is my own original work and has not been submitted to any other university in full or partial fulfilment of the academic requirements of any other degree or other qualification.

Signed at Pietermaritzburg on this the 2nd day of November 2013.

Signature: ----------------------------------
DEDICATION

I would like to dedicate this paper to my late father and mother. To my family and friends for all their support, love, encouragement and prayers throughout my studies and research.

I also thank them for believing in me in that I could achieve anything that I want. Lastly, I really like to thank God for bringing these people in my life and for giving me the strength to accomplish my goals.
ABSTRACT

This research paper focuses on the s424 (1) of the Companies Act 61 of 1973. It is deals specifically with the wording of the section and how courts have interpreted it. It critically explains the most cherished principles of corporate law as to the interpretation of the section.

Notwithstanding the existence of s424 (1), in 2011 the new Companies Act 71 of 2008 came into force. The new Companies Act also deals with the liability of directors for reckless and fraudulent trading. However, the new Companies Act deals with such liability differently from s424 (1) of the companies Act of 1973.

The difference between the s424 (1) of the Companies Act of 1973 and the new Companies Act of 2008 can be seen on the application of both Acts. Section 424 (1) of the Companies Act of 1973 applies by the application of creditors at the winding up of the company whereas the new Companies Act of 2008 introduces s22 which applies even when the company is still continuing to do business.

Furthermore, s424 (1) of the Companies Act provides remedies to the creditors for the debts incurred by the company whereas the new Companies Act introduces s77 (3) provides for remedies to the company for any loss, damages, or costs sustained by the company as a direct or indirect consequence of the directors’ conduct.

Accordingly, despite the coming to force of the Companies Act 71 of 2008, s424 (1) of the Companies Act 61 of 1973 still exist in the circumstances of winding up the company. The application of both s424 (1) and s22 and s77 (3) has encouraged me to deal with the topic of liability of directors for reckless and fraudulent trading. This research paper tries to look at both Acts and how they approach the liability of directors in the aforesaid manner. The research paper tries to look at what courts have said since the coming into force of the Companies Act of 2008 since 2011.

I wish to deeply pass my gratitude to supervisor Professor RC Williams of University of KwaZulu Natal who has helped and guided me in completing this research paper. I also wish to thank Professor B Grant and D Subramanien who have also helped me in formulating the structure of this research paper.
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1. **Introduction**

This research paper will look at the liability of directors where a company engages in fraudulent or reckless trading. In doing so, it will specifically and analytically deal with s424 (1) of the Companies Act of 1973 and s77 (3) (b) and s22 of the Companies Act of 2008. In doing so, it will firstly deal with the background of s424 (1) of the Companies Act of 1973 and s77 (3) (b) and s22 of the Companies Act of 2008. The background tries to establish the reasons for the enactment of s424 (1) of the Companies Act of 1973 and s77 (3) (b) and s22 of the Companies Act of 2008. In other words the background provides for general functioning of the sections so that there is a clear understanding of the reasons why this topic was chosen and what developments, if any, have been made by the introducing s77 (3) (b) and s22 of the Companies Act of 2008 as opposed to s424 (1) of the Companies Act of 1973.

Having said that the background will deal with the general functioning of the sections, it is important to deal with the wording of the sections in a detailed manner. Therefore, the provisions of the sections need to be discussed for a clear understanding of relationship between the sections. Accordingly, this research paper is aimed at providing the relationship, requirements, and the purpose of s424 (1) of the Companies Act 1973 and s77 (3) (b) and s22 of the Companies Act of 2008. Specifically, the research paper tries to deal with the requirements for liability under s424 (1) for fraudulent or reckless trading so that it is to understand why the courts cases on those requirements. In this regard there will be clear understanding on how the law affects the existing facts and what reasoning is given by the courts in those particular facts. Accordingly, the research paper focuses on what has been held by the courts as general meaning of reckless and fraudulent trading and thereafter specific meaning of fraudulent and reckless trading in terms of s424 (1). The research paper will then go on to deal the issue of *locus standi*, whereby the claim is brought in court in terms of s424 (1), and how the court have dealt with this issue where there was a ceding of rights by the creditors. The reason for discussing this is to have a better understanding to what has been held the court and which court had taken a convincing approach as to this issue. Thereafter, the research paper will deal with the issue of proving what has been known as causal link by the court between the conduct of directors and the carrying of the business...
of the company thereby incurring liabilities. The reason for this is the fact that the courts have had different approach as to this issue.¹

Having discussed all these issues, the research paper will look at the specific wording of s424 (1) and s22 and 77 (3) (b). Since the coming into force of the Companies Act of 2008, there has been a change as to the issue reckless trading and insolvency.² In this instance, it will look at what degree of recklessness is required for reckless trading; and when it is said that the business of the company was carried with intent to defraud. Thereafter, it will discuss what is meant by “any person who was knowingly a party to the carrying on of the business” in the aforementioned conduct. Lastly, it will look at the insolvency of the company and what has been changed by the Companies of 2008.

The ending of the research paper will discuss the critique on s424 (1) of the Companies Act of 1973 and the existence of s22 and s77 (3) of the Companies Act of 2008 as at 2011 when the act was enacted.

2. Background

When directors act on behalf of the company, they are not personally liable for the debts and liabilities of the company³ as obligations vest on the company itself not its members.⁴ It is only in exceptional circumstances that the directors of the company will be liable for the debts of the company.⁵ However, the separate legal personality of a company has often been abused by the directors of the company. As a result this abuse has been recognized by both courts and legislature and has dealt with the issue.⁶

Section 424 (1) of the Companies Act⁷ was enacted to prohibit the abuse of the separate legal personality of the company. This section is still applicable in the course of winding up the company, should a creditor make an application, since the court may declare any person, who was knowingly a party to the carrying on of the business of the company recklessly or fraudulently, to be personally liable or responsible for the debts and liabilities of the company.

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¹ See Saincic & Others v Indestro – Clean (Pty) Ltd & Another [2006] JOL 17559 (SCA) as the court took a different approach to what has been held by other courts.
² See s22 of Companies Act 71 of 2008.
⁵ Cassim Op cit note 3 at 39.
⁶ Ibid at 29.
when it appears that the business of the company was carried in the aforementioned manner. When it appears that the business of the company was carried in the aforementioned manner, Section 424 (1) is a far reaching provision as it provides that a party to the carrying on of the business of the company in the aforesaid conduct is liable without any limitation. Generally what happens is that at the winding up of the company the affairs of the company, and the conduct of directors, are investigated. If it appears that directors were carrying on the business of the company recklessly or fraudulently, they are held liable.

On the other hand, the new Companies Act was also enacted to prohibit the abuse of the separate legal personality of the company and provide a relief where the company has been carried in the prohibited aforementioned manner. However, sections 77 (3) (b) and 22 (1) of the Companies Act provide for liability of damages, costs, and any loss of the company on the part of directors where there was reckless and fraudulent trading in the business of the company.

However, despite the coming to force of the Companies Act of 2008, s424 (1) of the Companies Act of 1973 is still applicable for creditors to render liability for reckless and fraudulent trading when the company is being wound up. As a result directors, while trading in the course and scope of the company’s business, should be aware of the provisions of the old and new Companies Acts as far as personal liability is concerned. Section 424 (1) puts directors under light and specifically allow the courts to declare them personally liable for the debts of the company where the business of the company was carried on recklessly or fraudulently. On the other hand s22 and s77 (3) (b) allow the courts to declare them personally liable for damages an costs of the company where the business of the company was carried on recklessly or fraudulently.

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11. Ibid
13. See s22 and s77 (3) (b) of Companies Act 71 of 2008.
15. Section 424 (1) provides that ‘when it appears, whether it be in a winding-up, judicial management or otherwise, that any business of the company was or is being carried on recklessly or with intent to defraud creditors of the company or creditors of any other person or for any fraudulent purpose, the Court may, on the application of the Master, the liquidator, the judicial manager, any creditor, or member or contributory of the company, 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 any limitation of liability, for or all or any of the debts or other liabilities of the company as the Court may direct’.
Using s 64(1) of the Close Corporations Act 69 of 1984 the court held that those who are running the corporation may not use its formal identity to incur liabilities recklessly, gross negligently, or fraudulently because if they do, they risk being made personally liable. Accordingly, s424 (1) of the Companies Act of 1973 and s77 (3) (b) and s22 of the Companies Act of 2008 are relevant when dealing with the liabilities of directors for reckless and fraudulent trading.

3. **The provisions of s424(1) of the Companies Act**

3.1. **The wording of the section**

Section 424 (1) provides that:

\[\text{when it appears, whether it be in a winding-up, judicial management or otherwise, that any business of the company was or is being carried on recklessly or with intent to defraud creditors of the company or creditors of any other person or for any fraudulent purpose, the Court may, on the application of the Master, the liquidator, the judicial manager, any creditor, or member or contributory of the company, declare that any person who was knowingly a party to the carrying on of the business in the manner aforesaid shall be personally responsible, without any limitation of liability, for all or any of the debts or other liabilities of the company as the Court may direct.}\]

In other words the court may only grant relief:

- when it appears that any business of the company was or is being carried on recklessly or with intent to defraud creditors of the company or creditors of any other person or for any fraudulent purpose; and
- in respect of any person who was knowingly a party to the carrying on of business recklessly or fraudulently.

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17 2008 (6) SA 585 (SCA) at para 15.
18 This Act applies the same as s424 (1) of the Companies Act 61 of 1973.
20 See also Pressma Services (Pty) Ltd v Schuttler and Another 1990 (2) SA 411 (C) at 416 where Van Schalkwyk AJ took the same view and held that ‘the person, in respect of whom the relief is granted, is declared to be personally responsible, without limitation of liability, for all or any of the debts or other liabilities of the company’.
3.2. The purpose of section

The purpose and intention of s424 (1) has been interpreted by the courts. Seemingly, the courts agree as to the purpose and intention of s424 (1). In Pressma Services (Pty) Ltd v Schuttler and Another, Van Schalkwyk AJ held ‘The clear purpose of s 424(1) is to render personally liable all persons who knowingly participate in the fraudulent or reckless conduct of the business of a company’. In Philotex (Pty) Ltd & Others v JR Snyman & Others, Howie JA held that ‘the legislative intention in enacting s 424 was to broaden the scope of the earlier provision and to extend the remedy by means of which a restraining influence can be exercised on over-sanguine directors’. Howie JA interpreted s424 as to broaden the scope of liability and to provide for unlimited liability for debts and liabilities against any person who carries the business of the company recklessly or fraudulently.

Writers have also agreed with this purpose of s424 (1). Achada, for instance, makes the point that the intention of s424 (1) is protect creditors and prevent fraudulent and reckless trading of directors of the company as ‘it was enacted to provide a remedy against fraudulent and/or reckless behaviour by directors’. Sigwadi points out that the purpose of s424 (1) has two folds namely that it exists to render all those who are knowingly party to the carrying of business of the company recklessly or fraudulently personally liable for the debts or wrongful conduct; and to benefit creditors a ‘meaningful remedy against fraudulent and reckless trading’. Sigwadi further argues that second purpose may not be achieved if the creditors right to institute action under s424 (1) is compromised. This is supported by Achada as he argues if s424 (1) is compromised, then this means that s424 (1) is worthless and fraud and

21 Ibid
22 1998 (2) SA 138 (SCA) at page 143.
23 See also Pressma Services (Pty) Ltd v Schuttler and Another Op cit note 15 at 416 where Van Schalkwyk AJ held ‘the corollary of this purpose is to provide a meaningful remedy against the abuses at which the subsection is directed and it is, in my view, unthinkable that the Legislature could have intended that the aforesaid purpose could be frustrated…’
25 M Sigwadi ‘Compromise and personal liability of directors under s424 of the Companies Act 61 of 1973’ (2003) 15 (3) South African Mercantile Law Journal 388-389. He further argues that if s424 (1) is compromised, it thus means that s424 (1) is worthless and fraud and reckless, by dishonest directors of a company, is encouraged. See also Triptomia Twee (Pty) Ltd & Others v Connolly & Another 2003 (4) SA 558 (C) at page 562 where the court held that the two phrases which are require to do the work if s424 (1) is to be applied are ‘knowingly a party to the carrying on of the business in the fraudulent manner; and carried on recklessly with an intent to defraud creditors of the company or creditors of any other person or any fraudulent purpose’.
26 Ibid
reckless, by dishonest directors of a company, is encouraged.\textsuperscript{27} McLennan\textsuperscript{28} points out that this section empowers the court to impose liability to any person who was knowingly a party to the carrying on of business of company and such liability is imposed without any limitation for all or any debts or liabilities of the company.

3.3. \textit{The relationship between s424 and s77 (3) and s22 of the Companies Act of 2008}

Section 77 (3) (b)\textsuperscript{29} of the Act provides that a director of the company will be liable for any loss, damages or costs sustained by the company as a direct or indirect consequence of the director having acquiesced in carrying on of the company’s business, despite knowing that it was being conducted in a manner prohibited by s 22 (1) of the Act.\textsuperscript{30} This section provides the court with the powers as s 424 (1)\textsuperscript{31} of the 1973 Act as s 424 (1) empowers the court to have a discretion to hold anyone liable in respect liability of directors depending on the circumstances of the case.\textsuperscript{32} Therefore, one has to consider s 424 (1) in dealing with liability of directors as “our courts are prepared to use this section as an effective measure to control directors’ actions”.\textsuperscript{33} The interpretation and application of both s77 (3) of the Companies Act of 2008 and s424 of the Companies Act 61 of 1973 are similar in that they have the elements that are required to prove liability. Under s424 (1) director must knowingly be a party to the carrying on of the business of the company recklessly or fraudulently and secondly, the business of the company must be carried on recklessly or in a fraudulent manner. On the other hand, s77 (3) (b) apply ‘to render liable all persons, not only directors, who knowingly participate or acquiesce in the fraudulent or reckless conduct of the company’s business’.\textsuperscript{34} In this instance, it may be arguably said that these sections have the same required elements as they render liable, even though not the same persons since s424 (1) provides liability to the creditors of the company whereas s77 (3) (b) provides liability of to the company, any party who was knowingly a party or participated in the carrying of business of the company

\textsuperscript{27} Op cit 19 at page 395.
\textsuperscript{29} Companies Act 71 of 2008.
\textsuperscript{30} Ibid. This section provides that a company must not carry on its business recklessly, with gross negligence, with intent to defraud any person or for any fraudulent purpose.
\textsuperscript{31} Companies Act 61of 1973.
\textsuperscript{32}Op cit note 15.
\textsuperscript{34} Cassim Op cit note 3 at 588.
recklessly or fraudulently. Both these sections apply to provide a meaningful remedies for the abuses at which they are directed.\textsuperscript{35}

However, the fact that s77 (3), s22, and s424 (1) are to be read in conjunction with each are, they are not necessarily the same. These sections may seem to appear as the same since they deal with recklessness, fraudulent purpose, and intent to defraud, but they are not necessarily the same in a manner that they are enforced.\textsuperscript{36} However, the wording of the sections is not the same in a manner that some of the words do appear in one section while they do not in the other section. Under s22, the Commission prohibits the reckless and fraudulent carrying on of the business of the company\textsuperscript{37} whereas under s424 (1) it is the court which prohibits reckless and fraudulent trading.\textsuperscript{38} In this instance, it is quite clear that the prohibition of reckless and fraudulent trading under s424 (1) becomes an issue and is dealt with at the winding up of the company whereas under s22 the issue is dealt with when the company is still trading. This creates the issue of factual and commercial insolvency.\textsuperscript{39} Furthermore, it is indeed true that both s22 and s424 (1) render any person who was knowingly a party to the carrying on of the business of the company recklessly or fraudulently. However, the persons who make such findings are not the same.\textsuperscript{40} Under s22 the Commission makes such findings whereas under s424 (1) the court makes such findings.\textsuperscript{41} The Commission is a juristic person which functions as an organ of the state within public administration and it performs its functions without fear, favour, or prejudice.\textsuperscript{42} Clearly this shows that one is to look closely as to who has a jurisdiction to make findings as reckless and fraudulent trading under both Companies Act of 1973 and Companies Act of 2008. As result it may be argued said that the new Companies Act has come with changes as to the person who should make findings. Under the 2008 Companies Act the issue of recklessness and fraud is dealt with by the Commissioner before it is taken to court. Therefore, one needs to have this in mind since the court may throw out the case if the issue is raised under the Companies Act of 2008 and the procedure under 2008 has not been complied with.

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{35} Ibid
\item \textsuperscript{36} P Delport (ed) \textit{Henochberg on the Companies Act 71 of 2008} (2012) 100.
\item \textsuperscript{37} Section 22 (2) provides that ‘if the commission has reasonable grounds to believe that the company is engaging in conduct prohibited by subsection 1, or is unable to pay its debts as they become due and payable in the normal course of business, the Commission may issue a notice to the company to show why the company should be permitted to continue carrying on its business, or to trade, as the case may be’ \textsuperscript{38} Op cit note 15.
\item \textsuperscript{39} This is the issue which the research paper is going to deal with at a later stage of this research.
\item \textsuperscript{40} Delport Op cit note 36.
\item \textsuperscript{41} See the wording of s22 (2) and wording of s424 (1).
\item \textsuperscript{42} See s185 of the Companies Act 71 of 2008.
\end{itemize}
\end{footnotesize}
Section 77 (3) (b), on the other hand, protects the company against any loss, damages or costs sustained by the company as a result of the director's conduct in carrying on of the business of the company recklessly or fraudulently. On the other hand, s424 (1) protects creditors from director's conduct in carrying on of business recklessly or with an intention to defraud creditors. It should be noted that s77 (3) (b) deals with the claim by the company for any reckless or fraudulently by the directors of the company. Therefore, if s77 (3) is interpreted in its sense, it can be said that its focus is on the protection of the company and not the creditors. As a result, s424 (1) still plays a vital role as it protects the creditors of the company. If there is no s424 (1) it may be hard for creditors to claim for their debts as s77 (3) (b) has a loophole of focusing only on the protection of the company against reckless or fraudulent trading. Furthermore, s424 (1) partially benefits the company itself. In Ex Parte Lebowa Development Corporation Ltd Stegmann J held:

'It would appear that a declaration under s 424(1) is also intended to be for the benefit of the company itself in various ways. Naturally, if the claimant should choose to recover from the declared wrongdoer, and to forgo his claim against the company, the company would indirectly have derived a benefit from the declaration. Further, more direct, benefits for the company may also have been intended. For example, if the claimant should pursue his remedy against the company alone, the declaration of personal responsibility, without any limitation of liability on the part of the declared wrongdoers, may well have been intended by the Legislature to enable the company to enjoy at least such rights of contribution from the declared wrongdoers as may exist between persons who are jointly liable. It may even have been intended to entitle the company to a complete indemnity from the declared wrongdoers, at least in an appropriate case'.

Moreover, s424 (1) is still important as to the claim against reckless and fraudulent trading. Section 424 (1) declares that ‘any person who was knowingly a party to the carrying on of the business in the manner aforesaid shall be personally responsible, without any limitation of liability, for or all or any of the debts or other liabilities of the company as the Court may direct’. In this instance, the liable person is liable “without any limitation” for any debts and other liabilities of the company. On the other hand, s77 (3) (b) provides that a person is liable for any loss, damages or costs sustained by the company. Accordingly, in s77 (3) (b) there is no “without any limitation” in its wording. It appears to be a problem as to which section is wider so as to include a coherent mechanism.

43 In its sense, s424 (1) deals with the liability to creditors of the company.
44 In its sense, s77 (3) (b) deals with the liabilities to the company itself and not to the creditors of the company.
45 1989 (3) SA 71 (T) at page 110.
46 Op cit note 19.
One may argue that the new Companies Act is wide as to the inclusion of damages in its wording.\textsuperscript{47} It is indeed true that, s77 (3) (b) introduces an increased exposure on directors to be personal liability where the business of the company is recklessly or fraudulently conducted. This section\textsuperscript{48} introduces the claim for damages sustained by the company as a result of the directors’ conduct in carrying on of the business of the company recklessly or fraudulently. In this sense, directors are easily exposed to the company’s liabilities and costs for the company to claim. However, even this is the case, the creditors do not enjoy the benefit of s 77 (3) (b) as the section protects the company against reckless and fraudulent carrying on of its business by the directors. As a result both sections are applicable but they provide mechanisms for different persons.

### 3.4. The liability requirements

#### 3.4.1 General

Section 424 (1) in its basic and general sense requires that:

- any business of the company must have been or is being carried recklessly or for fraudulent purpose; or
- any other person was knowingly a party to the carrying on of the business in the manner aforesaid; and
- the company must have incurred debts and liabilities.

Directors may incur personal liabilities by reason of the role that they play in governing the company. It is true that the company is a separate legal entity with its own liabilities but proceedings may also be institute against directors and ‘the most commonly encountered basis for liability is that a director or any other person took part in, allowed, or authorized specific conduct of the company’.\textsuperscript{49} In this instance, the directors are generally liable in accordance with the above general requirements.

\textsuperscript{47} Cassim Op cit note 3 at 588 as he argues that s22 of the new Companies Act applies even if the company is still an on-going business irrespective of whether or not the company is wound up or not. Therefore, as a result of this, s22 is not confined to a winding up of the company.

\textsuperscript{48} Section 77 (3) (b) of Companies Act 71 of 2008.

However, in its specific sense, s424 (1) is to be interpreted as including the carrying of business of the company:

- recklessly;
- with the intent to defraud the creditors of the company;
- with the intent to defraud creditors or any other purpose; and
- for any other fraudulent purpose.\(^{50}\)

In this instance, these categories include reckless and fraudulent trading in carrying on of the business of the company. As a result if any of these categories apply, a creditor may claim against the directors of the company in terms of s424 (1).\(^{51}\) Accordingly, creditors obtain *locus standi* to approach the court in terms of s424 (1).

### 3.4.2. Locus Standi

The creditor has a *locus standi* in court for a claim under s424 (1).\(^{52}\) It does not matter that other creditors, where there are more than one creditor, have not applied in terms of s424 (1) but s424 (1) will automatically benefit such creditor.\(^{53}\) As soon as it appears that business of the company is or was being carried on recklessly, with gross negligence or with intent to defraud any person or for any fraudulent purpose, the creditor can enforce the remedy against

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\(^{50}\) *Terblanche No & Others v Damji & Another* 2003 (5) SA 489 (C) at page 510 Knoll J held: ‘in order for this court to exercise discretion to visit the respondent with personal liability for the company's debts the relevant portions of s 424(1) require the applicants to establish that:

(a) any business of the company, which may refer to any one transaction, was carried on

(b) (i) recklessly; or
    (ii) with intent to defraud creditors
    (aa) of the company; or
    (bb) of any other person; or
    (iii) with any fraudulent purpose; and

(c) by any person who was knowingly a party to the carrying on of business in the manner aforesaid’. See also *Cooper & Others NNO v Mutual Life Assurance Society & Others* 2001 (1) SA 967 (SCA) at para 14B-D where the court took the same view.

\(^{51}\) In *Burley Appliances v Groabelaar No & Others* 2004 (1) SA 602 (C) at page 610 the court held that s64 of the Close Corporation Act, which applies the same as s424 (1), created statutory rights and corresponding liabilities when the business of the Close Corporation is carried out recklessly or with gross negligence or with the intent to defraud any person or for any fraudulent purpose.

The section provides that ‘the Court may, on the application of the Master, the liquidator, the judicial manager, any creditor, or member or contributory of the company, 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 any limitation of liability, for or all or any of the debts or other liabilities of the company as the Court may direct’.

\(^{53}\) *Terblanche No & Others v Damji & Another* Op cit note 44 at page 515. See also *Bowman NO v Sacks & Others* 1986 (4) SA 459 (W) at page 516 where the court held that persons who are regarded as possible applicants under s424 (1) are those with a direct and substantial interest in the subject matter in question.
a director or any other person conducting or has conducted a business of the company in the aforesaid conduct. In *Burley Appliances v Grobelaar*[^54] Nel J held:

‘In my view as soon as it 'appears that any business of the corporation was or is being carried on recklessly, with gross negligence or with intent to defraud any person or for any fraudulent purpose' and the corporation has debts or other liabilities, a creditor can enforce the remedy which was created by s 64. The remedy is the right to apply to a Court for a declaration that a particular person or particular persons should be held personally liable for all or any of such debts or liabilities as the Court may direct’.

Accordingly, the creditor is protected by s424 (1) to have *locus standi* as the aim of the Act is to protect creditors against the possible prejudice created by reckless, gross negligence or fraudulent conduct of the business of the company.^[55]

However, for many years there had been a large disagreement and criticism of judgments amongst the courts’ decisions as to who has a right to claim where creditors have compromised their rights. In *Pressma Services (Pty) Ltd v Schuttler and Another*[^56] Van Schalkwyk AJ in his judgment held that:

‘The words “creditors of the company” refer to the existing creditors and former creditors. As a result, even if s 311 of Companies Act 61 of 1973 applies, the former creditors may also have a claim under s424. These words could mean either a person who is creditor of a company at the time when he approaches the court in terms of s424 (1) in the sense that there is an existing indebtedness which ceased to exist upon the sanctioning and implementation of the compromise. The first, more restricted meaning, is the more obvious and ordinary one which, in the absence of an indication to the contrary, would be the meaning to be ascribed to the words. The second, extended meaning would be permissible only upon the basis it is consistent with the true intention of the Legislature while the first, more restricted meaning, is not. The true intention of the Legislature in this regard must, in my view, be determined with reference to the primary objects of s 424(1). These, as I have mentioned, are twofold. The first is to render personally liable all personally liable all the persons who knowingly participate in the fraudulent or reckless conduct of the business of a company. The second is to provide a meaningful remedy against the abuse at which the subsection is directed. The first of these objects would be attained if, upon sanctioning and implementation of a compromise, the personal liability of the persons concerned was maintained. This would be the case even if the rights conferred on a creditor by s424 (1) were to pass to the offeror upon the sanctioning and implementation of the compromise. The second object, however, would in my view not be attained if the remedy provided by the subsection were to be lost to

[^54]: Op cit note 44 at page 614.
[^56]: Op cit note 23 at page 417 B-H.
the creditors for, in the final analysis, it is to them to them that the debts of the company in respect of which personal liability is created by the subsection are owed'.

The judgment by Van Schalkwyk AJ was based on the reasoning that both existing and former creditors have claim in terms of s424 (1). The court’s interpretation of s424 (1) meant that it does not matter that former creditors have compromised their rights. As long as there was existing liability of the company, prior to the compromise, former creditors may also claim. However, this decision received a lot of criticism by other courts. In Ex Parte De Villiers and Another NNO: In re Carbon Development (Pty) Ltd the court criticized Van Schalkwyk AJ. In his judgment Stegman J held:

‘this is, I must respectfully observe, a curious choice to have postulated, for if the creditors contemplated by s424 (1) are to be understood as including not only existing creditors but also former who had disposed of their claims to existing creditors in terms of a compromise. The Legislature would have created an unlikely situation in which the company’s debt, or some of them, would have to be paid twice over: once to the existing creditor and one to the former creditor. Such a result would be an absurdity which the Legislature could not have contemplated, and I have no doubt that the implication was not brought to the attention of Van Schalkwyk AJ, and certainly not intended by him’.  

According to the court Van Schalkwyk AJ ‘appears to have postulated an ambiguity in s 424(1), suggesting that “creditor” may have been confined to existing creditors, or may have been extended to include former creditors who had ceased to be creditors by virtue of a compromise in terms of s 311’. This issue was also to be decided on appeal but the appeal court did not deal with the issue and left an open question as to whether the former creditors may claim in terms of s424 (1).

The issue of compromise has recently been dealt with and solved by the court in Freidlein (Pty) Ltd v Simaan & Others where the court confirmed the decision of the court a quo in Ex Parte De Villiers and Another NNO: In re Carbon Development (Pty) Ltd. In her judgment Kathree-Setiloane J held:

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57 1992 (2) SA 95 (W).
58 Ibid at page 106 B-D.
59 Ibid at page 106 A-B.
60 See Ex Parte De Villiers & Another NNO: In re Carbon Developments (Pty) Ltd 1993 (1) SA 493 (A) where Goldstone JA held: ‘In the view I take in this matter, it is not necessary to decide this interesting and difficult question. I shall assume that the effect of compromise, on sanction by the court, would be to preclude relief under s424 (1) at the instance of the creditor.
'having considered the judgment of Stegman J in *Ex Parte De Villiers*, I am unable to find that either his conclusion or reasoning is wrong. I therefore endorse his judgment in all respects in relation to the question of whether creditors can both surrender their claims against the company in an offer of compromise and retain any rights they may have against its representatives under s424 (1) of the Companies. I am thus of the view that the judgment of Van Schalkwyk AJ is clearly wrong as it fails to have regard the following essential factors:

(a) the freedom conferred upon creditors in an offer of compromise between a company and the creditors, in terms of s311 of the Companies Act, to agree to deal with their rights as they see fit by agreeing to either compromise, alienate or extinguish their rights;

(b) for s424 (1) of the Companies Act to be of application, the company must have debts and liabilities.\(^{62}\)

From this judgment it is clear that the former creditor does not have claim under s424 (1) of the Companies Act. This makes logic as it prevents the company from being sued twice for the same acts of the same debts. If one accepts that the previous creditors are to claim, it means that they benefit twice. They benefit in ceding their claims to current creditors and benefit from the debtor at the time they invoke s424 (1). Accordingly, if this is the case there would not be anyone may want to trade for the company because everybody will know that if it happens that the company becomes wound up, he may be sued twice if the creditors have ceded their rights to each other. This may also create injustice because some directors may make profit by ceding their rights to each other concurrently knowing that they will claim in either debtor. The position remains the same that where creditors have agreed to compromise their rights, in terms of s311 of Companies Act, s424 (1) may not apply as these creditors are not existing creditors. The position is that if the creditors are deemed to have ceded their rights to claim against the company, any of those rights, in terms of s424, are extinguished upon the sanctioning and implementation of an offer of compromise.\(^{63}\)

### 3.4.3. The proof of recklessness, fraudulent or intent to defraud creditors

The underlying principle is that directors of the company owe a fiduciary duty to exercise their powers *bona fide* in the best interest of the company.\(^{64}\) If they fail to act *bona fide*, and

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\(^{62}\) Ibid at para 15. See also *Ex Parte De Villiers & Another NNO: In re Carbon Developments (Pty) Ltd* Op cit note 42 at page 106 where Stegman J held: ‘There is no reason to doubt that, in making provision in s 311 for a compromise between a company and its creditors, the Legislature intended to leave the creditors free to agree to deal with their rights as they saw fit, i.e agree to compromise their rights, to alienate them, or to extinguish them, as they chose. There is nothing in s 424(1), or its context, which abridges a creditor's freedom to agree in terms of s 311 to compromise any rights he may derive from s 424(1), or to alienate such rights, or to extinguish them’.

\(^{63}\) Ibid at para 21.

\(^{64}\) J.S. McLennan *‘Reckless or Fraudulent Conduct of Corporate Business’* (1998) 115 (4) *SALJ* 597.
the creditors suffer, such creditors may claim against the directors in terms of s424 (1)\(^\text{65}\). However, writers have concluded that the plaintiff, a person who has made the application to the court e.g. creditor, has to prove that there has been a reckless or fraudulent trading by the defendant.\(^\text{66}\) Sigwadi\(^\text{67}\) points out that to hold a person liable under s424 (1) of the Companies Act, the applicant is to prove on balance of probabilities that the company’s business was carried on recklessly or with an intent to defraud creditors. Sigwadi’s point confirms what had been pointed out by Williams\(^\text{68}\) as the learned author points out that when the court declares a person liable in terms of s424 (1) of the Companies Act, ‘the court must be satisfied on balance of probabilities that the creditor’s claim exists and that is quantified by acceptable evidence’.

Courts have taken the same view as to the \textit{onus} of proof. Courts have accepted the view that the plaintiff has to prove on balance of probabilities that the company was or is carried on recklessly or with intent to defraud creditors. In \textit{Philotex (Pty) Ltd & Others v Snyman & Others}\(^\text{69}\) Howie J took the view that:

‘the legislative intention in enacting s 424 was to broaden the scope of the earlier provision and to extend the remedy by means of which a restraining influence can be exercised on “over-sanguine directors”... The \textit{onus} is upon the party alleging recklessness to prove it and, these being civil proceedings, to establish the necessary facts according to the required standard, which is on a balance of probabilities’.

This point was also emphasized by the court in \textit{Strut Ahead Natal v Burns}\(^\text{70}\) where the court held that in circumstances where the plaintiff has a claim against the defendant for personal liability for all debts and liabilities, in terms of s424 (1) of the Companies Act of 1973, one requisite to be met is that the plaintiff bears the \textit{onus} to prove on a balance of probabilities that the defendant was knowingly a party to the carrying on of the business of the company recklessly or with intent to defraud creditors of the company. This was also confirmed by the court in \textit{Terblanche No & Others v Damji & Another}\(^\text{71}\) where the court held that the \textit{onus} lies on the applicant to establish the necessary facts on balance of probabilities. This was further

\(^{65}\) Op cit note 23.
\(^{66}\) See McLennan Op cit note 58 as he argues that ‘the plaintiff has the \textit{onus} of proving that the defendant had knowingly been a party to the fraudulent and reckless carrying on of the business of the close corporation’.
\(^{69}\) Op cit note 22 at page 142.
\(^{70}\) 2007 (4) SA 600 (D) at page 607F.
\(^{71}\) Op cit note 50 at page 510.
confirmed by the Supreme Court of Appeal in *Heneways Freight Services v Groggor*\(^\text{72}\) where Zulman JA held:

‘the section penalises fraud or recklessness on the part of anyone who carries on or manages the business of a company with intent to defraud creditors of the company... it is necessary to consider whether the appellant proved, on a balance of probabilities, that he had no reason for thinking that there would be funds available to pay the cheques on their due dates... this is plainly relevant both to the question of fraud and recklessness’.

The learned judges and academics take this reasoning following the fact that one who alleges must prove on balance of probabilities in civil cases. Since a creditor is the one who alleges that the defendant had acted recklessly or conducted the business of the company with intent to defraud creditors, the creditor bears the onus of proof. If the creditor fails to prove on balance of probabilities, then such creditor may not successfully claim under s424 (1) of the Companies Act of 1973.\(^\text{73}\)

**3.4.4. The causal link between the conduct of the director and the carrying on of the business of the company**

The arising issue amongst our courts is whether the plaintiff should prove a causal link between the relevant conduct and debts and liabilities of the company. For many years, it was believed that the plaintiff may claim under s424 (1) without the proof of a causal link. Writers\(^\text{74}\) and courts\(^\text{75}\) took the view that the plaintiff can successfully claim under s424 (1) without a proof of causal link between the relevant conduct and liabilities and debts of the company. The reason for this is the fact that our courts have interpreted s424 at the end of the company’s existence as this section is applied at the winding up of the company. In other words, creditor was not obliged to prove that there was a causal link between the relevant acts and the consequences resulted to the liabilities of the company. For example, Achada\(^\text{76}\) argues that s424 (1) relieves the applicant from proving a causal link between the conduct that amounts to fraud in carrying on the business of the company and the debts in which the

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\(\text{72}\) 2007 (4) SA 561 (SCA) at para 4-5.

\(\text{73}\) Ibid, where the court held that there was no evidence drawn that there was fraudulent and reckless trading on the respondent because post-dated cheque were amongst many cheques that were issued and paid in time. See also *Joh – Air (Pty) Ltd v Rudman* 1980 (2) 420 (T) at page 426D where the court held that in terms of s424 the applicant is obliged to put evidence before court so as to enable the court to make determination and the applicant, in civil matter, has to discharge the onus of proof.


\(\text{75}\) See for example *Joh – Air (Pty) Ltd v Rudman* 1980 (2) 420 (T) at page 426D or *Philotex (Pty) Ltd & Others v Snyman & Others* Op cit note 22 at page 142G-H.

\(\text{76}\) Achada Op cit note 74.
director or company may be liable. Furthermore, our courts have submitted that the provisions of s 424(1) of the Companies Act 61 of 1973 enable the Court to declare such director liable ‘for all or any of the debts or other liabilities of the company’ without any proof of the causal connection between the fraudulent conduct of the business of the company and the debts or liabilities for which he may be declared liable. In *Howard v Herrigel & Another NNO* Goldstone JA in his judgment held:

‘At common law a director of a company who is knowingly a party to fraud on the part of his company would be liable in damages for any loss suffered by any person in consequence of the fraud. It would be necessary, in order to fix the liability of such a director, to establish a causal connection between the fraud of the company and the damages claimed from the director. The quantum of the damages would also have to be proved. The provisions of s 424(1) of the Act enable the Court to declare such a director liable ‘for all or any of the debts or other liabilities of the company’ without proof of a causal connection between the fraudulent conduct of the business of the company and the debts or liabilities for which he may be declared liable’.

This point was also followed and stressed by the court in *Philotex (Pty) Ltd & Others v Snyman & Others* where Howie JA held:

‘Obviously, therefore, the legislative intention in enacting s 424 was to broaden the scope of the earlier provision and to extend the remedy by means of which a restraining influence can be exercised on ‘oversanguine directors’. That, of course, does not mean that recklessness is lightly to be found. The remedy is a punitive one; a director can be held personally liable for liabilities of the company without proof of any causal link between his conduct and those liabilities.

This point was later confirmed also in *Nisbet & Others v Kalinko* where Claassen J held:

‘It has been held that this section supplements and does not replace remedies which may be available at common law to any person... The section also enables the Court to impose a liability on a person where at common law such liability might not exist at all. The section comes to the aid of a claimant in circumstances where a claim under the common law may be difficult to prove. In particular it relieves the claimant of proof of any causal connection between the fraudulent or reckless conduct of the business of the company and the debts or liabilities for which the wrongdoer may be declared liable’

This position was later followed by the court in *Nel & Others NNO v McArthur & Others* where the court held that there is no causal link that is required, in terms of s424 (1), between the reckless conduct in which defendants are alleged to have knowingly participated and the

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77 1991 (2) SA 660 (A) at page 672D-E.
78 Op cit note 22 at page 142G-H.
79 2002 (5) SA 766 (W) at page 774B-D.
80 2003 (4) SA 142 (T) at page 156.
debts or other liabilities for which they may be liable. Plaintiff only needs to prove that defendant was knowingly a party to the carrying on of the business with fraudulent intent or fraudulent purpose.\footnote{Ibid at page 159.}

However, in 2006 the position was changed by the court. Until 2006, it was clear that claims, in terms section 424(1), did not require the proof of causal link between the conduct of directors and debts and liabilities of the company. It was not necessary for a claimant to prove a causal link between the reckless or fraudulent conduct of a director and the quantum of its claim. The case of \textit{Saincic & Others v Industro – Clean (Pty) Ltd & Another}\footnote{[2006] JOL 17559 (SCA).} changed the existing law. According to this case a causal link is a factor to be taken into account when applying for a claim under s424 (1). Endorsing \textit{dictum} in \textit{L & P Plant Hire BK en Andere v Bosch en Andere}\footnote{Op cit 55 where the court held that the aim of the s64 of Close Corporation Act 69 of 1989 is to protect creditors against the possible prejudice created by reckless or gross negligent or fraudulent conduct of the business of the close corporation. However, in the light of the foregoing, the applicant is to show a causal link between the relevant conduct and the debts and liabilities of the close corporation as the mere suspicion of financial inability on the part of the corporation is insufficient for the purpose of s64. Section 64 of the Close Corporation Act is regarded as counterpart of s424 (1) of the Companies Act of 1973 as it provides that ‘If at any time it appears that any business of a corporation recklessly, with gross negligence or with intent to defraud someone or for a fraudulent purpose, or be driven, a court on application by the Master, or a creditor, member or liquidator of the corporation, stating that anyone who knowingly a party to the drive of the business in any such manner was or is personally liable for all or any of the debts or obligations of the corporation the Court may direct, and the court may further orders as it deems fit in order to comply with the release order and to enforce that liability’.} Farlam JA held:

\textquote{It is true that it is not necessary to prove a causal link between the relevant conduct and the debts or liabilities for which there is a declaration of personal liability in terms of section 424. But the absence of such a proven link is a factor to be taken into consideration by the court in the exercise of its discretion and in order to decide whether such a declaration is, in all the circumstances, just and equitable}.\footnote{Op cit note 82 at para 20. See also \textit{M A Vleisagentskap CC & Another v Shaw Another} 2003 (6) SA 714 (C) at para 723 held ‘to the extent that the provisions of s 64(1) confer a discretion upon this Court, that discretion, in my view, cannot be exercised in favour of plaintiffs who might, in future, be in receipt of substantial dividends in addition to those already received’.}

It is from these judgments that the question arises as to whether s424 (1) is still an existing remedy for creditors. Seemingly, courts such as that in \textit{Saincic} case are trying to apply s424 (1) in line with the new Companies Act. The reason for this is that for a long time s424 (1) has been regarded as punitive remedy. After the judgment of \textit{Saincic} the position is not clear as to whether the court nullified the punitive remedy that has been regarded as important in earlier decision. After the judgment of \textit{Saincic} the creditors are put in a much stricter onus of
proving their claim. It is more difficult for creditors to render directors personally liable for the debts and liabilities of the company, under s424 (1), where the business of the company has been carried on recklessly or fraudulently. Section 424 (1) does not have anything to do with quantum of damages. However, Farlam JA in his judgment held:

‘Although I am of the view that the section is wide enough to cover a declaration of personal liability for debts incurred after the period when the offending conduct took place and that such an order would not be inappropriate where the new debts take the place, as it were, of old debts incurred during the period because the balance owing on the running account does not decrease, I am still unable to say that it is just and equitable that the declaration sought should be made’.

In this reasoning of the court, the court clearly used s424 (1) but s424 (1) does not include the quantum of damages in its wording. The idea which may be adopted here is the fact that the court was trying to shape what should be done when applying s424 (1). It may argued that, because the new Companies Act focuses on claim by the company itself to the directors, s424 (1) is going to be interpreted in lines of the new Companies Act because the new Companies Act does not deal with the claim of creditors. However, this is difficult for creditors as it means that the creditor should bear in mind that before instituting claim against the directors of the company, such creditor should secure an evidence of the causal link between the relevant conduct and the debts and liabilities of the company. Furthermore, the creditor should prove the quantum of damages before the court. Failure to do so will render such creditor to be liable for the costs to be incurred by it in the action.

However, the factor of the causal link has had contradctions after the decision of Saincic case. In Strut Ahead Natal v Burns the court held that the remedy is a punitive one as directors may be held personally liable for any debts or liabilities of the company without proof of any causal link between their conduct and liabilities of the company. It is indeed true that the court in Saincic endorsed the dictum in L & P Plant Hire BK en Andere v Bosch en Andere. However, Brand JA has recently explained what he meant in L & P Plant Hire. According to Brand JA what he meant was that where a company was able to pay its debts, a causal link needs to be proved but if the company is hopelessly insolvent, then no causal link

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85 Op cit 82 at para 21.
86 According to Farlam JA ‘these statements imply, at the least, that, as far as creditors are concerned, there must be some or other causal link between the fraudulent conduct and the inability to pay the debt’. Ibid
87 2007 (4) SA 600 (D) at page 609. The court did not take into account the decision of the court in Saincic case as it held that the distinction which was made in Saincic case did not make any difference to the outcome of the case. The court held that it is unnecessary to consider whether the plaintiff established fraud on the part of the defendant for the purposes of s424 (1).
needs to be proved.\textsuperscript{88} In this instance, it may be argued that where a company is hopelessly insolvent, there is no need to prove a causal link. In that case creditors are protected where the company is hopelessly insolvent as they are not required to prove causal link\textsuperscript{89}. Accordingly, the time of insolvency of the company and the relevant of the conduct of the directors is relevant as that is where it can be said that the conduct of directors towards the creditors was around the insolvency of the company.\textsuperscript{90} As for the present date, the position of Brand JA in \textit{Fourie} case remains which means that the only time when the creditor will be required to prove a causal link is where the company is able to pay its debts. One may argue that this is the situation which draws the attention of the application of the new Companies Act as it deals with circumstances where the company is able to pay its liabilities as opposed to the circumstances where the company is factual insolvent. Factual insolvent can be said to be circumstances whereby the company is hopelessly insolvent which result to the company being wound up.

\section*{4. The wording of s424 (1) of the Act}

\subsection*{4.1. When it appears}

These words, as contemplated in the Act, do not mean that the court is to decide the case on a \textit{prima facie} case, but the applicant must prove on balance of probabilities.\textsuperscript{91} Furthermore, these words should not be ‘interpreted in such a way as to exclude a single reckless or

\textsuperscript{88} \textit{Fourie v Firstrand Bank Ltd & Another} 2013 (1) SA 204 (SCA) at para 30 where Brand JA held ‘thus understood, \textit{L & P Plant Hire} finds no application in a case such as the present where the company proved to be hopelessly insolvent and was clearly unable to pay the debt which the plaintiff-creditor seeks to recover from the miscreant conductor of the company’s business in a fraudulent or reckless way, under s 424. Hence it is no authority for the proposition that in these circumstances the plaintiff-creditor is required to establish a causal link between the fraudulent or reckless conduct relied upon and the company’s inability to pay its debt. On the contrary, \textit{L & P Plant Hire} was never intended to deviate from those decisions of the courts which expressly laid down the general principle that s424 does not require proof of a causal link between the relevant conduct and the company’s inability to pay the debt’.

\textsuperscript{89} Ibid.

\textsuperscript{90} See \textit{Cheng-Li Tsung & Another v Industrial Development of South Africa Ltd & Another} [2013] ZASCA 26 at para 27 where Lewis JA held ‘it seems to me to hold more than that there must be some link or connection in time between the conduct complained of and the company’s inability to pay.

\textsuperscript{91} See R.C. Williams Op cit note 68 at 688 as he argues that ‘if the word or “or otherwise” are given full effect, then in any proceedings against the company, the plaintiff or applicant will be entitled to ask for declaration that the persons who had been party to the reckless or fraudulent carrying on of the business be declared personally liable for its debts or other liabilities if there was evidence of such fraud or recklessness, or if such evidence came to light in the course of the proceedings’. See also \textit{Joh – Air (Pty) Ltd v Rudman} 1980 (2) 420 (T) at page 426D where the court held that in terms of s424 the applicant is obliged to put evidence before court so as to enable the court to make determination and the applicant, in civil matter, has to discharge the \textit{onus of proof}.

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fraudulent transaction from the ambit of the section’.\textsuperscript{92} As a result, a single act by the director is enough to render him personally liable for debts and liabilities of the company under s424 (1). It does not matter whether the act of recklessness or fraud was committed once, by those who are responsible for carrying out the business of the company, as long as there is relevant conduct, they may be liable under s424 (1).\textsuperscript{93}

4.2. Recklessness

Recklessness is not whether the judgment of the defendant was in error, but is more of a disregard to the consequences of one’s action or conduct\textsuperscript{94}. The test for such recklessness is partly objective and partly subjective. It is partly objective ‘to the extent that the defendant’s actions are measured against the standard of reasonable man’.\textsuperscript{95} The definition of ‘recklessness’ was firstly defined by Stegmann J in \textit{Ex Parte Lebowa Development Corporation Ltd}\textsuperscript{96} as follows:

‘In s 424 the term ‘recklessly’ is used in contradistinction to the term ‘fraudulently’. In that context ‘recklessly’ implies the existence of an objective standard of care that would be observed by the reasonable man in conducting the business of the company concerned in the particular circumstances’.

The same reasoning was used by the court in \textit{Ozinsky No v Lloyd and Others}\textsuperscript{97} the court held that if a company continues to carry on business and to incur liabilities when, in the opinion of a reasonable businessman standing in the director’s shoes, there would be no reasonable prospect of the creditors receiving payment when due, it will in general be proper inference that the business is being carried recklessly. It is partly subjective ‘insofar as the defendant’s knowledge is taken to account’.\textsuperscript{98} In \textit{Strut Ahead Natal v Burns}\textsuperscript{99} the court held that the

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\textsuperscript{92} Gibson Op cit note 8 at 353.
\textsuperscript{93} In re Gerald Cooper Chemicals Ltd [1978] 2 All ER at 268.
\textsuperscript{94} In \textit{Ebrahim & Another v Airport Cold Storage (Pty) Ltd} Op cit note 17 at para 14 Cameron J held: ‘Acting “recklessly” consists in an entire failure to give consideration to the consequences of one’s actions, in other words, an attitude of reckless disregard of such consequences’. In applying the recklessness test to the running of a closed corporation, the court should have regard to amongst other things the corporation’s scope of operations, the members’ roles, functions and powers, the amount of the debts, the extent of the financial difficulties and the prospects of recovery, plus the particular circumstances of the claim ‘and the extent to which the [member] has departed from the standards of a reasonable man in regard thereto’\textsuperscript{95}
\textsuperscript{96} Cassim Op cit note 3 at 591.
\textsuperscript{97} Cassim Op cit note 4 at page 111.
\textsuperscript{98} 1992 (3) SA 396 (C) at page 414.
\textsuperscript{99} Cassim Op cit note 3 at page 591. The criticism of this is the fact that ‘the less the defendant knows and the less experience he has, the smaller the chances of finding him liable under the section’. See M.P. Larkin ‘Fraudulent and Reckless Trading: 1999 Case Law: section 424 of Act 61 of 1973 and 64 of Act 69 of 1984’ (1999) \textit{Annual Survey} 433.
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plaintiff is to prove on balance of probabilities that the defendant was knowingly a party to the carrying on of the business of the company recklessly, or with intent defraud creditors of the company.

The test has been used by most of the court, and argued by writers, when dealing with the issue of recklessness. In *M A Vleisagentskap CC & Another v Shaw Another* Davis J in his judgment held:

‘Whatever inference can legitimately be drawn from the evidence, the test remains whether a reasonable business person standing in the shoes of the defendant would run a business for a long time in circumstance where clearly there had been cash flow problems which in fact he had continued to communicate to his directors’.

This court did not make it clear of whether a reasonable man would only look at whether the business of the company would run for a long time. The issue which remained was what would happen if the business of the company looked as if it would run for a long time but suddenly drops down thereby becoming being wound up. In that instance would that mean the business of the company was not carried in a reckless manner? As a result the court in *Ebrahim and Another v Airport Cold Storage (Pty) Ltd* interpreted the recklessness test in a more vivid manner. Cameron JA endorsed that acting recklessly consists in ‘consideration to the consequences of one’s actions, in other words, an attitude of reckless disregard of such consequences’. For example, ‘a director who, despite remaining on board, fails to attend board meetings or to acquaint himself with the company’s affairs may be arguably be said to be evincing a lack of genuine concern for prosperity of the business of the company, thus personally placing himself in an enormous position should the business of the company ever

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99 Op cit note 70. The facts of the case provided that at all times the defendant had denied that he was the director of the company. Defendant had denied that he was the sole director of the company. However, the evidence showed that at all times he was the one with authority to allow any transactions by the company. At all times third parties thought they were dealing with the defendant. Accordingly, he could not escape liability under s424 (1) of the Companies Act.

100 2003 (6) SA 714 (C) at page 722.

101 Op cit note 17 at para 14. Cameron J held: ‘Acting “recklessly” consists in an entire failure to give consideration to the consequences of one’s actions, in other words, an attitude of reckless disregard of such consequences’. In applying the recklessness test to the running of a closed corporation, the court should have regard to amongst other things the corporation’s scope of operations, the members’ roles, functions and powers, the amount of the debts, the extent of the financial difficulties and the prospects of recovery, plus the particular circumstances of the claim ‘and the extent to which the [member] has departed from the standards of a reasonable man in regard thereto’. This test was also used in *S v Dhlamini* 1988 (2) SA 302 (A). See also M Havenga ‘Director’s Personal Liability for Reckless Trading’ (1998) 61 (4) *Tydskrif vir Hedendaagse Romeins-Hollandse Reg* 720.

102 Ibid
fail and an enquiry is instituted in terms of s424 (1)’. 103 In applying the recklessness test to the running of a close corporation the court should have regard to amongst other things the corporation’s scope of operations, the members’ roles, functions and powers, the amount of the debts, the extent of the financial difficulties and the prospects of recovery. 104 In this instance it is clear that where a director of the company enters to a contract, and then causes the company to be wound up while fully aware that the creditor will not receive any dividend from the insolvent estate of the company, is thus guilty of the reckless conduct of the affairs of the company, as intended in s 424(1) of the Companies Act. In McLuckie v Sullivan 105 the company’s balance sheet reflected, after tax, a loss on the company’s business. It was common cause that the company would have been wound up prior to the agreements between the defendant and the plaintiff. The defendant had failed before to carry the work due to the plaintiff. The defendant knew that the company had experienced financial difficulties and was hopelessly insolvent but nevertheless continued to take money from the plaintiff without any work being done. The court held that allowing the company to take moneys paid in terms of agreement well knowing that there is no possibility that the company can pay back amounts to reckless trading. Blieden J in his judgment held:

‘The company Dansk could only perform its obligations to the plaintiff with the financial support of the defendant. The defendant’s statement that Dansk would not comply with its written undertaking constitutes repudiation by the company of its agreed obligations to the plaintiff. By allowing Dansk to keep the moneys paid in terms of the agreement, well knowing that there was no possibility that Dansk could pay it back to the plaintiff, unless he paid it, the defendant caused it to act recklessly, as envisaged in s 424 of the Act, and as submitted by counsel for the plaintiff’. 106

Blieden J further held:

‘This case is a classic example of a party who owns all the shares and is in control of a company attempting to use its formal identity to avoid it paying a debt due by it to a creditor, where he on behalf of that company caused it to incur that debt at a time he knew it could not pay it without his financial assistance. Section 424 of the Act was passed to avoid the injustice of such conduct’ 107.

103 Naidoo Op cit note 9 at page 180.
105 2011 (1) SA 365 (GJ).
106 Ibid at page 372 at para 10.
107 Ibid at para 12.
Furthermore, in *Strut Ahead Natal v Burns* \(^{108}\) the court held that carrying on of a company recklessly means to carry on business through actions which show lack of any genuine concern of prosperity. In this instance it may be said that the test for recklessness requires that directors should act in a way that a reasonable man would have acted in the same circumstances. If a director does not act in a manner that a reasonable man would have, such director is carrying the business of the company recklessly. After all if director fails to take reasonable steps in conducting the business of the company thereby acting recklessly, he may be liable under s424 (1) for failing to take positive steps. This is the case even if the director was lazy to take reasonable steps that a reasonable person would have taken. \(^{109}\)

The recklessness requirement was further formulated by the court in *Rafletac SA (Pty) Ltd v Bell and Another* \(^{110}\) where the court held that ‘the conduct of the defendant must be weighed when considering whether they entirely failed to give consideration to the consequences of their actions and adopted ‘an attitude of reckless disregard of such consequences’. One may conclude that from the wording of the Act, it is clear that negligence on its own does not amount to recklessness but there must be a gross negligence. Arguably gross negligence, judging from this judgment, means that a person knows about negligence of his conduct but nevertheless continues with his conduct thereby causing more negligence than the original negligence he knew about. What is only required is the fact that the director knew of the conduct of recklessness while carrying the business of the company in that manner. \(^{111}\)

Another important note to be considered is that when the courts refer to a reasonable man, it is not just any other reasonable man. It is not enough to just conclude that a reasonable man would have acted differently, or in the same conduct, on the relevant circumstance. It is not enough to take any reasonable man and apply the test in the relevant circumstances. A reasonable man should have the knowledge of the relevant background circumstances or the

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\(^{108}\) Op cit note 87 at page 607.


\(^{110}\) (2012) JOL 28625 (ECG) at page 15. As a result the court held that far from recklessly incurring further with the plaintiff, every effort was made by the defendant to limit the prejudice to the plaintiff by seeking to park the existing debt and to make future purchases on a cash delivery or cash before delivery basis. Accordingly, the defendant could not be said to have conducted the business of the company recklessly, or with the intention to defraud creditors.

\(^{111}\) Ibid.
type of field in which the issue is based on. In *Fourie NO & Another v Newton*\(^{112}\) Cloete J held:

‘In evaluating the conduct of the directors, courts should not be astute to stigmatise decisions made by businessman as reckless simple because perceived entrepreneurial options did not pan out. What is required is not the application of the exact science of hindsight, but a value judgment bearing in mind what was known, or ought reasonably to have been known, by individual director at the time the decisions were made. In making that value judgment, courts can usefully be guided by the opinions of businessmen who move in the world of commerce and who are called upon to make these decisions in the performance of their functions as directors of companies, and by experts who advise businessmen in the making of such decisions or who evaluate them at the time they are made’.

Based on this argument, it may be said that the reasonable man is a person with a sound knowledge of the relevant field of practice in question. A reasonable man is a person who may have experienced or has a detailed knowledge of the conduct that should be taken in the circumstances.

However, the court went too far in concluding that experts are relevant in the circumstances. This is because it is likely to find that a person who is conducting the business of the company is still new in the field of conducting the business of the company. If we accept that his conduct must be the same as that of an expert, this may cause injustice as such person may not be aware of what an expert knows. Our company law does not preclude person who are not expert to start their own companies. Anyone can start his/her own company as long as it is registered. Therefore, when deciding the cases of recklessness, the court should have the mentality that some people are not expert in the handling of the business of the company. Accordingly, it is unfair to compare such persons to the mind of an expert as their minds are not the same and the way they think is not the same. It is enough to hold them liable on the reasonable man test with the knowledge of conducting the business of the company but not an expert. The reason is the fact that the higher the expert knows about the conducting of business the easier it is for ordinary person, with companies, to be found liable using the reasonable man test. After all, one may argue that in order to be successful, the applicant is to adduce evidence that a reasonable court can conclude ‘that when credit was incurred by a

\(^{112}\) [2010] ZASCA 150 at para 45. The court found that the defendant had conducted a business recklessly. The court was unable to find that a reasonable of the business in the position of the defendant would have foreseen, when credit was incurred, that there was a strong chance that creditors would get paid. The reason was the fact that it was indeed true that there was an overdraft but the cash flow would not shortly fluctuate to cover the debts incurred.
company, while the defendant was running the business of the company, there was evidence that such credit would not be paid’.

4.3. Intent to defraud or fraudulent purpose

The provision of s424 (1) imposes liability to anyone who had intention to defraud creditors, and such intention may be express or actual. In considering whether the business of the company has been carried on fraudulently, one is to look at the evidence in question. As per *Strut Ahead Natal v Burns* plaintiff is to prove on balance of probabilities that the defendant was knowingly a party to the carrying on of the business of the company with intent defraud creditors of the company. This principle was also used by the court in *Terblanche No & Others v Damji & Another* where the court held that the issue of whether the business was carried on with intent to defraud creditors or for fraudulent purpose involves a subjective enquiry as to the respondent’s intention in carrying on the business in the manner alleged. Fraud in its sense may be defined as ‘an unlawful and intentional making of a misrepresentation which causes actual prejudice or which is potentially prejudicial to another’. The wrongdoer must be aware that the representation will be prejudicial to another party. In this instance the wrongdoer must have no honest belief that the representation is true. In respect of the intention to defraud creditors of the company, the relevance is where a company continues to carry on with incurring debts, even though it is to the knowledge of directors that there is no reasonable prospect that creditors will receive their payment, then such inference is that the business of the company was carried with intent to defraud. In this instance *dolus eventualis* is sufficient as Knoll J in *Terblanche No & Others v Damji & Another* held the following:

‘In my view, applicants have proved on a balance of probabilities that the first respondent committed fraud in November 1999 by altering the amount payable on a cheque made out to the company. She was the perpetrator of the transaction. All the elements of fraud are present. In so doing, she dishonestly inflated the

115 Op cit note 70.
116 Op cit note 50 at page 511.
118 Ibid at 539.
120 Op cit 50 at page 511.
assets of the company. The most probable inference to be drawn is that in so acting she was carrying out the business of the company. Such business was carried out with a fraudulent purpose'.

In *Heneways Freight Services v Grogor*¹²¹ the court held that fraud is only committed if the wrongdoer had no reason to believe, at the time when the debt in question was incurred, that the funds would become available to pay the debt when due. In this case the respondent was found not to have acted with intent to defraud creditors by issuing cheques which were stopped or dishonoured almost immediately after the due dates appearing on the cheques, in order to overcome liquidity difficulties of the company. In reaching the decision Zulman JA held:

‘One needs to bear in mind that the majority of the 700 cheques issued by the company during the relevant period were met. The reality of the matter was that the company was experiencing cash-flow problems during the year in question. The respondent was aware of this and in order to keep the business of the company going he delayed, and I would add, made arrangements, with some of the company’s creditors, in order to pay more pressing debts by buying time, as it were’.¹²²

The court further held the following:

‘As already pointed out, of the approximately 700 cheques issued, the number of cheques stopped was not considerable in number or amount and was approximately only about 8% of the total number of cheques issued. Indeed it is apparent that approximately 650 out of 700 cheques were paid on the due date thereof and that, of those that were countermanded, all but the cheque handed to the appellant were met shortly after the due date of the cheque... In my view, the Court a quo was correct on the basis of the undisputed evidence that I have mentioned above, in finding that the respondent had not acted with fraudulent intent’.¹²³

Clearly the court’s reasoning in this case was about the fact that ‘where a debtor, knowing or having good grounds to suspect that he does not have and will not have sufficient asset to pay all his creditors in full, pays some but not others, or pays them in unequal portion, with the consequence that some creditor either is not paid at all or is paid a lesser proportion for his debt than others, this does not *per se* amount to carrying on business with intent to defraud creditors or for any fraudulent purpose’.¹²⁴ If the acts, in the carrying of the business of the company, were merely incidental to the dominant activity, such acts are not to be said to have been fraudulent. However, if those acts are not merely incidental but they played dominant

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¹²¹ 2007 (2) SA 558 (SCA).
¹²² Ibid at para 6.
¹²³ Ibid at para 10-11.
¹²⁴ M.S. Blackman... et al *Comentary on the Companies Act* (2002) 539.
activity in an integral part, then they may, arguably, be said to connote fraudulent purpose.\textsuperscript{125} The evaluation which can be drawn from these cases is the fact that fraudulent purpose or intention to defraud creditors is proved by an inference that is drawn and consistent with the facts of each case. If it cannot be shown that the respondent is aware of the fraud being perpetrated, then it may be difficult to impose liability. For a defendant to be liable, applicant is to show that the defendant had no honest belief that the debt would be paid at the time the debt was contracted.\textsuperscript{126} Intention to defraud ‘entails more than just foresight of the harm which may result from engaging in the conduct in question, but it requires actual dishonesty involving, according to current notions of fair trading among commercial men, real moral blame’.\textsuperscript{127} Furthermore, fraud may also be committed where one party has a duty to disclose facts. In other words, non-disclosure of facts may amount to fraud. However, in order to be able to claim under s424 (1) one is to prove that facts were material.\textsuperscript{128} In Hemphill & Another v Shone NO & Others\textsuperscript{129} plaintiff learnt about the company’s liquidation. He asked the first defendant, and the defendant denied that the company was in liquidation. The third defendant led the plaintiff to believe that the property it had purchased was available knowing that it was not available. The court held that the defendants could not escape liability under s424 (1) as they misled the plaintiff and allowed the company to contract while its business was unsound. Accordingly, they did so fraudulent with the intent to defraud plaintiff.\textsuperscript{130} Having said that the defendant may be liable for reckless and fraudulent trading under s424 (1), such defendant may also escape liability in certain circumstances. The defendant may escape liability if the inference drawn from the facts shows that carrying on of the business of the company was consistent with honest belief or intention.\textsuperscript{131} In Raficata case\textsuperscript{132} the court held that ‘the conduct of the defendant must be weighed when considering whether they

\begin{footnotesize}
\begin{enumerate}
\item Ibid at page 536.
\item F Flynn ‘A Comparative Study of Statutory Liability for Culpable Management’ (1992) 17 (2) Tydskrif vir regwetenskap 56.
\item Williams Op cit note 68 at 691. See also W. A. Joubert Op cit note 114 at page 302.
\item [2009] ZAWCHC 223.
\item Ibid at para 25.
\item Blackman op cit note 124 at page 538.
\item Op cit 110. See also Fisheries Development Corporation of SA Ltd v Jargensen & Another 1980 (4) SA 156 (T) at page 165-166 where the learned judge held that personal capacities of a director must be taken into account, although expert to perform his duties honestly, he may not be liable for mere error of judgment. Further held that defendant’s conduct is to be judged according to the carefulness that might be reasonably having been expected of someone with their knowledge.
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entirely failed to give consideration to the consequences of their actions and adopted “an attitude of reckless disregard of such consequences. The court used the word “entirely” to decide whether the defendants were recklessly. If we look at the meaning of the expression “gross negligence, as used in the Act, it can be concluded that the word “entirely” confirms that one has to fail entirely in order to conclude that there was gross negligence which results to recklessness. This is an existing law because if one is to look previous cases the courts were of the same view with the fact that one is to grossly negligence to be liable under s424 (1).133 If the debtor makes an effort to prevent prejudice against the creditor, while conducting the business of the company, such debtor is said to be acting with honest intention.134

4.4. Any person who is knowingly a party to the carrying on of the business of the company in the aforesaid manner

4.4.1. Any person

The phrase “any person” is wide enough to include natural person and juristic person. Section 19 (1) (b)135 provides that from the time the incorporation of a company is registered, the company has all the legal powers and capacity of an individual to enter into contracts. Arguably, if the corporation acts in capacity of being a person, it does not act as the corporation but it is acting as person136. As a result s424 (1) may apply against the company137. It may be, arguably, said that this is the reason why the new Companies Act138 was enacted so as to enable the company to act against its directors where they have conduct the business of the company. The new Companies Act was not enacted to abolish s424 (1) as the provisions of s424 (1) and the provisions of the new Act do not focus on the same person. Section 424 (1) focuses on persons such as creditors in which it includes natural persons. On the other hand s22 and s77 of the new Companies Act focuses on the company as juristic person which may claim against its directors. Accordingly, despite the coming into force of

133 See Philotex v JR Snyman 1998 (2) SA 138 (SCA) at page 147 where the court held that a director’s honest belief as to the prospect of payments, when due, is not itself the determinant of whether he was reckless. 134 See Raflatac SA (Pty) Ltd v Bell & Another Op cit note 100 at page 16 where the court held that every effort was made by the defendant to limit the prejudice to the plaintiff by seeking to park the existing debt and to make future purchases on a cash delivery or cash before delivery basis. In these circumstances the defendant could not be said to have acted recklessly or with the intent to defraud the creditor. 135 Op cit note 12. 136 Blackman Op cit note 124 at page 540. 137 ibid 138 Op cit note 12.
the Companies Act of 2008, s424 (1) of the Companies Act of 61 of 1973 continues to apply as both sections focus on different persons. It may be said that both the 1973 Act and the 2008 Act are mechanisms of the penalty which may be imposed against directors for fraudulent and reckless trading. In enacting the new Act, Legislature did not intend to abolish s424 (1) but the new Act was enacted to provide for remedies of the company against its directors.

4.4.2. **Knowingly**

Section 424(1)\(^{139}\) of the Act imposes penalties to anyone who knowingly and acted recklessly in running a company. Section 424 (1) of the 1973 Companies Act provides that “knowledge” or “knowingly” ‘means the knowledge of the facts from which the conclusion may properly be drawn that the business of the company was or is being fraudulently or recklessly conducted’.\(^{140}\) In *Philotex (Pty) Ltd & Others v Snyman & Others*\(^{141}\) Howie JA concluded the word “knowingly” as the following:

‘Knowingly means having knowledge of the facts from which the conclusion is properly drawn that the business of the company was or is being carried on recklessly; it does not entail knowledge of the legal consequence of those facts’.

The conclusion which can be drawn here is the fact that, in terms of s424 (1), it is not necessary to prove that a person had actual knowledge of the legal consequences of facts.

However, there has been a change in the interpretation of the word “knowingly” between the Companies Act of 1973 and Companies Act of 2008. It is indeed true that s424 (1) of the Companies Act of 1973 and s77 (3) of the Companies Act of 2008 render liable any person who was knowingly a party to the carrying on the business of the company recklessly or fraudulently, but both Acts are different in the interpretation of the word “knowingly”. As it has been said above, s424 (1) of the Companies Act of 1973 does not require that a person must have actual knowledge of the consequences. On the other hand, s1 of the Companies Act of 2008 provides that person must have actual knowledge of the matter.\(^{142}\) As a result,

\(^{139}\) Op cit note 19.

\(^{140}\) Cassim Op cit note 3 at 589.

\(^{141}\) Op cit note 17 at page 142.

\(^{142}\) Op cit note 12. Section 1 provides that ‘knowingly, when used with respect to a person, and in relation to a particular matter, means that the person either had actual knowledge of the matter; or was in position in which the person reasonably ought to have had actual knowledge; investigated the matter to an extent that would have provided the person with actual knowledge; or taken other measures which, if taken, would reasonably expected to have provided the person with actual knowledge of the matter’.
under a new Companies act ‘a person who could have acquired knowledge by the exercise of reasonable diligence will fall within the scope of s77 (3) (b) and s 214 (1) (c)’. 143

Even though the new Companies Act has come into force, the current position remains with s424 (1) when creditors are applying in court for liability of directors for reckless and fraudulent trading. The reason for this is the fact that our courts have used s424 (1), as to the word knowingly, in recent case. 144 The situation is different as to the causal link in respect of the insolvency of the company. 145 One may argue that both Acts render any person who was knowingly a party to the aforementioned conduct. Therefore, it is important to deal with the meaning of the phrase “party to” as contemplated by Acts.

### 4.4.3. Party to

The phrase “party to” is wide enough to cover a third party who participated in the carrying on the business of the company recklessly or with intent to defraud creditors. Section 424 (1) requires that the person must have been party to the carrying on of the business of the company in the aforesaid manner. In this instance s424 (1) is the same as s77 (3) and s22 (1) of the Companies Act of 2008 146 as they both require that for a person to be liable, he must have been party to the carrying on of business recklessly or fraudulently. It is important to note that a party to the carrying on of the business of the company reckless or fraudulent must have been associated with the common pursuit as everybody else who is liable, and need not to have taken positive steps. In Powertech Industries Ltd v Mayberry & Another 147 Nugent J defined “party to” as the following:

‘To be a “party” to the conduct of a company's business requires an association with it in a common pursuit. That is the ordinary meaning of the word as it is used in the statute. The meaning given to that sense of the word by The Oxford English Dictionary is 'one who takes part, participates, or is concerned in some action or affair; a participator; an accessory', conveying the idea of a person who associates with the company not in pursuit of his own ends, but in pursuit of those of the company. A “party” to the carrying on of a company's business is one who has joined with the company in a common pursuit. Generally this would include its directors and managers, all of whom are acting in common pursuit of the company's business’.

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143 Op cit note 110.
144 See Raf lateral SA (Pty) Ltd v Bell & Another Op cit note 110; McLuckie v Sullivan 2011 (1) SA 365 (GJ); Hemphill v Shone NO [2009] ZAWCHC 223.
145 Op cit note 88.
146 Section 22 prohibits conduct of reckless or fraud to the person who is party to the carrying of the person in the aforesaid manner. On the other hand, s77 (3) (b) provides that a director may be liable if he acquiesced in the carrying on of the company’s business despite knowing that it was being conducted in a manner prohibited by s22 (1).
147 1996 (2) SA 742 (W) at page 749D-F.
In *Philotex (Pty) Ltd & Others v Snyman & Others*\(^ {148}\) the court held that being party to the carrying on of the business of the company recklessly or fraudulently does not have to involve the taking of positive steps, but it is enough to support or concur in the conduct of the business. In *Triptomania Twee (Pty) Ltd & Others v Connolly & Another*\(^ {149}\) the court held that the wording of s424 (1) involves that the party must have taken part or concurred in such business practice. Therefore, it may be, arguably, said that the phrase “party to” includes that a party to the carrying on of the company’s business is the one who has joined with the company in the common pursuit as the existing parties of the company.\(^ {150}\) As a result, “a company director, though, because of his duties of utmost good faith towards the company and of exercising reasonable skill and diligence, might be liable as a party under s424 (1) for failing to take positive steps in the carrying on of the business correctly and his laziness could even constitute agreement with that conduct”\(^ {151}\). What is only needed is that the defendant is intimately involved in the company’s business. In *Firstrand Bank v Fourie & Another*\(^ {152}\) the learned judge held signature of financial statements by the auditor and/or the director of the company and/or the accountant who prepared the financial statements is a clear indication they are not just working documents but are documents which to be used by a creditor. As a result, defendant was knowingly a party to the carrying on of the business of the company recklessly and fraudulently as the defendant knew about the company’s history of being in cash flow difficulties\(^ {153}\).

4.4.4. **Debts and Other Liabilities**

Section 424 (1) requires that the company must have debts and other liabilities. In this instance, once the creditor has suffered debts or any other liability, such creditor may then use s424 (1) to claim against any party who was knowingly a party to the carrying on of the company’s business in the aforesaid manner. On the other hand, 77 (3) of the new Companies Act allows the company, in the same instances, to claim against any person who conducted the business of the company in the aforesaid manner. The situation is different where there was extinguishing of debts. Where debts of the company have been extinguished by the

\(^{148}\) Op cit note 17 at page 142. See also Blackman Op cit note 124 at page 542 as he argues that ‘a director may well be a party to the carrying on of the business of the company without positive steps provided his supine attitude can, on the facts, be interpreted as condonation of or occurrence in the conduct complained of’.

\(^{149}\) 2003 (3) SA 558 (C) at page 563.

\(^{150}\) Cooper & Others NNO v SA Mutual Life Assurance Society & Others 2001 (1) SA 967 (SCA) at para 17.


\(^{152}\) [2011] ZAGPPHC 94 at para 34.

\(^{153}\) Ibid at para 42.
creditors of the company through their agreement, s424 (1) will not be applicable and may not be invoked to render directors personally liable for non-existing debts.\textsuperscript{154} In \textit{Ex Parte De Villiers and Another NNO: In re Carbon Development (Pty) Ltd}\textsuperscript{155} Stegman J held:

‘What is aimed at by an application in terms of s424 (1) is that a person contemplated by the subsection (often a director or officer of an insolvent company and whom I shall call a wrongdoing company representative) should be declared personally responsible for... For s424 (1) to be operative at all, the company must have debts and other liabilities. If the company has no debts or liabilities, an essential requirement is missing and s424 (1) cannot provide a remedy... It seems to me obvious that s424 (1) cannot possibly function after the extinction of such debts and liabilities by the agreement of the creditors and sanction of the court’.

This court’s view can be said to be in line with the fact that the company’s insolvency is a going concern. In this instance, at the winding up of the company, creditors may agree that debts are to be extinguished. It is important to emphasize that the application of s424 (1) is executable at the winding up of the company. The problem arises as to the interpretation of the new Company’s Act. The new Companies Act does not wait for the company to be wound before it applies. As a result the problem may be in the situation whereby the creditors agree to extinguish debts but at a later stage the company continues to accrue other debts. If that is the case, then the question would be whether the company was carried on recklessly or fraudulently at the first instance or at the time after creditors have agreed to extinguish debts. The courts have not yet faced such situation, and the position may be, arguably, be said that the company will be said to have been conducted recklessly or fraudulently at the very first time.\textsuperscript{156}

The issue of insolvency is a concern in the Companies Act of 2008. Section 22 (1) (b) of the 2008 Act adds another prohibited business trading known trading under insolvent circumstances. This section prohibits directors to trade on insolvent circumstances.\textsuperscript{157} In this instance it may said that the new Companies Act specifically prohibits the trading of the company under insolvent status. Section 22(2), as Cassim argues, ‘is aimed at deterring

\begin{footnotesize}
\textsuperscript{155} Op cit note 57 at 107-108.
\textsuperscript{156} See \textit{In re Gerald Cooper Chemicals Ltd [1978] 2 All ER 49} at 268 as the court held that ‘it does not matter that only one creditor was defrauded, and by one transaction, provided that the transaction can be properly be described as a fraud on a creditor perpetrated in the course of carrying on of business’.
\textsuperscript{157} Section 22 (2) provides that ‘if the commission has reasonable grounds to believe that the company is engaging in conduct prohibited by subsection 1, or is unable to pay its debts as they become due and payable in the normal course of business, the Commission may issue a notice to the company to show why the company should be permitted to continue carrying on its business, or to trade, as the case may be’.
\end{footnotesize}
companies from trading or carrying on business while commercially insolvent. In this sense, the directors of the company are prohibited from incurring debts and liabilities of the company irresponsible while the company is nearly insolvent. Insolvency in respect of s22 (1) (b) has two folds namely factual insolvency and commercial insolven. The question is how to do decide whether the company is commercially insolvent or factually insolvent. The splitting of insolvency in this manner has been dealt with by academics and courts. Cassim says that factual insolvency is the one where company’s liabilities exceed its assets while commercial insolvency ‘relates to liquidity or the company’s ability to pay its debts as they become due in the ordinary course of business’. In Exparte De Villiers NNO: In re Carbon Developments (Pty) Ltd the court approved that the test for a company’s insolvency is not whether company’s liabilities exceed its assets, but whether it is able to pay its debts. However, it may be argued that the court in this was referring to the commercially insolvency as Cassim argues that factual insolvency does require that for a company to be factually insolvent its liabilities must exceed its assets. In respect of factual insolvency it may then be, arguably, said that s424 (1) plays essential part because factual insolvency may clearly arise at the winding up of the company. In the recent case of Absa Bank Ltd v Erf 1252 Marine Drive (Pty) Ltd the court held that actual insolvency is a powerful indicator that the company is unable to pay its debts and evidence of failure of the company to pay, on demand, its debts when due, is a prima facie proof that the company is factually insolvent. Accordingly, it is not an issue to prove factually insolven and the application of s424 (1) of the Companies Act. Issue arises as to commercially insolvency as contemplated by new Companies Act.

Even though the test of insolvency is so important and crucial but our courts have had different opinions as to the interpretation of it. In the recent case of Nedbank Ltd v Zonnekus Mansions (Pty) Ltd the court held that commercially insolvency pertains to illiquidity and encompasses two elements namely available funds and readily realisable assets. This was the confirmation of the reasoning of the court in Absa Bank Ltd v Erf 1252 Marine Drive (Pty)

158 Cassim Op cit note 3 at 592.
159 Ibid
161 Op cit note 60.
162 Op cit note 3 at 591-2.
where the court held that it is not necessary that for the applicant, who proceeds for winding up of the company, to show that the company is actually insolvent, but the applicant is to prove to the satisfaction of the court that the company is unable to pay its debts. In this case the court was using the interpretation of the 1973 Companies Act rather than the 2008 Companies Act. However, it may not be said that the court should have used the 2008 Companies Act simple because of the fact that the 2008 companies Act focuses on the claim by the company. Therefore, even if the courts are using the 2008 Companies Act in relation to insolvency, they will refer back to 1973 Companies Act because it is the one which focuses on creditors of the company. Accordingly, it is relevant to use the decisions which have been decided before the enactment of the Companies Act of 2008 when one is dealing with the claim by creditors.

It is indeed true that insolvency has been so crucial in our courts, but they have had different opinions as to the interpretation of it in relation to the risk which is imposed to the creditors. The courts have concluded differently as to whether the imposing of risk to the creditors amounts to reckless or fraudulent trading. In *Nel & Others NNO v McArthur & Others* the court held that as long as the conduct in question involves a risk that will not receive their payment, it can be regarded as reckless trading. However, in *Heneways Freight Services v Grogor* the court held that the mere fact that defendant puts the creditors at risk does not mean that he acted negligently. When the company is technically solvent, the enquiry remains as to whether the directors genuinely believe that the company will be able to pay its debt. The court which has articulated this in a logical detail is the case of *Fourie NO & Another v Newton* where Cloete J held:

‘A question whether the company is unable to pay its debts when they fall due is always a question of fact to be decided as a matter of commercially reality in the light of all the circumstances of the case, and not merely by looking at the accountants and making mechanical comparison of assets and liabilities. The situation must be viewed as it would be by someone operating in a practical business environment. This requires a consideration of the company’s financial condition in its entirety, including the nature and the circumstances of its activities, its assets and liabilities and the nature of them; cash on hand, monies procurable within a relatively short time, relative that is to the nature and demand of the debts and to the circumstances of the

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165 Op cit 152 at page 24.
166 Op cit note 80.
167 Op cit note 121 at para 12.
168 Ibid
company including the nature of its business, by the sale of assets, or by way of loan mortgage or pledge of asset, or by raising capital'.

The court clearly tried to overcome the situation of disagreements as to the risk that can be imposed to the creditors by the debtor. Here, it may be argued that it does not matter to look at the risk, but one must look at practical business environment. In this sense, factors such as the liabilities of the company; the financial condition of the company; and whether money can be recoverable when due to creditors. In this sense the court may look at whether the debtor has failed entirely to communicate with the creditor as to its financial position and the raising of monies to the company. If this is the case, it may be argued that the company was trading under insolvent circumstance which is prohibited by the Companies Act. Furthermore, the reasoning of the court requires that the scrutiny of company’s business must have been insolvent as opposed to the mere comparison of assets and liabilities of the company. The assets and liabilities must be compared to the conduct of someone who is the same business as the debtor. In that sense it may be, arguably, said that the reasonableness id applied in circumstances where there is argument that the business of the company was conducted under insolvent status of the business.

5. **A critique of both s424 (1) of the Companies Act of 1973 and s22 and s77 (3) of the Companies Act of 2008**

The purpose of s424 (1) is a good remedy and has been applied by the courts. Courts are prepared to use this section as a remedy available for creditors. This section protects creditor as it provides that where directors have carried the business of the company in a reckless or fraudulent manner, they are personally liable to the creditors. Despite the coming to force of the Companies Act of 2008, which has its own sections pertaining reckless and fraudulent trading, this section continues to apply. The section is clear as to who is creditor; when a person was reckless or fraudulent in trading; and when he was knowingly a party to the carrying of the business in the aforementioned conduct. This section is ‘not intended to create a joint and several liability between the company and those responsible for the reckless

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170 See Powertech Industries v Mayberry Op cit note 136 where the directors of the company had known of the insolvency of the company but continued to trade in its name and court held that in light of those facts they acted recklessly. See also Roflatac SA (Pty) Ltd v Bell & Another Op cit note 100 at page 16 where every effort was made by the defendant to limit the prejudice to the plaintiff by seeking to park the existing debt and to make future purchases on a cash delivery or cash before delivery basis and the court not found the defendant to have acted recklessly in relation to insolvency.
conduct of its business, but rather to protect creditors against the prejudice they might suffer as a result of the business of the company being carried on in that way.\textsuperscript{171} However, the problem about this section, as opposed to the provision of s22 of the Companies Act of 2008, is that s424 (1) is aimed at the winding up of the company. In other words s424 (1) is only applicable at the time when the company is being wound up. In this instance, the court looks at the factual insolvency of the company. The issue about s424 (1) is around the issue of commercial insolvency. In recent case courts have used s424 (1) while dealing with commercial insolvency. On this circumstance, we should then ask ourselves whether the courts are trying to shape what is going to happen in future.

The case which illustrate the idea that courts are trying to adopt the style of using the new Companies Act, while dealing with s424 (1) of the old Companies Act, is the case of \textit{Fourie v Firstrand Bank Ltd}\textsuperscript{172}. What happened in this in this case is that Firstrand instituted an action against Fourie, under s424 (1), for payment of debts owed by the company on the basis that Fourie and Du Preez were severally and jointly liable. This case is important as it makes directors aware for the personal liability for damages in terms of section 77 and section 22 of the Companies Act 2008 even though the case was dealing with s424 (1) of companies act of 1973. According to Brand JA a causal link needs to be proved where a company is able to pay its debts, but if the company is hopelessly insolvent no causal link needs to be proved\textsuperscript{173}. If this reasoning is interpreted correctly, it may be, arguably, said that the court was referring to commercial insolvency when it concluded that causal link is to be proved if the company is able to pay its debts. The reason for this is the fact that if the company is hopelessly insolvent it may be indeed wound up immediately. As a result s424 (1) is applicable without hesitation.

However, as to commercially insolvency of the company s22 (2) applies as it prohibits the conducting of the company if company is unable to pay its debts as they become due. In this instance, the company need not to reach the stage where it is wound up before it is prohibited to trade under insolvent circumstances, but even if it is still trading it may be prohibited from continuing to do so unless it shown that it may be able to continue trading. On these argument, one may draw an inference that when courts are dealing with the company under s424 (1) they do visit the provision of s22 (2) because they ask whether the company was

\textsuperscript{171} Subramanien Op cit note 15 at page 181
\textsuperscript{172} Op cit note 88.
\textsuperscript{173} Ibid.
unable to pay its debts, when they are due, if they want to see that the directors were reckless or fraudulent in conducting the business of the company.

In recent cases the courts are looking at the time to decide whether the directors were conducting the business of the company recklessly or fraudulently. In this instance it may be said that time refers to whether the company was trading under commercial insolvency as this will be relevant in deciding whether the directors are liable. The reason for this is the fact that time may not be an issue if s424 (1) is applied at the winding up of the company because that will be the relevant time which is self-evidentiary that the company is insolvent and that is why it is wound up. The time referred to in Cheng-Li Tsung case is the time which may be, arguably, said to refer to commercially insolvency of the company. However, even in this case of Cheng-Li Tsung the court was dealing with s424 (1) but introduced this reasoning of time and its necessity in deciding whether the directors are liable under s424 (1). In Fourie case the court looked at the fact that Fourie had contended that the company was financially sound, whereas Pienaar testified that, if he knew that the financial statements provided by Supreme Car misrepresented its financial position in that its business was in fact not profitable nor financially sound, he would not have recommended an increase in the floor-plan credit facility as and when he did. Arguably, it can be said that the court looked at the commercial insolvency of the company as it took these arguments and held that Fourie was personally liable for the debts of the company. As for the present date, the position of time necessity is relevant as creditor will be required to prove a causal link whether the company is able to pay its debts if the creditor is applying under s424 (1). Even though s424 (1) does not deal with commercial insolvency, seemingly our courts are prepared to question the existence of commercially insolvency when dealing with s424 (1).

Furthermore, the case of Fourie introduces the fact that directors may also be liable for damages even when s424 (1) was used to decide whether directors were liable for reckless and fraudulent trading. In his judgment Brand JA used “But for” test to decide that Fourie was personally liable. In reaching decision Brand JA held the following:

‘The ‘but for’ or causa sine qua non test, which is the accepted yardstick for determining factual causation, requires a hypothetical enquiry as to what probably would have happened, but for the wrongful conduct of the defendant...In my view, but for this series of misrepresentations, the total facility of R13 million would not have been granted. Thus understood, Supreme Car’s indebtedness at the time of the termination of the floor

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174 See Cheng-Li Tsung & Another v Industrial Development of South Africa Ltd & Another Op cit note 90.
plan agreement was directly caused by Fourie's misrepresentations...In this light I do not agree with the court a quo's finding that the delictual element of factual causation had not been established by FirstRand. This leads me to three further conclusions: Firstly, Fourie is liable, not only in terms of s 424, but also in delict for the agreed amount of damages claimed by FirstRand; and secondly, the second respondent, as executor in the deceased estate of Du Preez, is also liable, jointly and severally with Fourie, for these damages; Thirdly, the cross-appeal should be upheld with costs, including the costs of two counsel.

When one is reading this judgment closely, it can be, arguably, said that s77 of the Companies Act of 2008 is introduced. Section 424 does not deal with damages as a remedy, only the new Companies act has introduced this type of remedy. Therefore, it can be said that this case is introducing the interpretation of s424 (1) using the provision of s77 of the new Companies Act. Accordingly, the court is trying to shape what may happen in future. The reasoning of the court is essential here because even though s424 (1) is still existing, but it does not include the provisions contained in the new Companies Act of 2008. Furthermore, the submission is that there is a logic here s424 (1) and s22 and 77 of the Companies Act deal with different kinds of people. It is going to be easy for creditors under s424 (1) to claim for damages using s424 (1) since it is the section which protects creditors. It seems s424 (1) is going to be interpreted beyond its specific provisions. However, this does not mean that it is going to be abolished because it is the core remedy to the creditors since the new Companies Act is focusing on the remedies to be provided to the company itself. It is indeed true that both the Companies Act of 1973 and 2008 have the similar meaning as to the prohibition of reckless and fraudulent trading, but they do apply to remedy similar persons. Accordingly, if s424 (1) is going to be abolished, that may create problem since creditors will not have provisions to use to claim for reckless and fraudulent trading by the directors.

6. Conclusion

This dissertation has looked at the liability of directors where a company engages in a fraudulent or reckless trading. The conclusion which can be drawn from this research paper is that the directors of the company must be aware of their conduct and should ensure that they conduct the affairs of the company in an honest and lawful manner. Section 424 (1) and s22 read with s77 are there to impose personal liability on all directors who carry on the business.

of the company recklessly, or fraudulently, or with intent to defraud creditors of the company. These sections provide useful remedies particularly to the creditors of the company and the company itself. Section 424 is a useful provision which protects creditors from any reckless or fraudulent trading by the directors of the company. On the other hand, s22 and s77 (3) (b) are useful provisions as they provide for protection of the company from any reckless and fraudulent trading by the directors of the company.

Courts are using s424 (1) to benefit the creditors at the winding up of the company where the Commission uses s22 to determine whether or not the company is trading under insolvent circumstances. Furthermore, the courts are applying s 424 in line with s77 read with s22 of the new Companies Act to find the relevant provision that may benefit the company or creditors of the company. Accordingly, the position makes it clear that the directors should be aware of liability that may arise against them when they conduct the business of the company recklessly or fraudulently. As a result directors, while trading in the course and scope of the company’s business, should be aware of the provisions of the s424 (1) and s22 and s77 (3) (b) as far as personal liability is concerned.
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