

A critical analysis of the piercing of the corporate veil in South African corporate law, with special reference to the position in groups of companies

by

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I certify that the whole research paper, unless specifically indicated to the contrary in the text, is my own work. It is submitted as part of research component in partial fulfilment for the degree of Masters in Business Law (LLMBL) in the School of Law, University of KwaZulu-Natal, 2016.

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Abstract

Companies in South Africa have a separate legal existence and this gives shareholders limited liability. If a company cannot pay its debts, creditors will generally have no recourse against shareholders or directors in respect of those debts. The real problem arises if the separate personality of the company has been abused by shareholders and/or directors. The remedy of piercing the corporate veil was a common law remedy used by courts in an attempt to remedy the abuse of the corporate personality by directors and shareholders of the company. It became a statutory remedy in relation to companies when it was codified in the Companies Act 2008. Section 20(9) of the Companies Act 2008 does not give any guidance as to the conduct which constitutes ‘unconscionable abuse’ and leaves it open for interpretation by court. The potential for abuse may be increased by the creation of company groups.

This dissertation seeks to analyse and examine the statutory piercing of the corporate veil with the objective of providing a guideline to interpreting the meaning of ‘unconscionable abuse’ in the general context and then in the context of groups of companies. This research assesses whether piercing of the corporate veil protects creditors and investors in cases where corporate identity is abused, especially in the context of company groups. There is the hope that the research becomes a potent tool in providing creditors with guidelines and insight into determining ‘unconscionable abuse’ generally and then with respect to company groups, especially where letters of comfort have been involved. Finally, this research will give insight on the possible future of the piercing of the corporate veil as a remedy.

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I dedicate this work to my parents: Paul and Mercy Mashiri. I also dedicate it to my siblings Tinashe, Kudakwashe, Panashe, Simbarashe and Faith Mashiri. I thank the Lord for such abundant blessings.

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CHAPTER 1: INTRODUCTION

In South African company law, shareholders of companies enjoy limited liability because a company is regarded as a separate legal entity that exists on its own as a juristic person.¹ In this respect a company is regarded as having a corporate identity upon its incorporation.² This means that a company is liable for its own debts and shareholders are not normally liable.³

However, the courts and the legislature have recognised that the corporate identity of a company has the potential to be abused by shareholders and/or directors.⁴ An example of this abuse is when a company is used as an ‘alter ego’.⁵ This occurs where the company conducts the business of the controlling members and does not carry on its own business or affairs.⁶ The company, in this case, is merely an avenue for the controlling members to carry on their own personal business.⁷ This results in the abuse of the separateness of the company.⁸ Another example of the abuse of the separate legal existence of a company is the use of a company to commit fraud.⁹ The case of *Cape Pacific v Lubner Controlling Investments Limited*¹⁰ is an example of the piercing of the corporate veil where there was fraud.¹¹ In these instances, the shareholders and/or directors would have conducted the affairs of the company for their own personal gain or benefit and then

¹ *Dadoo v Krugersdorp Municipality* 1920 AD 530 550. The concept of the separate legal existence of a company came from the English case of *Salomon v Salomon* [1897] AC 22 (HL) 30.

² Section 14 (1) of the Companies Act 2008.

³ *Salomon v Salomon* [1897] AC 22 (HL) 30.

⁴ *Amlin (SA) Pty Limited v Van Kooij* 2008 (2) SA 558 (C) para 22.

⁵ *Wallersteiner v Moir* [1974] 3 All ER 217 (CA).

⁶ *ibid* 238.

⁷ *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168 234.

⁸ *ibid* 196.

⁹ This may occur when shareholders incorporate a limited liability company that does not have enough capital to operate efficiently. The shareholders can cause the company to incur huge debts in its own name, with little or no hope of being able to meet these debts. When the creditors pursue payment, the shareholders and/or directors argue that they are not liable for the debt because the company is the debtor and is a separate legal person. See V Khanna ‘To Strictly Maintain the Salomon Principle or Not: That is the question?’ 2 available at http://www.privatelawtutor.co.uk/pdf/salomon_principle.pdf accessed on 03 February 2015.

¹⁰ *Cape Pacific v Lubner Controlling Investments Limited* 1995 (4) SA 790 (A).

¹¹ *ibid* 800.

they may want to hide behind the corporate veil as the company incurs the liabilities that arise as a result of the transaction made in its name.¹²

The problem is that the company as a separate legal entity may not be able to pay those debts and normally shareholders are not liable for the debts of the company.¹³ The other problem is that if a company is liquidated either as a result of the abuse of the separate legal existence or poor management, the consequences of liquidation are borne by the creditors and not the wrongdoers, that is, shareholders and/or directors.¹⁴ However, there is a way to impose liability on the shareholders and/or directors. As stated in *Lategan and Another NNO v Boyes and Another*,¹⁵ this can be done through the courts which may grant an order to pierce the corporate veil upon application by the aggrieved party.¹⁶ The remedy of piercing the corporate veil allows a disgruntled party to get an order from the court which will treat the rights and liabilities of the company as those of the shareholders and or directors.¹⁷

‘Piercing the corporate veil is a common law remedy’ and it was relied on by the plaintiff in the case of *Hulse Ruetter v Godde*.¹⁸ The Companies Act of 1973 contained provisions that allowed courts to hold the controllers personally liable for debts of the company in certain circumstances, but these provisions did not directly give courts discretion to pierce the corporate veil.¹⁹ Some of these provisions include section 50(3),²⁰ section 66,²¹ section 172(5)b,²² section 280(5),²³ section

¹² *Dadoo* (note 1 above; 548).

¹³ *Cape Pacific* (note 10 above; 814).

¹⁴ D J Baker et al ‘Corporate Governance of Troubled Companies and the Role of Restructuring Counsel’ 2008 63(3) *The Business Lawyer* 855 873 available at <http://www.jstor.org/stable/pdfplus/40688514.pdf?acceptTC=true> accessed on 03 February 2015.

¹⁵ *Lategan and Another NNO v Boyes and Another* 1980 (4) SA 191 (T).

¹⁶ *ibid* 201.

¹⁷ *Atlas Maritime Co SA v Avalon Maritime Ltd* [1991] 4 All SA 769 (CA) 779.

¹⁸ D Subramanien “‘Unconscionable abuse’ - section 20(9) of the Companies Act 71 of 2008 Ex Parte Gore NNO 2013 (3) SA 382 (WCC): cases’ (2014) 35(1) *Obiter* 150 150 available at http://reference.sabinet.co.za/webx/access/electronic_journals/obiter/obiter_v35_n1_a11.pdf accessed on 3 March 2015.

¹⁹ R Cassim *Contemporary Company Law* 2 ed Cape Town Juta (2013) 63. Cassim states that being held personally liable for loss, costs or damages incurred by the company was a form of piercing of the corporate veil under the Companies Act 1973.

²⁰ Section 50(3) provides that if a director, officer or any person on the company’s behalf issues or signs a bill of exchange, a promissory note, a cheque or an order for money or for goods on behalf of the company (or authorises the issue or signing of such a document) in which the registered name of the company is not cited in the correct manner, it will amount to an offence. That person will be personally liable to the holder of that bill of exchange, promissory note, cheque or order for the amount thereof, unless it is duly paid by the company.

344(h)²⁴ and section 424(1).²⁵ The remedy was initially codified within the corporate laws of South Africa, in section 65 of the Close Corporations Act 69 of 1984 (hereafter the Close Corporations Act 1984).²⁶ This remedy which allowed for piercing of the corporate veil in instances where there has been ‘gross abuse’ of the separate corporate form.....applied only to close corporations. the Companies Act 71 of 2008 (hereafter the Companies Act 2008) which repealed most of the 1973 Companies Act introduced a new statutory veil piercing remedy in section 20(9) which seems to echo the approach adopted in the Close Corporations Act.²⁷ In essence, section 20(9) of the Companies Act 2008 gives the courts the discretion to pierce the corporate veil when the activity by the company amounts to ‘unconscionable abuse’.²⁸

Although the section makes provision for a valuable remedy which would be available to creditors and investors, unfortunately it does not seem to give any guidance as to the conduct which constitutes ‘unconscionable abuse’ and leaves it open for interpretation by court. The laymen or creditors in the commercial arena do not know what may constitute ‘unconscionable

²¹ Section 66 provides that where a public company carries on business for more than six months while it has less than seven members, every person who is a member of the company during the time that it carries on business after those six months shall be personally liable for the payment of the debts of the company incurred during that time.

²² Section 172(5)b provides that until a certificate is issued permitting the company to commence business any debts or liabilities incurred prior to receipt of the certificate is the joint and several liability of the directors and the members of the company.

²³ Section 280(5) provides that if the directors of a Company fail to appoint an auditor to fulfil a vacancy after the receipt of written notice to do so by the Registrar the directors and the company shall be held jointly and severally liable for any debts incurred by the company during the existence of the vacancy.

²⁴ Section 344(h) provides that a company may be wound up by the Court if it appears to the Court that it is just and equitable to do so. The actual state of affairs between the members may be looked at in determining whether the circumstances justify the winding up.

²⁵ Section 424(1) of the Companies Act 1973.

²⁶ The section provides that, ‘Whenever a Court on application by an interested person, or in any proceedings in which a corporation is involved, finds that the incorporation of, or any act by or on behalf of, or any use of, that corporation, constitutes a gross abuse of the juristic personality of the corporation as a separate entity, the Court may declare that the corporation is to be deemed not to be a juristic person in respect of such rights, obligations or liabilities of the corporation, or of such member or members thereof, or of such other person or persons, as are specified in the declaration, and the Court may give such further order or orders as it may deem fit in order to give effect to such declaration.’

²⁷ Section 20(9) of the Companies Act 2008. The section provides that, ‘If, on application by an interested person or in any proceedings in which a company is involved, a court finds that the incorporation of the company, any use of the company, or any act by or on behalf of the company, constitutes an unconscionable abuse of the juristic personality of the company as a separate entity, the court may – (a) declare that the company is to be deemed not to be a juristic person in respect of any right, obligation or liability of the company or of a shareholder of the company or, in the case of a non- profit company, a member of the company, or of another person specified in the declaration; and (b) make any further order the court considers appropriate to give effect to a declaration contemplated in paragraph (a).’

²⁸ Section 20(9) of the Companies Act 2008.

abuse' in terms of section 20(9) of the Companies Act 2008 and the circumstances in which the court are likely to pierce the corporate veil. There is the need for the laymen (creditors and/or investors) to understand the difference between 'unconscionable abuse',²⁹ 'gross abuse'³⁰ and the test that was formulated in the case of *Botha v Van Niekerk*,³¹ which is 'unconscionable injustice' whilst applying the common law remedy of piercing the corporate veil.³² Just as there is the potential for the abuse of the separate legal personality in the context of one company there is the possibility of similar abuse in the context of a group of companies.³³

As stated in the case of *Airport Cold Storage (Pty) Limited v Ebrahim and Others*,³⁴ companies are recognised by law as juristic persons and each company within a group of companies has a separate legal existence.³⁵ Each company can be sued in its own capacity to the exclusion of all other companies in the group; and the courts have normally not treated groups an entity.³⁶ The parent company as a shareholder in the subsidiary is not normally liable for any debts of the subsidiary.³⁷ The problem is that there is a temptation to use the corporate structure of the subsidiary to evade obligations of the parent and to manipulate the credit of the subsidiary to support transactions which may not benefit investors and/or creditors of the subsidiary.³⁸ There is also the problem that the group of companies can protect the assets of one part of the business from claims arising from the activities of the other part of the business (that is, entity shielding).³⁹ Furthermore, as stated in the case of *Van Zyl v Kaye*,⁴⁰ the parent company may exercise excessive control over the subsidiary such that the subsidiary would not be able to

²⁹ *ibid.*

³⁰ The term used in section 65 of the Close Corporations Act of 1984.

³¹ *Botha v Van Niekerk* 1983 (3) SA 513 (W).

³² *ibid* 515.

³³ R Cassim 'Hiding Behind the Veil' (2013) *De Rebus* 34 35.

³⁴ *Airport Cold Storage (Pty) Limited v Ebrahim and Others* 2008 (2) SA 303.

³⁵ *ibid* para 15.

³⁶ H W Ballantine 'Separate Entity of Parent and Subsidiary Corporations' (1925) *California L R* 14(1) 12 13 available at <http://www.jstor.org/stable/3475351> accessed on 17 July 2014.

³⁷ *Airport Cold Storage* (note 34 above; para 15).

³⁸ A Berle 'Subsidiary Corporations and Credit Manipulation' (1927-1928) *Harv L Rev* 41 874 892 available at http://www.heinonline.org/HOL/Page?handle=hein.journals/hlr41&div=57&collection=journals&set_as_cursor=0&men_tab=srchrresults&terms=SUBSIDIARY|C|P|ATIONS|CREDIT&type=matchall accessed on 2 August 2014.

³⁹ E Ferran *Principles of Corporate Finance Law* 2011 26.

⁴⁰ *Van Zyl v Kaye* 2014(4) SA 452.

operate as an independent entity.⁴¹ In such a case the creditors might not understand whether the group of companies is a single unit or whether it consists of a number of separate legal entities.

In addition to the above, there is the problem of the use of letters of comfort that are frequently used in the context of groups of companies.⁴² These letters are used in a situation where the subsidiary borrows money from a lender and the parent company issues a letter of comfort to the lender, instead of issuing a letter of guarantee or signing as surety for the debt.⁴³ The legal status of letters of comfort is uncertain.⁴⁴ Normally, they do not create legally enforceable obligations.⁴⁵ However, the letters of comfort continue to be in use because they are convenient to the parent company in the sense that they require less formalities than guarantees and on the balance sheet of the parent company, the letter of comfort will not create a potential liability.⁴⁶ In as much as the letters of comfort are convenient, there is the possibility that parent companies may abuse letters of comfort and also manipulate the credit of the subsidiary to support transactions which may not benefit investors and/or creditors of the subsidiary.⁴⁷ In the event that the subsidiary is not able to pay the debts, the shareholder will not be liable for those debts.⁴⁸ In the light of these problems, the research will also look at groups of companies and what constitutes ‘unconscionable abuse’ in the context of groups of companies.

⁴¹ *ibid* para 33.

⁴² L Schulz ‘Letters of Comfort: where do we stand?’ (2013) *Australian Banking and Finance Law Bulletin* 34 34 available at <http://www.minterellison.com/publications/Letters-of-comfort/> accessed on 19 March 2014. In the banking and finance context, a letter of comfort typically takes the form of a letter issued by a parent company or other related party (issuer) of a borrower to the borrower’s lender. The intention of the issuer is to provide some form of “comfort” to the lender in relation to the obligations of the borrower under its loan agreement.

⁴³ R Stevens ‘Circumventing Veil Piercing: Possible Delictual Liability of A Holding Company to a Creditor of its Insolvent Subsidiary’ (2013) 24(1) *STELL LR* 93 99 available at http://reference.sabinet.co.za/webx/access/electronic_journals/ju_slr/ju_slr_v24_n1_a5.pdf accessed on 17 March 2014.

⁴⁴ L Schulz (note 48 above).

⁴⁵ G A Wittuhn ‘Kleinwort Benson Limited v. Malaysian Mining Corporation Berhad -- A Comparative Note on Comfort Letters’ (1990) 35 *McGill Law Journal* 490 492 available at http://www.heinonline.org/HOL/Page?handle=hein.journals/mcgil35&div=31&collection=journals&set_as_cursor=0&men_tab=srchresults&terms=kleinwort|benson|limited|v.|malaysian|mining|corporation|berhad|a|comparative|note|on|comfort|letters|georg|a.|wittuhn*&type=matchall accessed on 18 September 2014.

⁴⁶ L Thai ‘Comfort letters — a fresh look?’ (2006) 17 *Journal of Banking and Finance Law and Practice* 15 16 available at http://www.researchgate.net/publication/228283209_Comfort_Letters__A_Fresh_Look accessed on 28 July 2014.

⁴⁷ A Berle (note 38 above).

⁴⁸ *Airport Cold Storage* (note 34 above; para 15).

The dissertation will include a comparison of the use of the remedy in the United Kingdom, and Australia for the purposes of supporting arguments or discussions and also to be guided by the approach of the jurisdictions where possible. These jurisdictions will be compared with the South African common law approach of piercing of the corporate veil. These jurisdictions may also give a guideline of how groups of companies and the use of letters of comfort can be dealt with. These jurisdictions have been chosen because the legal systems of these jurisdictions originated from Roman law, which is one of the laws from which the South African legal system originated from.⁴⁹

Therefore, the research serves to put creditors and investors on their guard since the corporate identity of a company has the potential of being abused. The dissertation is conducted in consideration of creditors and/or third parties dealing with groups of companies. These personas need to be aware of the potential problems that are associated with groups of companies and also to be aware that there is the statutory remedy contained in section 20(9) at their disposal. The dissertation provides creditors with knowledge on circumstances in which the statutory remedy could be used.

This research will take a corporate legal point of view and this will be done by analysing the law and legal processes surrounding the remedy of piercing of the corporate veil. The study will be a desktop literature research which will involve the use of primary and secondary sources. The primary sources include statute and case law. The secondary sources will be journals and articles.

This dissertation is structured as follows. This introductory chapter has set the scene for the research. The chapter also gave an outline of the rationale for the study, the purpose, significance and goals of the research.

Chapter 2 will consider the remedy of piercing of the corporate veil, starting with its development from common law to statute. The chapter will set out the statutory remedy of the

⁴⁹ B Lenel 'The History of South African Law and its Roman-Dutch Roots' 2002 1 7 available at <http://www.africanafican.com/folder11/world%20history5/black%20history/history-of-sa-law-en.pdf> accessed on 20 May 2014.

piercing of the veil starting with the Close Corporations Act of 1984. There will also be a brief discussion of provisions in the Companies Act 61 of 1973 which allowed for wrongdoers to be held personally liable for loss, costs or damages incurred by the company as a result of their wrongdoing.

Chapter 3 will explore the statutory remedy of piercing of the corporate veil contained in section 20(9) of the Companies Act 71 of 2008. The term ‘unconscionable abuse’, which is found in section 20(9) of the Companies Act 2008, will be analysed. The chapter will focus on what courts in South Africa may consider to be ‘unconscionable abuse’. The chapter will refer to foreign jurisdictions to help develop arguments and where it is possible to be guided by their approach in respect of the use of the remedy of piercing of the corporate veil.

Chapter 4 will highlight the nature of groups of companies and issue of ‘unconscionable abuse’ in that context. The chapter will briefly explore the use of letters of comfort by company groups and the potential abuse thereof. There will be a discussion on how creditors are affected by such letters of comfort and the uncertainty surrounding them. The issue of ‘unconscionable abuse’ in the context of letters of comfort will also be considered.

Chapter 5 will close by summing up the findings of the entire dissertation. The comparison in the preceding chapters will also allow for a discussion of how a change in approach might impact on effectiveness of the remedy. The chapter will include a recommendation on the possible future of piercing as a remedy. The dissertation concludes that statutory piercing is a viable and may be an effective remedy in the context of company groups where the corporate identity has been abused to the detriment of investors and/ or creditors.

CHAPTER 2: PIERCING OF THE CORPORATE VEIL IN SOUTH AFRICA

2.1 Introduction

The remedy of ‘piercing of the corporate veil is a common law remedy’⁵⁰ that has been developed in South Africa and has become a statutory remedy. This chapter discusses the development of the common law remedy and its subsequent codification in South African Company law. Provisions in the Companies Act of 1973 which allowed courts to impose personal liability on wrongdoers are discussed in this chapter. The sections include section 50(3), section 66, section 172(5)b, section 280(5), section 344(h) and section 424(1). There is also a deliberation on the statutory remedy of the piercing of the veil found in the Close Corporations Act of 1984. The chapter briefly refers to the position of the United Kingdom and Australia with respect to the use of the remedy of piercing of the corporate veil. Reference is made to these jurisdictions because the legal systems of these jurisdictions originated from Roman law, which is one of the laws from which the South African legal system originated from.⁵¹

2.2 Development and codification of the common law remedy

2.2.1 The corporate veil

Before discussing the common law remedy it is important to first examine the nature of a company which creates what is metaphorically described as a ‘veil’ for the controllers. The veil allows controllers to be exempted from liability for debts of the company.⁵²

⁵⁰ *Ex parte Gore* (note 21 above; para 2). See also A Karapanço and I Karapanço ‘The Piercing of the Corporate Veil Doctrine: A Comparative Approach to the Piercing of the Corporate Veil in European Union and Albania’ 2013 2(9) 153 154 available at <http://www.mcser.org/journal/index.php/ajis/article/view/829/860> accessed on 15 May 2015.

⁵¹ B Lenel (note 55 above).

⁵² *Airport Cold Storage* (note 34 above; para 15).

It is a well-established principle in company law that once incorporated, a company is a separate legal entity.⁵³ Its assets and liabilities are its own.⁵⁴ This means that a company is a legal person which can acquire rights and incur obligations.⁵⁵ Therefore, as a practical consequence of incorporation, the company can sue to enforce its rights and it can be sued in its own name as it incurs liabilities. This means that when a company is sued by an aggrieved party for performance or by its creditors for money it owes, it is the company that incurs liability for the performance or the debt. The shareholders are not normally liable for the company's debts.⁵⁶ The reason for this is that the corporate veil protects shareholders and directors from claims against the company by exempting them from liability for debts of the company.⁵⁷ Furthermore, the shareholders have limited liability in the sense that if and when a company is liquidated, they only lose their claim to the return of their contribution to the share capital.⁵⁸ Even when the company has incurred millions in liabilities, the shareholders cannot be held liable for those liabilities.⁵⁹

2.2.2 Piercing of the corporate veil under common law

As mentioned above, a company has a separate legal existence. There is the potential that this separate legal existence may be abused by shareholders and/or directors,⁶⁰ thus, the need for holding shareholders, directors and officers of the company liable for obligations and activities that appear to be those of the company and piercing of the corporate veil in certain circumstances.⁶¹ This normally occurs when an aggrieved party or creditor suffers harm as a result of the abuse of the corporate structure by an insider (shareholder or director) and it is suggested that the aggrieved party may apply to court for the corporate veil of the company to be pierced in an effort to hold the insider liable for the debt of the company.⁶² The remedy is based on the rule that a corporation should not be formed for the purposes of committing fraud.⁶³ In

⁵³ *Salomon* (note 3 above). See also Section 14 (1) of the Companies Act 2008.

⁵⁴ *Salomon* (note 3 above).

⁵⁵ *ibid.*

⁵⁶ *Airport Cold Storage* (note 34 above; para 6).

⁵⁷ *Salomon* (note 3 above; 52).

⁵⁸ *Salomon* (note 3 above; 52).

⁵⁹ Section 19(2) of the Companies Act 2008.

⁶⁰ *Amlin (SA) Pty Limited v Van Kooij* 2008 (2) SA 558 (C) para 22.

⁶¹ *Cape Pacific* (note 10 above; 802).

⁶² Section 20(9) of the Companies Act 2008.

⁶³ *Lazarus Estates Ltd v Beasley* [1956] 1 QB 702 712.

this respect, the corporate identity of a company will be disregarded when the corporation is used as an instrument to commit fraud, to justify wrong or to defend crime.⁶⁴ Therefore, the remedy was developed as a means of addressing injustices resulting from the abuse of the corporate identity of the company which is to the detriment of creditors and other third parties.⁶⁵

The remedy of piercing the corporate veil allows a disgruntled party to obtain an order from the court which will treat the rights and liabilities of the company as those of the shareholders.⁶⁶ The common law remedy allows for the courts to treat the people behind the company, that is, the shareholders and/or directors ‘as if they were conducting the business affairs of the company in their own personal capacities.’⁶⁷ However, under common law, courts were reluctant to pierce the corporate veil.

In *Dadoo (pty) Limited v Krugersdorp Municipal Council*,⁶⁸ the court held that a company is a separate person from its shareholders and the court refused to pierce the corporate veil.⁶⁹ The court in the case of *Botha v Van Niekerk*⁷⁰ held that it could not arrive at a finding of personal liability (by first respondent) because there was no conviction that the applicant had suffered an unconscionable injustice, and that as a consequence of something which, to right-minded persons, was clearly improper conduct on the part of first respondent.⁷¹ Domanski argues that the court in the *Botha* case could have been justified in piercing the corporate veil to hold the first respondent liable for the contractual obligations of the second respondent. The abovementioned cases show the reluctance of the courts to pierce the corporate veil under common law.

In the case of *Hulse-Ruetter v Godde*,⁷² an application was initially made in terms of section 424 of the Companies Act 1973. However, this case involved a foreign company and not a company within the meaning of the Companies Act 1973. Therefore, reliance was made on the common

⁶⁴ *Ex parte Gore* (note 21 above; para 28).

⁶⁵ *Airport Cold Storage* (note 34 above; para 19).

⁶⁶ *Atlas Maritime* (note 17 above; 779).

⁶⁷ *Airport Cold Storage* (note 34 above; para 20).

⁶⁸ *Dadoo* (note 1 above; 575).

⁶⁹ *Ibid* 574.

⁷⁰ *Botha* (note 31 above).

⁷¹ *Botha* (note 31 above; 515).

⁷² *Hulse-Reutter and Others v Gödde* 2001 (4) SA 1336 (SCA).

law remedy of piercing the corporate veil.⁷³ The court, in this case, stressed that ‘there must be some misuse or abuse of the corporate structure resulting in an unfair advantage being given to those who control the corporate entity.’⁷⁴ The above was stated obiter since the court did not pierce the corporate veil because the respondents failed to prove the misuse or abuse of the corporate structure.⁷⁵ The case shows the reluctance of the courts to pierce the corporate veil.

Sher states that the courts have failed to formulate a single coherent principle on which to base decisions made by courts to pierce the corporate veil.⁷⁶ The courts appear to have relied on a number of categories of conduct to justify their decisions.⁷⁷ Domanski refers to this approach as the ‘categorising approach’.⁷⁸ The dominant categories of conduct included fraud, improper conduct, evasion of legal obligations and abuse of the separate legal existence of a company. Domanski includes the use of a company by a shareholder as an agent as a category.⁷⁹

The remedy has been criticised for being ‘incoherent and unprincipled’ in its application.⁸⁰ This is evident in the application of the remedy in a number of cases. In *Orkin Brothers Ltd v Bell*⁸¹ the court pierced the corporate veil and held the directors liable for the debts that appeared to be those of the company.⁸² The directors had allowed the company to buy goods on credit, whilst

⁷³ *ibid* para 5.

⁷⁴ *ibid* para 20.

⁷⁵ *ibid* para 21 and 24.

⁷⁶ H Sher, *Piercing the Corporate Veil*, (1994) 4 Part 2 JBL 51 51 available at <http://heinonline.org/HOL/LandingPage?handle=hein.journals/jutbusil4&div=22&id=&page=> accessed on 15 August 2014.

⁷⁷ A Domanski ‘Piercing The Corporate Veil - A New Direction’ (1986) 103(2) *SALJ* 224 224 available at http://www.heinonline.org/HOL/Page?handle=hein.journals/soaf103&div=36&collection=journals&set_as_cursor=16&men_tab=srchresults&terms=Piercing/The|Corporate|Veil|A|New|Direction%E2%80%99&type=matchall accessed on 19 August 2014.

⁷⁸ A Domanski ‘Piercing The Corporate Veil - A New Direction’ (1986) 103(2) *SALJ* 224 224 available at http://www.heinonline.org/HOL/Page?handle=hein.journals/soaf103&div=36&collection=journals&set_as_cursor=16&men_tab=srchresults&terms=Piercing/The|Corporate|Veil|A|New|Direction%E2%80%99&type=matchall accessed on 19 August 2014.

⁷⁹ A Domanski ‘Piercing The Corporate Veil - A New Direction’ (1986) 103(2) *SALJ* 224 224 available at http://www.heinonline.org/HOL/Page?handle=hein.journals/soaf103&div=36&collection=journals&set_as_cursor=16&men_tab=srchresults&terms=Piercing/The|Corporate|Veil|A|New|Direction%E2%80%99&type=matchall accessed on 19 August 2014.

⁸⁰ F H Easterbrook and D R Fischel ‘Limited Liability and the Corporation’ *The University of Chicago L R* (1985) 52(1) 89 89 available at <http://www.jstor.org/stable/1599572> accessed on 28 November 2014. See also *Ex parte Gore* (note 21 above; para 19).

⁸¹ *Orkin Brothers Ltd v Bell* 1921 TPD 92.

⁸² *Ibid* 107.

they had knowledge that the company would not be able to repay the debt.⁸³ This had amounted to fraud.⁸⁴ Loux J in *Lategan v Boyes*,⁸⁵ stated that ‘fraud is the essential requirement for piercing the corporate veil and that a fraud committed by the company need always be present before the courts can pierce the veil’.⁸⁶ Blackman commented on this dictum stating that the court in the *Lategan* case had no intention to put down such a strict fraud requirement since there was no fraudulent conduct found within the facts.⁸⁷ One can argue that fraud may be considered by court to be improper conduct, but it is not a requirement for piercing the corporate veil. The importance of the *Lategan* case is that it shows how much the courts relied on categories of conduct for the purposes of piercing the corporate veil.

A different test was then applied in *Botha v van Niekerk*,⁸⁸ the court held that ‘there could be personal liability if it could be proved that the applicant had suffered an ‘unconscionable injustice’ as a result of what a reasonable person would identify to be improper conduct on the part of the respondent’.⁸⁹ Domanski states that the decision was harsh on the seller and he goes further to highlight that the first respondent failed to comply with the obligations of the contract in time and exercised the right to appoint a nominee at a late stage. He submitted that these factors show that the first respondent may have had the intention to evade contractual obligations. The ‘unconscionable injustice’ test formulated in this case was obiter since the court did not pierce the corporate veil based on this test.

In *Shipping Corporation of India Ltd v Evdomon Corporation*⁹⁰ Corbett CJ held that ‘the separate personality of the company and the members is of supreme significance and that deviation from this rule should only occur in exceptional cases, especially where fraud and improper conduct are present’.⁹¹ The court in *Cape Pacific v Lubner Controlling Investments*

⁸³ Ibid 99.

⁸⁴ Ibid 107.

⁸⁵ *Lategan* (note 15 above).

⁸⁶ Ibid 202.

⁸⁷ M S Blackman *Commentary on the Companies Act (2002) Volume 1* Juta and Co. 4-141.

⁸⁸ *Botha* (note 31 above).

⁸⁹ Ibid 525.

⁹⁰ *Shipping Corporation of India Ltd v Evdomon Corporation* 1994 (1) SA 550 (A).

⁹¹ Ibid 566.

(Pty) Ltd⁹² stated that ‘the test of ‘unconscionable injustice’ was too rigid and that a more flexible test was required, that is, a test that made it necessary for the courts to look at the facts of each case’.⁹³ In *Hulse-Reutter & Others v Godde*⁹⁴ the court held that there should be improper or fraudulent conduct which results in an unfair advantage being afforded to the ones controlling the company.⁹⁵ The above cases applied different tests in deciding whether the corporate veil should be pierced and it shows how incoherent and unprincipled the application of the remedy was in terms of common law. One can argue that approach in *Cape Pacific v Lubner Controlling Investments (Pty) Ltd*⁹⁶ allows for flexibility in the application of the remedy and reduces the possibility of having the controllers of companies take advantage of loopholes that may be created by a rigid test or according to Domanski,⁹⁷ the categorising approach.

In relation to the categorising approach, on one hand, Domanski highlighted the flaws of the approach since it was described as a means of deciding whether or not to pierce the corporate veil.⁹⁸ Domanski states that there would be facts which require consideration on fairness, public policy or equity, but the courts would not be able to categorise the particular issue into one of the defined categories.⁹⁹ Eventually the courts would not be able to pierce the corporate veil causing injustice. On the other hand, Gallagher and Zeigler also argue that these categories can be summed up into one test, which is, the prevention of injustice which may be caused by the abuse of the corporate form of an entity.¹⁰⁰ They also commented that, it appears that, the courts are willing to pierce the corporate veil where justice would be achieved by doing so.¹⁰¹ It appears

⁹² *Cape Pacific* (note 10 above).

⁹³ *ibid* 803.

⁹⁴ *Hulse-Reutter* (note 72 above).

⁹⁵ *ibid* para 20.

⁹⁶ *Cape Pacific* (note 10 above).

⁹⁷ A Domanski ‘Piercing The Corporate Veil - A New Direction’ (1986) 103(2) *SALJ* 224 224 available at http://www.heinonline.org/HOL/Page?handle=hein.journals/soaf103&div=36&collection=journals&set_as_cursor=16&men_tab=srchresults&terms=Piercing/The|Corporate/Veil|A|New|Direction%E2%80%99&type=matchall accessed on 19 August 2014.

⁹⁸ *Ibid* 225.

⁹⁹ A Domanski ‘Piercing The Corporate Veil - A New Direction’ (1986) 103(2) *SALJ* 224 230 available at http://www.heinonline.org/HOL/Page?handle=hein.journals/soaf103&div=36&collection=journals&set_as_cursor=16&men_tab=srchresults&terms=Piercing/The|Corporate/Veil|A|New|Direction%E2%80%99&type=matchall accessed on 19 August 2014.

¹⁰⁰ L Gallagher and P Ziegler ‘Lifting the Corporate Veil in the Pursuit of justice’ 1990 *The Journal of Business Law* 292 300.

¹⁰¹ L Gallagher and P Ziegler ‘Lifting the Corporate Veil in the Pursuit of justice’ 1990 *The Journal of Business Law* 292 313.

that the incoherence still existed despite Gallagher and Zeigler's effort of summing up the categories into a test of the prevention of injustice. It is argued that a much more flexible approach was still required and it would be one which takes into account the facts of each case.

One may support the view of the court in *Cape Pacific (Pty) Ltd v Lubner Controlling*¹⁰² because it allows for a flexible approach; one which does not allow for potential wrongdoers to take advantage of possible loopholes that may be created by rigid approaches. It may further be submitted that if the courts look at the conduct of the wrongdoer, circumstances in which the courts may pierce the corporate veil may become wider. The result of the conduct may be the one that normally leads to litigation and it may also help to determine unconscionability of the conduct of the wrongdoer.¹⁰³ However, if the courts focus on the result of the conduct only, it may not be sufficient to justify application of the remedy. One may argue that both may be essential because unconscionable conduct may, in most instances, cause harm to the plaintiff. It may further be argued that such an approach has the potential to widen the ambit of circumstances in which the court may pierce the corporate veil. One may submit that if such an approach is taken, the result would protect the interests of creditors in the end.

However, some guidelines have been provided in the case of *Cape Pacific (Pty) Ltd v Lubner Controlling (Pty) Ltd*.¹⁰⁴ The Appellate Division in this case gave general principles in relation to the instances in which the corporate veil can be pierced under common law. The court stated that each case should be decided upon its facts¹⁰⁵ and the court should consider substance rather than form.¹⁰⁶ The 'unconscionable injustice' test which was formulated in *Botha v Van Niekerk en 'n Ander*,¹⁰⁷ was described by Smalberger JA as perhaps too rigid a test.¹⁰⁸ The approach of this court to the doctrine of piercing of the corporate veil can be applauded because each case brings a different set of facts. One can even agree with court in the *Cape Pacific case* in relation to the test of 'unconscionable injustice' which indeed may be rigid since it focuses on the result of the

¹⁰³ *Ex parte Gore* (note 21 above; para 34).

¹⁰⁴ *ibid.*

¹⁰⁵ *Cape Pacific* (note 10 above; 805)

¹⁰⁶ *ibid* 803.

¹⁰⁷ *Botha* (note 31 above).

¹⁰⁸ *Cape Pacific* (note 10 above; 805).

conduct. The conduct may not necessarily result in ‘unconscionable injustice’ and yet the conduct itself is unconscionable.¹⁰⁹ The requirement of ‘unconscionable abuse’ in terms of section 20(9) of the Companies Act of 2008 will be discussed in the chapter that follows.

The court in *Cape Pacific (Pty) Ltd v Lubner Controlling (Pty) Ltd*¹¹⁰ further stated that a court has no general discretion simply to pierce the corporate veil whenever it regards it as just to do so.¹¹¹ Smalberger JA stated that fraud, dishonesty or improper conduct could provide grounds for piercing the corporate veil.¹¹² The court also emphasised that courts should make efforts to uphold a company’s separate legal personality.¹¹³ In as much as the court does not have general discretion to pierce the corporate veil under common law, it appears to have been the case so far that fraud, dishonesty and/or improper conduct have been present in cases where the corporate veil has been pierced.¹¹⁴ It should, however, be noted that fraud is not a requirement for courts to pierce the corporate veil.¹¹⁵ Furthermore, there was no guideline as to what constitutes improper conduct in relation to the application of the common law remedy of piercing the corporate veil. This was left to the courts to grapple with.

The court further stated that if a company is established and operated legitimately, but is later on misused in a particular instance to perpetrate a fraud, or for a dishonest or improper purpose, the court may pierce the corporate veil in relation to the transaction in question while giving full effect to it in other respects.¹¹⁶ The fact that a company was established for a legitimate purpose did not and does not preclude the courts from piercing the corporate veil when it is right to pierce the corporate veil in the event that the corporate structure of the company is abused.¹¹⁷

¹⁰⁹ *Cape Pacific* (note 10 above; 822).

¹¹⁰ *Cape Pacific* (note 10 above;).

¹¹¹ *ibid* 803.

¹¹² *ibid* 804.

¹¹³ *ibid* 803.

¹¹⁴ *Shipping Corporation of India Ltd v Evdomon Corporation* (note 90 above). See also *Hulse-Reutter* (note 72 above).

¹¹⁵ A Domanski ‘Piercing The Corporate Veil - A New Direction’ (1986) 103(2) *SALJ* 224 230 available at http://www.heinonline.org/HOL/Page?handle=hein.journals/soaf103&div=36&collection=journals&set_as_cursor=16&men_tab=srchresults&terms=Piercing/The|Corporate/Veil|A|New|Direction%E2%80%99&type=matchall accessed on 19 August 2014.

¹¹⁶ *ibid* 804.

¹¹⁷ *ibid* 805.

It was further stated by the court that the corporate veil may be pierced even if another remedy exists.¹¹⁸ It should also be noted that the existence of an alternative remedy does not stop one from applying for the courts to pierce the corporate veil and that also does not stop courts from piercing the corporate veil. If a number of remedies are available, it seems plausible for a plaintiff to have the liberty to apply the remedy of their choice.

According to Cassim, the abovementioned principles can be a useful guide for courts when dealing with cases that require the application of the common law remedy.¹¹⁹ Moreover, the court in the *Cape Pacific case* appears to have observed the need for a much more flexible approach for the courts to pierce the corporate veil. One can argue in support of Cassim and further argue that the abovementioned principles may also work as a guide in the application of the new statutory remedy of piercing the corporate veil which will be discussed in the next chapter.

There is also the need to discuss the application of the ‘sham’ and ‘mere façade’ principle when piercing the corporate veil in terms of common law in South Africa. The ‘sham’ principle has not really been applied in South Africa. The principle has been discussed in case law and the presiding officers have based the discussions mostly on English and Australian authorities. For example, in *Lategan the Gilford case* was used to discuss the sham principle. In the *Cape Pacific case*, the first and second respondents were held not to be the sham, mask or alter ego of Lubner. Nevertheless, in *Ex parte Gore*, Binns-Ward J stated in obiter that the evidence of the King Brothers’ disregard of the separate legal existence of the companies in King Group could have led the court to conclude that the group was actually a sham.¹²⁰ In the South African jurisdiction, the sham principle seems to be described as mere disregard of the separate legal existence of a company by the controllers. The principle can be discussed further based on the English case of *Prest v Petrodel Resources Ltd*.¹²¹

¹¹⁸ *ibid.*

¹¹⁹ R Cassim (note 19 above; 48-49).

¹²⁰ *Ex parte Gore NO* (note 21; para 15).

¹²¹ *Prest* (note 18 above).

The English court in *Prest v Petrodel Resources Ltd*,¹²² differentiated between a ‘mere façade’ and ‘sham’ in terms of common law with regards to piercing of the corporate veil.¹²³ It was stated that while the word ‘façade’ connotes concealment, ‘sham’ connotes evasion.¹²⁴ The court held that concealment is when a company is incorporated with the intention to hide the identity of the person who is actually conducting business.¹²⁵ On the other hand, evasion was held to be a circumstance where a company is incorporated with the intention to prevent the enforcement of a legal right against the controller of the company.¹²⁶

The majority of the court, in *Prest v Petrodel Resources Ltd*,¹²⁷ stated obiter that concealment does not call for the application of the remedy of piercing of the corporate veil.¹²⁸ The courts in this jurisdiction would only be looking behind the company to reveal the identity of the one actually conducting business or the facts which the corporate structure is concealing.¹²⁹ Mandaraka-Sheppard states that Staughton LJ equated the exercise of discovering what is concealed behind the veil with ‘lifting the corporate veil to peep behind it’.¹³⁰ However, it appears that the distinction between piercing and lifting of the corporate veil seems unnecessary since it comes to the same result of rendering the wrongdoer personally liable. If the matter was held in a South African court, both evasion and concealment may have warranted the piercing of the corporate veil since it brings out the same result which is holding the wrongdoer personally liable.

On the other hand, the majority of the court in *Prest*¹³¹ stated obiter that the remedy is applicable to cases where there is evasion.¹³² In relation to the evasion principle, Heintzman and Kain state that parties should not profit from their misconduct and courts should interpret statute so as to

¹²² *Prest* (note 18 above).

¹²³ *Prest* (note 18 above; para 28).

¹²⁴ *Prest* (note 18 above; para 28).

¹²⁵ *ibid* para 28.

¹²⁶ *ibid* para 28.

¹²⁷ *Prest* (note 18 above).

¹²⁸ *ibid* para 61.

¹²⁹ *ibid* para 61.

¹³⁰ A Mandaraka-Sheppard (note 115 above; 11).

¹³¹ *Prest* (note 18 above;).

¹³² *ibid* para 61.

suppress mischief.¹³³ However, it seems as though the approach of piercing the corporate veil in instances of evasion and not instances of concealment restricts the operation of the remedy to limited circumstances. It may further be submitted that the approach may be inflexible and may not be sufficient to address the issue of the abuse of the corporate personality of companies. One may argue in support of Lady Hale when she stated that:

‘...what the cases (concealment and evasion) do have in common is that the separate legal personality is being disregarded in order to obtain a remedy against someone other than the company in respect of a liability which would otherwise be that of the company alone’.

There is, therefore, no need to distinguish between lifting and piercing because it brings the same result even if it is a case of concealment or evasion.

The Australian courts may pierce the corporate veil when a company is used as a ‘sham or mere façade’.¹³⁴ The corporate veil has also been pierced in cases where the corporate form is used as a ‘sham’.¹³⁵ However, the corporate veil would not be pierced because of an unfair result that may occur from separate legal personality.¹³⁶ The South African court in *Cape Pacific (Pty) Ltd v Lubner Controlling (Pty) Ltd*¹³⁷ seems to have supported the notion that the corporate veil would not be pierced because of an unfair result that occurs from the abuse of the corporate form since the court rejected the ‘unconscionable injustice’ test that was applied in the case of *Botha v van Niekerk*.¹³⁸ It was held to be too rigid.¹³⁹ Although there are guidelines from the *Cape Pacific*

¹³³ T Heintzman and B Kain ‘Through the Looking Glass: Recent Developments in Piercing of the Corporate Veil’ (2013) 28 *Banking and Finance L R* 525 538 available at http://www.mccarthy.ca/pubs/Through_the_Looking_Glass_Recent_Developments_in_Piercing_the_Corporate_Veil.pdf accessed on 30 January 2015.

¹³⁴ *Qintex Australia Finance Ltd v Schroders Australia Ltd* (1990) 3 ACSR 267. See also J Kluver, ‘Entity vs Enterprise Liability: Issues for Australia’ (2005) 37 *Conn L Rev* 765 766 available at http://www.heinonline.org/HOL/Page?handle=hein.journals/contr37&div=29&collection=journals&set_as_cursor=5&men_tab=srchresults&terms=Legal/Issues/Involving/Corporate/Groups%E2%80%99&type=matchall accessed on 4 August 2014.

¹³⁵ *Official Assignee v 15 Insoll Avenue Ltd* [2001] 2 NZLR 492 para 42.

¹³⁶ *Bentley Poultry Farm Ltd v Canterbury Poultry Farmers’ Co-operative Ltd* (No.2) (1989) 4 NZCLC 64, 780.

¹³⁷ *Cape Pacific* (note 10 above).

¹³⁸ *Botha* (note 31 above).

case, the remedy under common law is regarded as an exceptional procedure, and a remedy of last resort.¹⁴⁰ There is a need to provide compelling reasons for the court to pierce the corporate veil under common law.¹⁴¹ The need to provide compelling reasons may be seen to be necessary because it may work as a measure to avoid having frivolous actions brought before the courts. However, one may argue that such a requirement may give the plaintiff a heavy burden of proof when attempting to obtain an order to pierce the corporate veil.

From the above discussion it has been established that the courts were more reluctant to pierce the corporate veil under common law. The application of the remedy was criticised for being incoherent and unprincipled. It has also been established that the tests propounded in *Lategan* and in *Botha* were both obiter since the corporate veil was not pierced in both cases. That means the tests are not binding and do not add much value to the application of the remedy. The *Lategan* case is of importance because it shows the meagreness of the categorising approach and most of the cases highlighted above show the inconsistency of the courts in the application of the common law remedy of piercing the corporate veil.

The common law remedy has been discussed highlighting the application of the remedy in foreign jurisdictions. The reason for this comparison is to determine whether it is possible to derive guidelines as to the approach to be taken when the remedy of the piercing of the corporate veil is applied for by the applicant. The guidelines may assist courts in the application of the remedy of piercing the corporate veil and also in reaching a judgement especially in cases where the new statutory remedy is applied. Recommendations may be moulded around the approaches of these foreign jurisdictions.

¹³⁹ *Cape Pacific* (note 10 above 805).

¹⁴⁰ *Amlin* (note 4 above; para 23).

¹⁴¹ *Airport Cold Storage* (note 34 above; para 21).

2.2.3 Piercing of the corporate veil under the Companies Act 1973 in South Africa

The Companies Act of 1973 contained provisions that allowed courts to hold the controllers personally liable for debts of the company in certain circumstances.¹⁴² Being held personally liable for loss, costs or damages incurred by the company was a form of piercing of the corporate veil under the Companies Act 1973.¹⁴³ Some of these provisions include section 50(3),¹⁴⁴ section 66,¹⁴⁵ section 172(5)b,¹⁴⁶ section 280(5),¹⁴⁷ section 344(h)¹⁴⁸ and section 424(1).¹⁴⁹ However, for the purposes of this dissertation section 424(1) will be discussed because the provision is couched in such a way that it prevents those in control of a company from using its corporate identity to incur obligations in a reckless, grossly negligent or fraudulent manner whilst benefiting from immunity from liability for debts. This is more or less the same case with piercing of the corporate veil under common law, save for the fact that the provision is limited to fraud and reckless management of a company's affairs.

Creditors and other plaintiffs relied on section 424 to hold shareholders and/or directors personally liable, especially in cases where the creditor did not have a cause of action against the

¹⁴² However, unlike section 20(9) of the Companies Act of 2008, these provisions did not directly give courts the discretion to pierce the corporate veil.

¹⁴³ R Cassim (note 19 above; 63).

¹⁴⁴ Section 50(3) provides that if a director, officer or any person on the company's behalf issues or signs a bill of exchange, a promissory note, a cheque or an order for money or for goods on behalf of the company (or authorises the issue or signing of such a document) in which the registered name of the company is not cited in the correct manner, it will amount to an offence. That person will be personally liable to the holder of that bill of exchange, promissory note, cheque or order for the amount thereof, unless it is duly paid by the company.

¹⁴⁵ Section 66 provides that where a public company carries on business for more than six months while it has less than seven members, every person who is a member of the company during the time that it carries on business after those six months shall be personally liable for the payment of the debts of the company incurred during that time.

¹⁴⁶ Section 172(5)b provides that until a certificate is issued permitting the company to commence business any debts or liabilities incurred prior to receipt of the certificate is the joint and several liability of the directors and the members of the company.

¹⁴⁷ Section 280(5) provides that if the directors of a Company fail to appoint an auditor to fulfil a vacancy after the receipt of written notice to do so by the Registrar the directors and the company shall be held jointly and severally liable for any debts incurred by the company during the existence of the vacancy.

¹⁴⁸ Section 344(h) provides that a company may be wound up by the Court if it appears to the Court that it is just and equitable to do so. The actual state of affairs between the members may be looked at in determining whether the circumstances justify the winding up.

¹⁴⁹ Section 424(1) of the Companies Act 1973.

shareholder(s) or directors due to the operation of the separate legal personality principle derived from the *Salomon* case.¹⁵⁰ Section 424 provides as follows:

‘the Court may declare that any person who knowingly took part in the carrying on of the business of the company recklessly or with intent to defraud creditors of the company or creditors of any other person or for any fraudulent purpose personally responsible for the debts or other liabilities of the company’.¹⁵¹

According to Henochsberg, the provision empowers the court to declare a respondent personally liable for debts and liabilities of the company.¹⁵² Section 424(1) applies when mismanagement of the company affairs goes beyond incompetence and becomes gross or dishonest.¹⁵³ When there is proof of such gross and dishonest handling of the company’s affairs, the courts would disregard the separate legal existence of the company.¹⁵⁴

Section 424 of the Companies Act 1973 was not limited to directors of the company but applied to “any person”, including a shareholder of the company, provided that the shareholder was knowingly a party to the reckless or fraudulent activity.¹⁵⁵ The word ‘knowingly’ was discussed in the case of *Philotex (Pty) Ltd v Snyman and Others*.¹⁵⁶ The court stated that:

“the word “knowingly” means having knowledge of the facts from which the conclusion is properly to be drawn that the business of the company was or is being carried on recklessly; it does not entail knowledge of the legal consequences of those facts. It follows that ‘knowingly’ does not necessarily mean consciousness of recklessness. Being a party to the conduct of the company’s business does not have to involve the taking of

¹⁵⁰ *Salomon* (note 3 above).

¹⁵¹ Section 424(1) of the Companies Act 1973. See also S M Luiz ‘Company Law (including close corporations)’ *Annual Report of South African Law 2007* 149 187 available at http://reference.sabinet.co.za/webx/access/electronic_journals/ju_assal/ju_assal_2007_a8.pdf accessed on 20 January 2015.

¹⁵² P A Delpont ... et al *Henochsberg on the Companies Act 71 of 2008* 2ed Butterworths: Lexis Nexis, (2011) 46[4].

¹⁵³ *ibid.*

¹⁵⁴ *ibid.*

¹⁵⁵ Section 424(1) of the Companies Act 1973.

¹⁵⁶ *Philotex (Pty) Ltd and Others v J R Snyman and Others* 1998 2 SA 138 (SCA).

positive steps in the carrying on of the business; it may be enough to support or concur in the conduct of the business.”¹⁵⁷

The provision seems to be broad in respect to the persons that can be held personally liable for the debts of the company. It, therefore, goes beyond directors and shareholders because it applies when ‘any person’ who knowingly took part in the reckless or fraudulent activity of the company. An example of an outsider who may be held personally liable for the debts of the company may be that of one who participates in insider trading which may cause both the company and other creditors to suffer loss. However, the usefulness of such a broad approach may be difficult to fuse into the new statutory remedy since it would deal specifically with the prevention of insiders from abusing the corporate form of a company.

The requirement of ‘recklessness’ was also considered in this case as implying something more than mere negligence, at the very least, gross negligence.¹⁵⁸ An example of recklessness is found in *Ozinsky NO v Lloyd*¹⁵⁹ where Van Deventer J stated that “If a company continues to carry on business and to incur debts when, in the opinion of reasonable businessmen, standing in the shoes of the directors, there would be no reasonable prospect of the creditors receiving payment when due, it will in general be a proper inference that the business is being carried on recklessly”.¹⁶⁰ In *Fourie v Newton*¹⁶¹ the Court stated that ‘[a]cting ‘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’.¹⁶²

It appears the reasonable man test is used to determine whether one acted recklessly in terms of s424 of the Companies Act 1973. In *Fourie v Newton*¹⁶³ the Court stated that

¹⁵⁷ *ibid* 144.

¹⁵⁸ *ibid*.

¹⁵⁹ *Ozinsky NO v Lloyd* 1992 (3) SA 396 (C).

¹⁶⁰ *Ibid* 414.

¹⁶¹ *Fourie v Newton* 2011 (2) All SA 265 (SCA).

¹⁶² *Ibid* para 29.

¹⁶³ *Fourie v Newton* (note 161 above)

“[t]he test for recklessness has both objective and subjective elements. It is objective, to the extent that the defendant's actions are measured against the standard of conduct of a notional reasonable person. The test is subjective, to the extent that it must be postulated that the notional person belongs to the same group or class as the defendant, moving in the same sphere and having the same knowledge or means of knowledge. In the context of s 424, the court should have regard, amongst other things, to the scope of operations of the company, the role, functions and powers of the directors, the amount of the debts, the extent of the company’s financial difficulties and the prospects, if any, of recovery”.¹⁶⁴

The reasonable man test appears to be useful in determining whether one was reckless and this reasonable man test may be useful in determining whether there is ‘unconscionable abuse’ of the corporate form of a company when there is the application of section 20(9) of the Companies Act of 2008.

There seems to have been an improvement from the common law remedy, especially in cases involving fraud and recklessness in that there was some certainty in the application of s424 of the Companies Act of 1973 than in piercing of the corporate veil in terms of common law. If common law was to apply in a case where there was recklessness, other conventional remedies would have been used. An example of such a remedy is payment of damages and compensation by the defendant, which may not necessarily restore the aggrieved party to their original position.

Despite the existence of these provisions and their successful use in certain cases,¹⁶⁵ section 424 deals specifically with fraudulent and reckless conducting of business. If the court was faced with a case where there is mere disregard of the separate legal existence of a company without the involvement of fraud or recklessness, the provision could possibly have not applied and the court would have had to rely on common law which was still incoherent and unprincipled in its application. Since the provision was limited to recklessness and fraud, it seems there was still the need for a more generalised remedy which would allow courts to pierce the corporate veil when the circumstances justified it. There was need for a more generalised remedy which was not

¹⁶⁴ Ibid para28.

¹⁶⁵ *Strut Ahead Natal (Pty) Ltd v Burns* 2007 (4) SA 600 (D)

specific to fraud or recklessness, but one which addressed the issue of the abuse of the separate legal existence of a company. It is possible that in a case where there is recklessness and s 20(9) of the Companies Act of 2008 applies, the reasonable man test may apply to assist the courts in coming to a decision to pierce the corporate veil.

It should be noted that the Companies Act of 2008 repealed and replaced the Companies Act 61 of 1973.¹⁶⁶ However, section 424(1) of the Companies Act 1973 still applies to the winding-up and liquidation of companies unless it is in conflict with a provision(s) of the Companies Act of 2008.¹⁶⁷ When there is such a conflict between provisions of the previous Companies Act¹⁶⁸ and the current Companies Act¹⁶⁹, the provisions of the current Companies Act will prevail.¹⁷⁰ The new statutory remedy will be discussed in the chapter that follows.

2.2.4 Piercing of the corporate veil under the Close Corporations Act 1984

At common law, ‘piercing the corporate veil is regarded as a drastic remedy that must be resorted to sparingly and as a last resort in circumstances where justice will not otherwise be done’.¹⁷¹ In 1984 the common law remedy of piercing the corporate veil was codified with respect to close corporations. The remedy is contained in section 65 of the Close Corporations Act of 1984 which provides that:

‘Whenever a Court on application by an interested person, or in any proceedings in which a corporation is involved, finds that the incorporation of, or any act by or on behalf of, or any use of, that corporation, constitutes a gross abuse of the juristic personality of the corporation as a separate entity, the Court may declare that the corporation is to be deemed not to be a juristic person in respect of such rights, obligations or liabilities of the

¹⁶⁶ Preamble of the Companies Act of 2008. See also S M Luiz ‘Company Law (including close corporations)’ *Annual Report of South African Law* 2008 144 144 available at http://reference.sabinet.co.za/webx/access/electronic_journals/ju_assal/ju_assal_2008_a8.pdf accessed on 20 January 2015.

¹⁶⁷ Schedule 5 clause 9(1) of the Companies Act of 2008.

¹⁶⁸ Companies Act of 1973.

¹⁶⁹ Companies Act of 2008.

¹⁷⁰ Schedule 5 clause 9(3) of the Companies Act of 2008.

¹⁷¹ *Hulse-Reutter* (note 72 above; para 23).

corporation, or of such member or members thereof, or of such other person or persons, as are specified in the declaration, and the Court may give such further order or orders as it may deem fit in order to give effect to such declaration.’¹⁷²

The statutory remedy, unlike the common law remedy, gives courts the discretion to pierce the corporate veil.¹⁷³ The courts could pierce the corporate veil of a close corporation if the court finds upon the facts that there was ‘gross abuse’ of the separate legal existence of the close corporation.¹⁷⁴ However, as per Henochsberg’s observation, the section did not describe the circumstances or facts that constitute ‘gross abuse’.¹⁷⁵ The legislature left it to the courts to determine on the facts of each case what would constitute ‘gross abuse’.¹⁷⁶

According to the Farlex dictionary the word ‘gross’ means flagrant and extreme.¹⁷⁷ It also means extremely objectionable, offensive, crude or shocking behaviour.¹⁷⁸ The word ‘abuse’ means to use improperly or to excessively misuse.¹⁷⁹ It is an unjust or wrongful or corrupt practice.¹⁸⁰ It may also be a deception.¹⁸¹ The thesaurus states that abuse can be a change of the inherent purpose or function of something.¹⁸² It can be deduced that ‘gross abuse’ is conduct or behaviour which is wrongful and extremely objectionable; giving rise to the application of section 65 of the Close Corporations Act of 1984. This may be conduct which is improper, crude, corrupt and/or offensive.¹⁸³

In terms of s 65 of the Close Corporations Act, the corporate veil may be pierced only in instances where there is ‘gross abuse’ of the juristic personality of the close corporation. The term gross abuse was not explained in the statutory provision. The courts had to grapple with the

¹⁷² Section 65 of the Close Corporations Act 63 of 1984.

¹⁷³ R Cassim (note 19 above; 57).

¹⁷⁴ Section 65 of the Close Corporations Act 63 of 1984.

¹⁷⁵ P A Delport ... et al *Henochsberg on the Companies Act 71 of 2008* 2ed Butterworths: Lexis Nexis, (2011) 46[4].

¹⁷⁶ *Airport Cold Storage* (note 34 above; para 24).

¹⁷⁷ The Free Dictionary by Farlex available at <http://www.thefreedictionary.com/> accessed on 28 January 2015.

¹⁷⁸ *Ibid.*

¹⁷⁹ *Ibid.*

¹⁸⁰ *Ibid.*

¹⁸¹ *Ibid.*

¹⁸² *Ibid.*

¹⁸³ *Ibid.*

meaning or what constituted gross abuse. The meaning of gross abuse will be discussed with reference to conduct which the court concluded to be gross abuse.

In the case of *Haygro Catering BK v Van der Merwe*,¹⁸⁴ the applicants were meat suppliers to the CC (Mr Meat Man, hereafter referred to as the third respondent).¹⁸⁵ The third respondent was trading without revealing its real name or pointing out the fact that it was close corporation.¹⁸⁶ The members of the close corporation and the close corporation itself were held jointly and severally liable for the debts of the close corporation in terms of section 65 of the Close Corporations Act.¹⁸⁷ The court concluded that it was justified in making an order in terms of section 65 of the Close Corporations Act because the failure to provide the name of the close corporation on the business premises or stationery constituted ‘gross abuse’ of the corporate structure.¹⁸⁸

In *TJ Jonck BK h/a Bothaville Vleismark v Du Plessis NO*,¹⁸⁹ the member of the close corporation was held personally liable for the debts of the close corporation in terms of section 64 of the Close Corporations Act. The close corporation had conducted its business under insolvent circumstances and the member of the close corporation knowingly took part in carrying on business in these circumstances.¹⁹⁰ The member had granted the corporation a loan and authorised for a notarial bond to be registered over the movable property of the corporation as security for the loan.¹⁹¹ He did this with the knowledge that the corporation was insolvent.¹⁹² The court concluded that the member had ‘conducted his affairs in such a manner that he would easily take over the movable assets if the corporation encountered difficulties; which he took over eventually’.¹⁹³ The court held the member personally liable for the debts of the corporation. It was further held that ‘the plaintiff could have also succeeded in terms of section 65 of the

¹⁸⁴ *Haygro Catering BK v Van der Merwe* 1996 (4) SA 1063 (C).

¹⁸⁵ *ibid* 1065.

¹⁸⁶ *ibid* 1065.

¹⁸⁷ *ibid* 1070.

¹⁸⁸ *ibid* 1070.

¹⁸⁹ *TJ Jonck BK h/a Bothaville Vleismark v Du Plessis NO* 1998 1 SA 971 (O).

¹⁹⁰ *ibid* 986.

¹⁹¹ *ibid*.

¹⁹² *ibid*.

¹⁹³ *ibid*.

Close Corporations Act because the conduct of the member constituted ‘gross abuse’ of the corporate structure.¹⁹⁴

According to the court in *TJ Jonck*,¹⁹⁵ the facts before it constituted ‘gross abuse’ and it appears that this was a development from the common law remedy of piercing the corporate veil. In this respect, writers like Larkin were of the view that in *TJ Jonck*¹⁹⁶ the corporate veil was pierced when the court could have brought the same result through another route.¹⁹⁷ Such a view could have been derived from the common law approach to piercing where the courts were reluctant to pierce the corporate veil. However, the approach in the case of *Cape Pacific*¹⁹⁸ is praiseworthy, where the court stated that one should be free to use the remedy of their choice.¹⁹⁹ It can be argued that one should be free to choose the remedy that works to their best advantage to give them the best possible result.

Section 65 of the Close Corporations Act 1984 was also relied on in the case of *Airport Cold Storage (Pty) v Ebrahim*.²⁰⁰ The provision gave the courts discretion to disregard the juristic personality of a corporation when that particular entity was misused by its members.²⁰¹ Facts of the case are provided for the purposes of bringing awareness to creditors of the examples of improper conduct or conduct that may constitute ‘gross abuse’ leading the courts to pierce the corporate veil. The creditors in this case had proven a claim against the corporation for the outstanding amount of R278 377 but received no payment because the corporation had no assets.²⁰² The creditors then sought to hold the members of the corporation accountable.²⁰³ The defendants had not kept any proper accounting records²⁰⁴ and they had no accounting officer.²⁰⁵

¹⁹⁴ *ibid.*

¹⁹⁵ *TJ Jonck BK h/a Bothaville Vleismark v Du Plessis NO* 1998 1 SA 971 (O).

¹⁹⁶ *ibid.*

¹⁹⁷ M P Larkin ‘Company Law (including Close Corporations)’ 1998 *Ann Surv S African L* available at http://www.heinonline.org.ezproxy.ukzn.ac.za:2048/HOL/Page?handle=hein.journals/assaf11998&div=27&collection=journals&set_as_cursor=9&men_tab=srchresults&terms=SECTION/65/OF/THE/CLOSE/C/P/ATIONS/ACT/O F/1984&type=matchall accessed on 25 July 2015.

¹⁹⁸ *Cape Pacific* (note 10 above).

¹⁹⁹ *Cape Pacific* (note 10 above; 805).

²⁰⁰ *Airport Cold Storage* (note 34 above).

²⁰¹ *ibid* para 15.

²⁰² *ibid* para 1.

²⁰³ *ibid* para 2.

²⁰⁴ *ibid* para 49.

They also ran the business in an informal manner in the sense that although they had a bank account they operated on a cash basis.²⁰⁶ It was alleged and proved that the business was started by the defendants for a fraudulent reason, that is, to avoid liquidation of their other business (Zaki Meat Market CC).²⁰⁷

In granting the order, the court held that ‘[it] has power to pierce the corporate veil in extraordinary circumstances,²⁰⁸ for example, if the corporation is used to conceal the true facts of how that particular entity is being run by its members.’²⁰⁹ The court concluded that the members of the corporation had not used the corporation as an independent entity and the corporate veil was pierced.²¹⁰ The veil of incorporation was pierced because the defendants chose to disregard the separate juristic personality of the corporation²¹¹ and the court held that they cannot hide behind its corporate identity in an effort to avoid liability for its debts.²¹² The defendants had not complied with legislative requirements for running the close corporation.²¹³ One may argue that the courts are justified when they pierce the corporate veil in circumstances where a company is formed and used for fraudulent purposes because this has the potential effect of protecting the interests of creditors and other interested parties like investors.

The cases explored above show that the courts had the discretion to pierce the corporate veil in terms of section 65 of the Close Corporations Act of 1984. The courts could only pierce the corporate veil of a close corporation where there was evidence of gross abuse of the separate juristic personality of the entity.²¹⁴ However, courts would still not lightly disregard the separate legal existence of a company under the Close Corporations Act.²¹⁵ They remain reluctant to pierce the corporate veil probably to avoid discouraging businessmen from making investments. It may be submitted that if the corporate veil is pierced often and with ease, then the concept of

²⁰⁵ *ibid* para 50.

²⁰⁶ *ibid* para 39.

²⁰⁷ *ibid* para 55-67.

²⁰⁸ *ibid* para 19.

²⁰⁹ *Philotex* (note 156 above; 249).

²¹⁰ *Airport Cold Storage* (note 34 above; para 79).

²¹¹ *ibid* para 78.

²¹² *ibid*.

²¹³ *ibid* para 39 and 50.

²¹⁴ Section 65 of the Close Corporations Act of 1984.

²¹⁵ *Ebrahim* (note 68 above; para 22).

the separate legal personality of a juristic person may become obsolete. Nevertheless, if the separate legal personality of a company is unconscionably disregarded by the members of a close corporation, this is an argument for suggesting that the courts would be justified in piercing the corporate veil.

It is noteworthy to highlight that even when the requirements for section 65 of the Close Corporations Act are not met; the common law remedy can apply to close corporations. It, therefore, appears that there was not much of an improvement from the common law remedy of piercing the corporate veil because the courts remained reluctant to pierce the veil of the close corporations. The development that came was brought in the form a test which was to be used by courts to pierce the corporate veil of close corporations and this test was that of conduct which constituted 'gross abuse' allowing courts to pierce the veil when it is found within the facts of the case before the court. However, the courts still had the burden of determining what constituted 'gross abuse', which is more or less similar to the burden it had of determining what constituted 'improper conduct' in relation to the common law remedy of piercing the corporate veil.

Furthermore, in relation to companies, there was no equivalent statutory remedy to pierce the corporate veil and it appears there was still a need for a remedy which was much more clear and certain than the common law remedy of piercing the corporate veil. The remedy provided by the Companies Act of 2008 will be discussed in the chapter that follows. It is submitted that the circumstances in which the corporate veil was pierced in terms of section 65 of the Close Corporations Act of 1984 may serve as a guideline in the application of section 20(9) of the Companies Act of 2008. A comparison will be made between gross abuse and unconscionable abuse when the issue of unconscionable abuse is considered in the context of section 20(9) of the Companies Act of 2008.

2.3 Conclusion

In summary, the common law remedy of piercing the corporate veil has been developed and integrated into the corporate laws of South Africa. As discussed above, in terms of common law, the remedy of piercing the corporate veil appears to be ‘unprincipled and incoherent’ in its application. Initially with respect to companies, the Companies Act of 1973 contained provisions that allowed courts to hold the controllers personally liable for loss, costs or damages incurred by the company as a result of the improper conduct of shareholders and/or directors. Section 424(1) was discussed because it prevents the abuse of the corporate form of a company by those who control it. The first statutory remedy which gave courts general discretion to pierce the corporate veil was section 65 of the Close Corporations Act of 1984. The test for piercing the corporate veil in terms of section 65 of the Close Corporations Act of 1984 is ‘gross abuse’ of the separate legal existence of the close corporation.

It has been established that the courts were more reluctant to pierce the corporate veil under common law. The application of the remedy was criticised for being incoherent and unprincipled. It has also been established that in terms of section 424(1) there has been development from the common law remedy in that there is the application of the reasonable man test to determine whether one was reckless or not. However, there was still the need for a more generalised remedy because section 424(1) was limited to fraud and recklessness. In terms of section 65 of the Close Corporations Act of 1984, development was brought in the form a test of ‘gross abuse’ allowing courts to pierce the veil when it is found within the facts of the case before the court that the corporate form of a close corporation has been grossly abused. However, the courts still had the burden of determining what constituted ‘gross abuse’, which is the same burden it had of determining what constituted ‘improper conduct’ in relation to the common law remedy of piercing the corporate veil.

With respect to companies, there was no statutory remedy of piercing of the corporate veil and the common law remedy applied. Since the common law remedy of piercing of the corporate veil appears to be ‘incoherent and unprincipled’ in its application, there was the need to have a statutory remedy that applies to companies. There was need for a more generalised remedy

which would address the issue of the abuse of the separate legal existence of a company. A remedy that gives the courts general discretion to pierce the corporate veil and the statutory remedy will be discussed below.

CHAPTER 3: PIERCING OF THE CORPORATE VEIL UNDER SECTION 20(9) OF THE COMPANIES ACT OF 2008

3.1 Introduction

The remedy of piecing the corporate veil was codified in respect of companies in 2008 when the Companies Act 71 of 2008 was enacted.²¹⁶ Codification may have been necessary because there was the need for certainty since under common law the remedy is unprincipled and it is unpredictable.²¹⁷ There is also the possibility that the legislature codified the remedy to bring the application of the concept of unconscionability to counter the abuse of the corporate structure.²¹⁸ The legislature may have also intended to give further protection to the weak against the strong because the concept of unconscionability is used as a defence against unjust, unfair and unreasonable conduct by controllers of companies.²¹⁹ If the abuse of companies as separate legal entities goes unaddressed, creditors may suffer harm and that may defeat the purpose of the Companies Act 2008.²²⁰ In this section the concepts of unconscionability and the piercing of the corporate veil have been connected by setting unconscionability as the standard for determining when the remedy of piercing the corporate veil is available.

This chapter will consider the statutory provision first, how it may be interpreted and then an evaluation of the provision will be made. The meaning of section 20(9) of the Companies Act of 2008 will also be discussed. A discussion of the difference in the wording of section 65 of the Close Corporations Act of 1984 and section 20(9) of the Companies Act of 2008 will be included in this chapter. The chapter will include a discussion of the meaning of ‘unconscionable abuse’ and in particular what may be considered by court as constituting ‘unconscionable abuse’. Critical comments will be made on the term ‘unconscionable abuse’. There will also be an evaluation of whether section 20(9) of the Companies Act of 2008 overrides the common law instances of piercing the corporate veil.

²¹⁶ Section 20(9) of the Companies Act of 2008.

²¹⁷ *Amlin* (note 4 above; para 15).

²¹⁸ E Nel ‘An Interpretive Account of Unconscionability in Trust Law’ (2014) 35(1) *Obiter* 81 83 available at http://reference.sabinet.co.za/webx/access/electronic_journals/obiter/obiter_v35_n1_a5.pdf accessed on 25 March 2015.

²¹⁹ *ibid* 81.

²²⁰ Section 7(b) of the Companies Act 2008.

3.2 Section 20(9) of the Companies Act of 2008 in general

Section 20(9) of the Companies Act provides that:

‘the court may on application by an interested person or in any proceedings in which a company is involved, a court finds that the incorporation of the company, any use of the company, or any act by or on behalf of the company, constitutes an ‘unconscionable abuse’ of the juristic personality of the company as a separate entity.’²²¹

There are different theories of interpretation applied within the laws of South Africa. It appears the statutory provision needs to be interpreted using a purposive approach and such an approach was taken by Binns-Ward J in *Ex parte Gore*,²²² the first case where this provision was applied. The purposive approach focuses on the purpose which the statute seeks to achieve.²²³ Furthermore, it should be noted that statutes must be interpreted giving regard to the Constitution.²²⁴ Section 39(2) of the Constitution provides that ‘When interpreting any legislation, and when developing the common law or customary law, every court, tribunal or forum must promote the spirit, purport and objects of the Bill of Rights. This shows that the Constitution mandates a purposive and value based approach when one interprets legislation.’²²⁵

Section 20(9) of the Companies Act 2008 must be interpreted taking section 7 and section 5 of the Companies Act of 2008 into account.²²⁶ Section 7 deals with the purpose of the Companies Act of 2008 and it appears that the purposive approach may be plausible in interpreting section 20(9) of the Companies Act of 2008. Thus, section 20(9) has to be interpreted giving effect to purposes set out in section 7. One of the purposes which may need to be given effect whilst interpreting section 20(9) include encouraging the responsible management of companies, having transparency and high standards of corporate governance.

²²¹ Section 20(9) of the Companies Act 71 of 2008.

²²² *Ex parte Gore* (note 21 above; para 32).

²²³ Du Plessis *Interpretation of Statutes and the Constitution* 2002 59.

²²⁴ *Ibid.*

²²⁵ *Ibid.*

²²⁶ *Ex parte Gore* (note 21 above; para 32).

The purposive approach may not work alone; it may have to work hand in glove with the contextual approach. With regards to the contextual approach, the one interpreting has to put the meaning of the words used in the statute into context. When looking at the context of the statute, the language of the entire statute, the purpose and the background of the statute have to be looked at. Binns-Ward J seems to have taken the contextual approach also because he looked at whether the statutory provision had replaced the common law provision. This stems from the background of the statutory provision whereby it appears to have come in place to address the inadequacies of the common law provision for piercing the corporate veil. These include the lack of clear principles to be followed when piercing the corporate veil which led to inconsistency, uncertainty and unpredictability which was highlighted above.²²⁷ It may be argued that the purpose of the statutory provision was to bring a clear test for piercing the corporate veil and that the legislature's intention was to bring consistency and certainty to the remedy of piercing the corporate veil.

The meaning of section 20(9) of the Companies Act 2008 may also be deduced from this rule. Section 5 deals with the general interpretation of the Act and section 7 deals with the purpose of the Act. The corporate law reform process seems to have emphasised the need for simplification, flexibility, corporate efficiency, transparency and predictable regulation. These are the values encapsulated in section 7 of the Companies Act of 2008. This is the reason why certain provisions within section 7 in particular can be of assistance in determining what may constitute 'unconscionable abuse'.

Section 7(k) provides that 'the purposes of this Act are to... provide for the efficient rescue and recovery of financially distressed companies, in a manner that balances the rights and interests of all relevant stakeholders (creditors)²²⁸...' ²²⁹ The Act does not define the concept of "stakeholders" in section 7 (k).²³⁰ Henochsberg submits that the ordinary meaning would also

²²⁷ See chapter 2.

²²⁸ The word creditors is used for the purposes of this dissertation because in relation to the concept under discussion they are, generally, the most affected.

²²⁹ Section 7 (k) of the Companies Act of 2008.

²³⁰ P A Delport ... et al *Henochsberg on the Companies Act 71 of 2008* 2ed Butterworths: Lexis Nexis, (2011) 46[4].

include the meaning as found in King III,²³¹ where it is defined as “[a]ny group affected by and affecting the company’s operations”.²³² One can argue that the words ‘any group affected by...the company’s operations’, may include creditors who may be affected by the operations by the company, especially when such operations result in the abuse of the separate legal personality of the company.²³³

Section 7(d) provides that directors have to manage a company in a way that promotes both economic and social benefits. Section 7(d) should also be construed to mean that directors must take note of the interests of stakeholders (creditors), but that stakeholders are not provided with direct rights. Henochsberg submits that the Act strives to create a balance between creating a flexible business environment and regulation that holds the company and its office bearers liable to the stakeholders (creditors) of the company.²³⁴ As it appears, section 7 of the Companies Act is in favour of piercing the veil where the corporate structure of a company has been abused.²³⁵

Section 20(9) gives courts discretion to pierce the corporate veil where it finds that there has been the ‘unconscionable abuse’ of the juristic personality of a company.²³⁶ A request for an order by court to have the corporate veil pierced may be brought by way of application.²³⁷ However, the court can act on its own initiative where there is ‘unconscionable abuse’ of the separate legal personality of a company.²³⁸ The use of the word ‘may’ is the one which indicates that courts have discretion whether to pierce the corporate veil. This means that even if the requirements of section 20(9) are met, a court is not obliged to pierce the corporate veil, but has discretion whether to do so. However, the courts are not given a general discretion to pierce the corporate veil when they think it is fair to do so, but they only have that discretion if there is evidence of ‘unconscionable abuse’ of the juristic personality of a company as a separate legal entity.

²³¹M King ‘King III report on corporate governance in South Africa 2009’ available at <http://www.mylexisnexis.co.za/Index.aspx> accessed on 27 November 2014.

²³²P A Delport ... et al (note 230 above).

²³³ *ibid.*

²³⁴ *ibid.*

²³⁵J Katzew ‘Crossing the divide between the business of the corporation and the imperatives of human rights – The impact of section 7 of the Companies Act 71 of 2008’ 2011 *SALJ* 686 703 available at <http://ipproducts.jutalaw.co.za/nxt/gateway.dll/jelj/salj/2/204/254/262/264> accessed on 27 November 2014.

²³⁶Section 20(9)(b) of the Companies Act of 2008. See also *Ex parte Gore* (note 21 above; para 34).

²³⁷*Ex parte Gore* (note 21 above; para 35).

²³⁸ *ibid.*

It is important to note that the statutory remedy did not ‘substitute the common law remedy as stated by the court in *Ex parte Gore*.²³⁹ Unlike section 165(1) of the Companies Act 2008 which deals with derivative actions,²⁴⁰ the statutory provision does not expressly state that the common law remedy of piercing the corporate veil has been abolished and substituted by statute. It appears that the common law remedy of piercing the corporate veil was not replaced because there may be instances, like the one in the case of *Hulse Ruetter v Godde*,²⁴¹ where the statutory remedy does not apply and yet common law would be appropriate. One may submit that common law may have not been replaced by the legislature because it has not been found to be unconstitutional since it has to be applied giving regard to the Constitution.

Cassim submits that the possible reason for that is the fact that the common law remedy may still apply in cases where section 20(9) requirements are not met.²⁴² One may argue, in support of Cassim, that this may have the effect of affording creditors additional protection to their interests in the sense that when section 20(9) of the Companies Act 2008 does not apply; the common law remedy may apply. Furthermore, Cassim submits that when interpreting section 20(9) of the Companies Act of 2008 the principles established at common law may be used as guidelines by courts to determine what may constitute ‘unconscionable abuse’.²⁴³

According to Binns-ward J, ‘[T]he language of section 20(9) is cast in very wide terms and it indicates the intention of the legislature that the provision finds application in widely varying factual circumstances.’²⁴⁴ This is reinforced by the fact that a court may also pierce the corporate veil of a company even where the applicant in the matter before it has not requested the court to do so.²⁴⁵ One may argue that applicants are now being afforded better protection by the law because the remedy applies in widely varying instances where the corporate form is abused. It

²³⁹ *Ex parte Gore* (note 21 above; para 34).

²⁴⁰ Section 165(1) of the Companies Act 2008 states that, ‘Any right at common law of a person other than a company to bring or prosecute any legal proceedings on behalf of that company is abolished, and the rights in this section are in substitution for any such abolished right.’

²⁴¹ *Hulse-Reutter* (note 72 above; para 5).

²⁴² R Cassim (note 19 above; 58).

²⁴³ *ibid.*

²⁴⁴ *Ex parte Gore* (note 21 above; para 32).

²⁴⁵ Section 20(9)(b) of the Companies Act of 2008. See also *Ex parte Gore* (note 21 above; para 34).

appears that the protection bought by the legislature involves courts stepping in when an aggrieved party has not requested for the piercing of the corporate veil.

Section 20 (9) refers to ‘incorporation of the company, use of the company or act by or on behalf of the company’. This means that the application of the statutory remedy does not start and end with the formation of the company as ‘a sham or device or stratagem’.²⁴⁶ In *Ex parte Gore*,²⁴⁷ the court stated that:

‘the words ‘unconscionable abuse of the juristic personality of a company’ used in s20(9) postulate conduct in relation to the formation and use of companies that is diverse enough to cover all the descriptive terms such as ‘sham’, ‘device’, ‘stratagem’, and conceivably much more’.²⁴⁸

The meaning of the statutory remedy, in particular, the term ‘unconscionable abuse’ will be discussed further below.

3.3 Meaning of ‘unconscionable abuse’ in general

The statutory remedy allows for courts to pierce the corporate veil of a company where there is evidence of the ‘unconscionable abuse’ of the juristic personality of the company. However, section 20(9) did not give the meaning of ‘unconscionable abuse’, nor did it state or give a guideline as to what constitutes ‘unconscionable abuse’. In South Africa the term ‘unconscionable’ was used and defined in the Consumer Protection Act of 2009.²⁴⁹ The word ‘unconscionable’ is described as ‘unethical or improper to a degree that would shock the conscience of a reasonable person’.²⁵⁰ In this section the concepts of unconscionability and the piercing of the corporate veil have been connected by setting unconscionability as the standard for determining when the remedy of piercing the corporate veil is available.

²⁴⁶ *Ex parte Gore* (note 21 above; para 34).

²⁴⁷ *Ex parte Gore* (note 21 above).

²⁴⁸ *ibid* para 34.

²⁴⁹ Consumer Protection Act 68 of 2009.

²⁵⁰ Advanced English Dictionary by Princeton University.

The word ‘unconscionable’ is generally related to actions, behaviour and conduct. The Oxford English Dictionary defines the word as ‘[actions, behaviour, etc.] showing no regard for conscience or not in accordance with what is right or reasonable.’ The thesaurus of the Free Dictionary by Farlex defines unconscionable as ‘greatly exceeding the bounds of reason or moderation’. The phrase ‘unconscionable abuse’ suggests a form of abuse that gives rise to the application of statutory the remedy.²⁵¹ It may be deduced, from the Thesaurus meaning of the word ‘unconscionable’, that the words ‘unconscionable abuse’ may mean that the conduct giving rise to the application of the remedy is conduct which is unethical and indefensible.²⁵²

The term ‘unconscionable’ is not new in the context of the piercing remedy. The term ‘unconscionable’ has also been considered in case law in the context of piercing under common law. The court in the *Botha v Van Niekerk*²⁵³ case stated that it would pierce the corporate veil if the plaintiff has suffered ‘unconscionable injustice’ as a result of the inappropriate conduct of the defendant.²⁵⁴ However, the court in *Cape Pacific (Pty) Ltd v Lubner Controlling*²⁵⁵ stated that ‘there is a need for a more flexible approach which allows the facts of each case to ultimately determine whether the courts should pierce the corporate veil’ because test formulated in *Botha v Van Niekerk en 'n Ander*²⁵⁶ is perhaps too rigid.²⁵⁷ It appears that the reasonable man test played a part in determining whether or not to pierce the corporate veil in terms of common law. The reasonable man test may still play a part in determining what constitutes unconscionable abuse. The court may use a fictional character as to what a reasonable man would have done to determine whether the wrongdoer acted reasonably given the circumstances. Therefore, the reasonable man test may remain relevant in the context of section 20(9) of the Companies Act of 2008 so as to determine what may constitute ‘unconscionable abuse’.

Currently, in terms of the Companies Act of 2008 the general test used to decide when the corporate veil may be pierced is ‘unconscionable abuse’ of the juristic personality of a company

²⁵¹ *ibid.*

²⁵² The words unethical and indefensible are taken from meaning of the word unconscionable found in the Thesaurus available at www.thesaurus.com accessed on 17 January 2014.

²⁵³ *Botha* (note 31 above;).

²⁵⁴ *ibid* 525.

²⁵⁵ *Cape Pacific* (note 10 above).

²⁵⁶ *Botha* (note 31 above; 525).

²⁵⁷ *Cape Pacific* (note 10 above 805).

as a separate legal entity. The court would look at the conduct of the wrongdoer to determine whether such conduct constitutes ‘unconscionable abuse’. If the conduct constitutes ‘unconscionable abuse’ of the juristic personality of a company as a separate legal entity, the court may exercise its discretion and pierce the corporate veil. This has the effect of rendering the wrongdoer personally liable for the debt that arose due to the ‘unconscionable abuse’ of the company.

Under the Close Corporations Act of 1984 the test for piercing the corporate veil is ‘gross abuse’ and it allows the court to disregard the separate legal existence of a close corporation. Courts would use the balancing approach when deciding whether to pierce or not to pierce the corporate veil.²⁵⁸ This approach requires the court to weigh the separate legal personality against the principles that favoured the piercing of the corporate veil.²⁵⁹ The wording in section 65 of the Close Corporations Act of 1984 and section 20(9) of the Companies Act of 2008 is almost similar. Neither Act replaces the common law remedy, but they are supplemental to it.²⁶⁰ However, there is a difference between the two provisions and it is important to look into the intention behind using the different wording. The Close Corporations Act uses the words ‘gross abuse’ and the Companies Act uses the words ‘unconscionable abuse’.

The term ‘unconscionable abuse’, according to the court in *Ex parte Gore*,²⁶¹ is less extreme as compared to the term ‘gross abuse’ used in the Close Corporations Act of 1984.²⁶² The court stated that this indicates that ‘the remedy may be used whenever the illegitimate use of the concept of juristic personality adversely affects a third party in a way that should not be tolerated’ and such illegitimate use should constitute ‘unconscionable abuse’.²⁶³ In terms of section 20(9) of the Companies Act of 2008, there is no requirement for the abuse to result in

²⁵⁸ *Cape Pacific* (note 10 above; 803).

²⁵⁹ *ibid.* See also A Domanski ‘Piercing The Corporate Veil - A New Direction’ (1986) 103(2) *SALJ* 224 231 available at http://www.heinonline.org/HOL/Page?handle=hein.journals/soaf103&div=36&collection=journals&set_as_cursor=16&men_tab=srchresults&terms=Piercing|The|Corporate|Veil|A|New|Direction%E2%80%99&type=matchall accessed on 19 August 2014.

²⁶⁰ *Ex parte Gore* (note 21 above; para 34).

²⁶¹ *Ex parte Gore* (note 21 above; para 34).

²⁶² *ibid* para 34.

²⁶³ *ibid.*

affording an unfair advantage to those controlling the company.²⁶⁴ This is unlike what was stated by the court in the case of *Hulse-Reutter & Others v Godde*,²⁶⁵ a case which dealt with the piercing of the corporate veil in terms of common law. This may therefore mean that the legislature intended to bring flexibility in the application of the remedy.²⁶⁶

Unlike South Africa, which now has a statutory remedy, there is no general test for deciding when to pierce the corporate veil in the English²⁶⁷ and the Australian jurisdictions.²⁶⁸ The absence of a general test can be attributed to the fact that the courts have regularly relied on certain established categories, such as fraud, agency, evasion of legal obligations and abuse of the corporate structure to decide whether the corporate veil in a particular case should be pierced.²⁶⁹ It appears that such categories may work as a guide in determining what may constitute ‘unconscionable abuse’, but circumstance which may constitute ‘unconscionable abuse’ are not limited to the categories.

In as much as categorisation may make application of the remedy of piercing of the corporate veil rigid, it may be argued that fraud and evasion of legal obligations may be circumstances where the corporate veil may have been pierced often.²⁷⁰ These two circumstances seem to have been proven as constituting ‘unconscionable abuse’ in the cases where a company is used to commit fraud, but ‘unconscionable abuse’ is not limited to fraud.²⁷¹ The courts would still have to decide each case upon its merits and allow for the remedy to apply when the circumstances justify it. Such an approach would keep the application of the remedy flexible.

²⁶⁴ *ibid.*

²⁶⁵ *Hulse-Reutter* (note 72 above).

²⁶⁶ *ibid.*

²⁶⁷ *VTB Capital plc v Nutritek International Corp* [2013] 2 AC 337.

²⁶⁸ *Briggs v James Hardie & Co Pty Ltd* (1989) 16 NSWLR 549 (NSWCA) 567.

²⁶⁹ A Domanski ‘Piercing The Corporate Veil - A New Direction’ (1986) 103(2) *SALJ* 224 230 available at http://www.heinonline.org/HOL/Page?handle=hein.journals/soaf103&div=36&collection=journals&set_as_cursor=16&men_tab=srchresults&terms=Piercing/The/Corporate/Veil/A/New/Direction%E2%80%99&type=matchall accessed on 19 August 2014.

²⁷⁰ *Ex parte Gore* (note 21 above; para 28).

²⁷¹ W J Rands ‘Domination of a Subsidiary by a Parent’ (1999) 13(2) *Indiana L R* 421 432 available at http://www.heinonline.org/HOL/Page?handle=hein.journals/indilr32&div=26&collection=journals&set_as_cursor=2&men_tab=srchresults&terms=domination/of/a/subsidiary/by/the/parent&type=matchall accessed on 30 January 2015.

Noteworthy is the fact that Section 20(9) of the Companies Act 2008 applies even when another remedy exists. As long as the separate juristic personality of a company has been unconscionably abused, the corporate veil may be pierced. In this regard, reference can be made to the case of *Cape Pacific v Lubner*²⁷² where the court stated that;

‘In principle, there is no reason why piercing of the corporate veil should necessarily be precluded if another remedy exists. As a general rule, if a person has more than one legal remedy at his disposal, he can select any one of them; he is not obliged to pursue one rather than the other (although there may be instances where once he has made an election he will be bound by it). If the facts of a particular case otherwise justify piercing the veil, the existence of another remedy, or the failure to pursue what would have been an available remedy, should not in principle serve as an absolute bar to a court granting consequential relief. The existence of another remedy, or the failure to pursue one that was available, may be a relevant factor when policy considerations come into play, but it cannot be of overriding importance.’²⁷³

Unlike the common law remedy of piercing of the corporate veil,²⁷⁴ despite the existence of another remedy, one should be at liberty to use the remedy of their choice and section 20(9) of the Companies Act of 2008 seems to allow for an aggrieved party to apply to the courts for piercing of the corporate veil even if another remedy exists to remedy the wrong.²⁷⁵

Having deliberated on the meaning of ‘unconscionable abuse’, one can agree with the court in the case of *Ex parte Gore*,²⁷⁶ where it was held that the words ‘unconscionable abuse’ have a ‘less extreme connotation than the words ‘gross abuse’ found in section 65 of the Close Corporations Act 1984. This may mean that certain conduct which was not considered to be ‘gross abuse’ may be considered by courts as ‘unconscionable abuse’. This widens the scope of the application of the remedy whilst giving further protection to the weak against the strong.

²⁷² *Cape Pacific* (note 10 above).

²⁷³ *ibid* 805.

²⁷⁴ *Amlin* (note 4 above; para 23).

²⁷⁵ D Subramanien (note 18 above; 159).

²⁷⁶ *Ex parte Gore* (note 21 above).

3.4 Conclusion

The new remedy seems to have widened the basis for piercing of the corporate veil. For the statutory remedy to apply there must be some form of ‘unconscionable abuse’ and factors considered by the courts for its application have been discussed above. Section 20(9) of the Companies Act of 2008 seems to be flexible since courts still decide each case upon its facts. There is also, unqualified availability of the remedy, unlike common law remedy which applies in extraordinary circumstances and does not apply where an alternative remedy is available.

It has been established that the term ‘unconscionable abuse’ relates to conduct giving rise to the application of the remedy and such conduct is unethical and indefensible. It has also been established that the terms ‘unconscionable abuse’ is different from the term ‘gross abuse’ which was used in section 65 of the Close Corporations Act of 1984. The chapter also established that the test of ‘unconscionable injustice used in the *Botha* case discussed above was a rigid and a more flexible test was necessary, that is, ‘unconscionable abuse’. It was also established that each case has to be determined upon its facts. If the courts find the conduct of the wrongdoer to constitute ‘unconscionable abuse’, the corporate veil would be pierced. Recommendations will be given at the end of the dissertation in relation to what measures South Africa may adopt and how they may reduce the abuse of the corporate structure.

This chapter established that there are problems associated with limited liability companies and it is possible that the problems with the separate legal personality are more complex in the case of groups of companies. Therefore next chapter will focus on groups of companies and the application of section 20(9) of the Companies Act of 2008. The next chapter will also include a discussion of letters of comfort which are used within the group companies structure.

CHAPTER 4: GROUPS OF COMPANIES

4.1 Introduction

Now that problems have been noted above in respect of individual companies and the new statutory remedy itself, there is the potential that there are more complex problems with respect to groups of companies and the application of the new statutory remedy in that context.²⁷⁷ Chapter 4 will discuss the nature of groups of companies and issue of ‘unconscionable abuse’ in the context of groups of companies. The chapter highlights the use of letters of comfort by company groups and the legal status thereof. There will be a discussion on how creditors are affected by such letters of comfort and the uncertainty surrounding them. It will also be questioned whether the use of letters of comfort can constitute ‘unconscionable abuse’ and under what circumstances this may occur. If abuse of letters of comfort ever does constitute ‘unconscionable abuse’ the use of the statutory remedy provided for in s 20(9) will be considered in this context. The chapter will also discuss other approaches which the creditors of the subsidiary may use in attempting to get the courts to pierce the veil and hold the parent company liable for the debts of the subsidiary, especially those debts incurred in reliance on the letters of comfort.

4.2 The nature of groups of companies

The formation of groups or the linking of companies together into a group structure is common commercial practice. The main reason for creating groups of companies is for the parent company to minimise risks which it may be exposed to in business transactions since every company within the group is a separate entity and liable for its own debts.²⁷⁸ Nevertheless, there are definitions that are relevant in this context.

²⁷⁷ R Cassim (note 33 above).

²⁷⁸ F H Easterbrook and D R Fischel (note 80 above; 97).

Section 1 defines a ‘group of companies’ as a holding company and all of its subsidiaries.²⁷⁹ The structure of groups of companies comprises a parent company²⁸⁰ and a subsidiary company or subsidiaries.²⁸¹ Section 1 provides a definition of a ‘holding company’. In relation to a subsidiary, ‘holding company’ means ‘a juristic person that controls that subsidiary...’²⁸² In this context control means the parent company exercises its voting powers which allow it to appoint or elect directors and to enforce its views concerning policies of the subsidiary company.²⁸³ Control also means that the parent company is entitled to receive dividends on its shares.²⁸⁴ According to Henochsberg, control is defined as the parent company’s power to exercise control over a subsidiary’s financial and operating policy so as to reap benefits from the activities of that subsidiary.²⁸⁵ Henochsberg further states that ownership does not constitute control.²⁸⁶

In as much as it is an acceptable commercial approach to have company groups and that although companies in the same group may often have a common goal or purpose, the law treats each company as a separate legal entity. Each company within a group of companies can acquire its own rights and obligations.²⁸⁷ Each company can be sued in its own capacity to the exclusion of all other member companies in that group and it would be liable for those obligations.²⁸⁸ Subsequently, each company has liabilities which are separate from other companies within the group.²⁸⁹ In a group of companies, if the subsidiary company that is liable cannot pay its creditors, normally creditors would not be able to attach the assets of the holding company in satisfaction of the debts of the subsidiary.²⁹⁰

²⁷⁹ Section 1 of the Companies Act of 2008.

²⁸⁰ Parent company is also known as holding company and Section 1 of the Companies Act 71 of 2008 provides that “**holding company**”, in relation to a subsidiary, means a juristic person that controls that subsidiary.

²⁸¹ C Schmitthoff and F Woodridge *Groups of Companies* 1991 24.

²⁸² Section 1 of the Companies Act of 2008.

²⁸³ Section 3 of the Companies Act of 2008.

²⁸⁴ *ibid.*

²⁸⁵ Section 3 of the Companies Act of 2008. See also P A Delpont ... et al *Henochnberg on the Companies Act 71 of 2008* (updated October 2014) available at <http://www.mylexisnexis.co.za.ezproxy.ukzn.ac.za:2048/Index.aspx> accessed on 18 April 2015.

²⁸⁶ *ibid.*

²⁸⁷ R Cassim (note 19 above; 53).

²⁸⁸ H W Ballantine (note 36 above).

²⁸⁹ F H Easterbrook and D R Fischel (note 80 above).

²⁹⁰ *ibid.*

However, there may be circumstances where perhaps the law should pierce the corporate veil and hold the parent company liable for the debts of the subsidiary. This could be where the parent company (as the only or perhaps major shareholder) amounts to an ‘unconscionable abuse’ of the juristic personality of the subsidiary as a separate entity. These circumstances shall be discussed below.

4.3 Examples of ‘unconscionable abuse’ in the context of groups of companies

As discussed above, section 20(9) of the Companies Act of 2008 gives courts the discretion to pierce the corporate veil, especially in cases where there is ‘unconscionable abuse’.²⁹¹ Piercing of the corporate veil in terms of section 20(9) of the Companies Act of 2008 will be discussed in the context of groups of companies, making reference to possible circumstances in which the corporate veil may be pierced.

It should be noted that the possible circumstances to be discussed are not a form of categorisation because normally each case has to be considered upon its facts. Categorisation may make the remedy inflexible and it may even create loopholes in the application of the remedy. Categorisation may provide shrewd businessmen with the opportunity of manipulating the loopholes. These possible circumstances are discussed in consideration of creditors dealing with groups of companies. Since creditors may suffer harm in the event that the controllers of the groups of companies abuse the corporate structure, there is the need for creditors to be well aware of those possible circumstances that may constitute ‘unconscionable abuse’. With such awareness creditors can be encouraged to apply to the courts to pierce the corporate veil in an effort to be restored to their original position.

4.3.1 Abuse of control by the parent company

The nature of company groups means that the parent company will control the subsidiary and control in itself is not the problem. Control is not enough to pierce the veil, but if it moves from

²⁹¹ S 20(9) of the Companies Act of 2008.

control to abuse then it becomes problematic. According to Anderson, in addition to control, it is a requirement that an act of wrongdoing on the part of the parent company should be present, either through its own actions or through the actions of the board of the subsidiary that it controls.²⁹² In such a case, it may happen that the parent company uses the subsidiary to get a loan, which does not benefit the subsidiary itself. The subsidiary in this case is acting as a servant of the parent company or other companies within the group and cannot be regarded as a separate legal entity.²⁹³ The subsidiary would not have independent freewill to make decisions on its own.²⁹⁴ Therefore, it appears that the manner in which control is exercised determines whether it constitutes ‘unconscionable abuse’ and if it does constitute ‘unconscionable abuse’, the court may pierce the corporate veil.

There is a recent case that dealt with piercing of the corporate veil in the context of a trust, namely, *Van Zyl v Kaye*.²⁹⁵ This case may provide insights into the application of the remedy in the context of groups of companies because in company law, a trust can operate as a holding company since it is regarded as a juristic person.²⁹⁶ The court held that the remedy of piercing the corporate veil applies in cases where the wrongdoer avoids liability for a debt or obligation by using the corporate structure of a company in a dishonest manner.²⁹⁷ The case provides principles which may serve as guidelines in determining what may or may not constitute ‘unconscionable abuse’. Control becomes ‘unconscionable abuse’ when it has been exercised by the defendant to commit a wrong or fraud or to evade a statutory legal duty or unjustly violating a plaintiff’s legal rights.²⁹⁸ One may submit that the aggrieved party needs to prove that the conduct of the wrongdoer constitutes ‘unconscionable abuse’ for the remedy to apply.

²⁹² H Anderson ‘Piercing the Veil on Corporate Groups in Australia: The Case for Reform’ (2009) 33(2) *Melbourne University L R* 333 354 available at http://www.mulr.com.au/issues/33_2/33_2_1.pdf accessed on 4 August 2014.

²⁹³ A Farat and D Michoň ‘Lifting the Corporate Veil: Limited Liability of the Company Decision-Makers Undermined? Analysis of English, U.S., German, Czech and Polish Approach’ (2011-2015) *Common L R* 21 22 available at <http://www.commonlawreview.cz/lifting-the-corporate-veil-limited-liability-of-the-company-decision-makers-undermined-analysis-of-englishus-german-czech-and-polish-approach> accessed on 7 February 2015.

²⁹⁴ J H Matheson ‘The Modern Law of Corporate Groups: An Empirical Study of Piercing the Corporate Veil in the Parent-Subsidiary Context’ (2009) 87 *North Carolina L R* 1091 1103 available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1871173 accessed on 7 February 2015.

²⁹⁵ *Van Zyl* (note 40 above).

²⁹⁶ Section 1 of the Companies Act 71 of 2008. Definition of ‘juristic person’ includes... a trust, irrespective of whether or not it was established within or outside the Republic.

²⁹⁷ *Van Zyl* (note 40 above; para 22).

²⁹⁸ W J Rands (note 266 above).

4.3.2 Insolvent trading

Another example of abuse of control is that of allowing the subsidiary to continue trading when the parent company is aware that the subsidiary is insolvent. Insolvent trading occurs where the holding company or its directors are conscious of or have reasonable grounds for suspecting that the subsidiary would become insolvent or that it is actually insolvent when it was dealing with creditors.²⁹⁹ If it is apparent that the subsidiary was trading whilst it was insolvent, the aggrieved party may apply to court for the piercing of the corporate veil and courts may pierce the veil in such circumstances.

4.3.3 Disregard of the separate legal existence of companies within the group by the controllers

Disregard of separate legal existence of companies may occur in cases where the parent company moves assets and liabilities from company to company within the group and this may be done to hide the true fiscal position of individual subsidiaries or the entire group, especially from their creditors.³⁰⁰ This may lead the parent company to rely on the limited liability of each and every company within the group as a way of avoiding liability from external creditors.³⁰¹ In this case the conduct of the company constituted ‘unconscionable abuse’ and the court was justified in piercing the corporate veil.

In *Ex parte Gore*,³⁰² ‘the controllers of the companies were treating the group in a way that drew no proper distinction between the separate personalities of the constituent members’.³⁰³ In the opinion of the court, this constituted an ‘unconscionable abuse’ of the juristic personalities of the relevant subsidiary companies by the controllers of the companies.³⁰⁴ The failure of the

²⁹⁹ T Hadden ‘The Regulation of Corporate Groups in Australia’ (1992) 15(2) *UNSW L J* 61 79 available at [http://www.heinonline.org/HOL/Page?handle=hein.journals/swales15&div=9&collection=journals&set_as_cursor=16&men_tab=srchresults&terms=The|Regulation\[of\]|Corporate|Groups\[in\]|Australia&type=matchall](http://www.heinonline.org/HOL/Page?handle=hein.journals/swales15&div=9&collection=journals&set_as_cursor=16&men_tab=srchresults&terms=The|Regulation[of]|Corporate|Groups[in]|Australia&type=matchall) accessed on 8 February 2015.

³⁰⁰ T Hadden (note 311 above; 65).

³⁰¹ *ibid.*

³⁰² *Ex parte Gore* (note 21 above).

³⁰³ *ibid* para 33).

³⁰⁴ *ibid.*

controllers of the companies to treat the constituent members as separate entities thus brought the case within the sphere of the statutory provision.³⁰⁵ Funds requested from investors had been moved by the controllers of the holding company between the several companies in the group at will.³⁰⁶ The controllers had no regard for the separate legal existence of the companies concerned.³⁰⁷ In many instances the documentation purporting to evidence an investment did not identify the company in which the particular investment ostensibly was being made.³⁰⁸ The invested funds were in fact allocated to any company in the group that required immediate funds at the time.³⁰⁹ This transpired without any proper accounting records being kept.³¹⁰ The court found that ‘the flow of funds within the group appeared to have been materially determined by the need of the controllers of the group to sustain their scheme by finding money to pay out existing investors who wished to withdraw their funds’.³¹¹ Accordingly, the court pierced the corporate veil and regarded the group of companies as a single entity by ignoring the separate legal existence of the subsidiaries concerned.³¹² The court treated the holding company as if it was the only company.³¹³

While section 20(9) of the Companies Act was applied in this case, it is interesting to compare this with the application of section 65 of the Close Corporations Act of 1984 in the case of *Airport Cold Storage (Pty) Ltd v Ebrahim*.³¹⁴ The court in the latter case held in a similar view with regards to activity of the controllers that ‘the conducting of the business of the group of corporations with scant regard for the separate legal personalities of the individual corporate entities of which it was comprised would in itself constitute a gross abuse of the corporate personality of all of the entities concerned’.³¹⁵ It can be argued from the above cases, that the courts may pierce the corporate veil in the context of groups of companies if the controllers do

³⁰⁵ *ibid.*

³⁰⁶ *ibid* para 8.

³⁰⁷ *ibid* para 8.

³⁰⁸ *ibid* para 8.

³⁰⁹ *ibid* para 8.

³¹⁰ *ibid* para 8.

³¹¹ *ibid* para 12.

³¹² *ibid* para 37.

³¹³ *ibid.*

³¹⁴ *Airport Cold Storage* (note 34 above).

³¹⁵ *ibid* para 52.

not give regard to the separate legal existence of the subsidiary companies within the group of companies.

4.3.4 The parent company financially draining the subsidiary

Another example of ‘unconscionable abuse’ of a subsidiary company is that of the parent company financially draining the subsidiary by taking too many dividends, to such an extent that the subsidiary would not be able to repay its loans or its creditors.³¹⁶ It may be argued that the corporate veil may be pierced in such circumstances because there is the disregard of the separate legal existence of the subsidiary. It appears that there is also the possibility for courts to pierce the corporate veil in circumstances where the parent company drains the subsidiary and fails to recapitalise it. This is because such draining may occur in such a manner that the parent company actually accounts for the profits of the subsidiary as its own, thereby disregarding the separate existence of the subsidiary. The subsidiary may not be able to meet its financial obligations and an aggrieved party may apply for the piercing of the corporate veil.

4.3.5 Proving fraud

The corporate veil may be pierced in circumstances where a subsidiary has been formed and/or used to commit fraud or for some other illegitimate purpose.³¹⁷ A parent company may establish subsidiaries for the purposes of committing fraud and the corporate veil may be pierced in such circumstances.³¹⁸ There is also the possibility that the subsidiary may present itself as the parent company and vice versa, in an effort to avoid certain regulations or corporate formalities.³¹⁹ In *Ex parte Gore*³²⁰ the court stated that the corporate veil has been pierced in a number of cases which involved fraud or other improper conduct.³²¹ Fraud may also occur in instances where the

³¹⁶ B Szathmary ‘Letters of Responsibility’ (1978) 6(3) *International B L* 288 299 available at [http://www.heinonline.org/HOL/Page?handle=hein.journals/ib16&div=92&collection=journals&set_as_cursor=1&men_tab=srchresults&terms=letters\[of\]responsibility&type=matchall](http://www.heinonline.org/HOL/Page?handle=hein.journals/ib16&div=92&collection=journals&set_as_cursor=1&men_tab=srchresults&terms=letters[of]responsibility&type=matchall) accessed on 9 December 2014.

³¹⁷ T Hadden (note 311 above; 69).

³¹⁸ *Ex parte Gore* (note 21 above; para 28).

³¹⁹ J H Matheson (note 297 above; 1128).

³²⁰ *Ex parte Gore* (note 21 above;).

³²¹ *ibid* para 28.

parent company or the subsidiary or the entire group does not keep proper accounting records for their business affairs with the purpose of concealing fraud or improper conduct.³²²

In the case of *VTB Capital plc v Nutritek International Corp*,³²³ a question was raised that, ‘if a person used a puppet company to enter into a contract with a third party in order to perpetrate fraud on that third party, can the court pierce the corporate veil and treat the person as a party to the contract?’³²⁴ The court answered the question in the negative on the basis that the law of tort afforded VTB a remedy for negligent or fraudulent misrepresentation and there was no proof of use of the corporation as a mere façade to conceal the true facts.³²⁵ However, in relation to the above mentioned case, the court in *Ex parte Gore*³²⁶ expressed that if section 20(9) of the Companies Act 2008 was applicable, the English Supreme court in the case of *VTB Capital plc v Nutritek International Corp* may have come to a different conclusion.³²⁷ One may argue, in support of what the court said in *Ex parte Gore*,³²⁸ that if a corporate entity is used as a puppet company and there is proof that it is just a mere façade, the corporate veil may be pierced on the basis that such conduct may constitute ‘unconscionable abuse’.

4.3.6 Mere façade or sham

The mere façade or sham principles have been discussed before in chapter 2. In this case it is being discussed in the context of the parent-subsidiary relationship. A subsidiary can be held by courts to have been established as a mere façade when it is used by the parent company as any instrument to hide the identity of the actual person acting or doing the transactions.³²⁹ In such a case the courts may pierce the corporate veil to reveal the identity of the actual party to the

³²² *Airport Cold Storage* (note 34 above; para 19).

³²³ *VTB Capital plc* (note 267 above).

³²⁴ *ibid* para 24.

³²⁵ *ibid*.

³²⁶ *Ex parte Gore* (note 21 above; para 24).

³²⁷ *ibid*.

³²⁸ *Ex parte Gore* (note 21 above;).

³²⁹ R B Thompson ‘Piercing the Veil Within Corporate Groups: Corporate Shareholders as Mere Investors’ (1999) 13(2) *Connecticut Journal of International Law* 379 390 available at http://www.heinonline.org/HOL/Page?handle=hein.journals/conjil13&div=17&collection=journals&set_as_cursor=40&men_tab=srchresults&terms=PIERCING/THE/VEIL/WITHIN/C/P/ATE/GROUPS&type=matchall accessed on 30 January 2015.

transaction, that is, the parent company. The aggrieved party needs to prove that the parent company was merely using the subsidiary as an instrument to conceal its own identity. One may argue that an aggrieved party can apply to court for the piercing of the corporate veil to reveal the true identity of the parent company so that it can be held liable for the debt.

In the case of *Van Zyl v Kaye*³³⁰ there is a discussion of how the courts may determine what a ‘sham’ is with respect to a trust. The court stated that ‘in determining that a trust is a sham there must be a finding that the requirements for establishing a trust were not met or compliance with the requirements was done in pretence or as a way of deceit.’³³¹ This may constitute ‘unconscionable abuse’ of the trust form and in such a case the courts to pierce the corporate veil. The court in *Van Zyl v Kaye*³³² further stated that when the trust form is abused, generally it is the case that the trustees would have treated the property of the trust as if it was their own personal property.³³³ Therefore, one may submit that there may be the need for the applicant to prove that the trust form was used in a dishonest manner in an effort to avoid liabilities or obligations.

One may argue that the principles highlighted in the paragraph above are applicable in determining what may constitute ‘unconscionable abuse’ in the context of companies and groups of companies. One may argue that there is a possibility that the parent company which is a sole shareholder of a subsidiary may have formed the subsidiary with the intention to use it to avoid liabilities or obligations, thereby hiding behind the veil of incorporation. Such conduct may constitute ‘unconscionable abuse’ and the courts may pierce the corporate veil.

There is, therefore, the need for creditors to base their claims on the conduct of the parent company to pierce the corporate veil, especially in cases where such conduct mentioned in the examples above would constitute ‘unconscionable abuse’.³³⁴ The remedy would allow for the

³³⁰ *Van Zyl* (note 40 above).

³³¹ *ibid* para 19.

³³² *Van Zyl* (note 40 above;).

³³³ *ibid* para 21.

³³⁴ D Subramanien (note 18 above; 157)

creditor to obtain an order from the court to have the parent company meet the financial obligations of the subsidiary so as to remedy the wrong done by the parent company.

4.4 Possible unconscionable abuse of letters of comfort by groups of companies

Parent companies follow the trend of issuing letters of comfort rather than guarantees. As mentioned above in chapter 1, letters of comfort are issued by parent companies to lenders in support of loans granted to their subsidiaries. Lenders and third parties that accept letters of comfort need to be aware of the potential problems that arise as a result of the use and acceptance of these letters.

A letter of comfort is a document issued by a parent company in place of a guarantee to inspire a lender to do business with its subsidiary.³³⁵ These letters of comfort differ from guarantees in that they are not legally binding.³³⁶ Because the letter of comfort is not legally enforceable, it does not create legal obligations for the issuing company.³³⁷ Bradgate and White refer to the letter of comfort as ‘a means of reassuring creditors that their loan or credit facilities will be repaid without actually guaranteeing repayment’.³³⁸ In other words, letters of comfort do not give a creditor the repayment assurance which it requires from the issuing company. Therefore, there is a need to determine whether the corporate veil may be pierced because of ‘unconscionable abuse’ of letters of comfort, since letters of comfort offer little or no enforceability.

4.4.1 Unconscionable abuse through use of letters of comfort

The conduct of the parent company is of importance in determining whether or not to pierce the corporate veil. An example of a case where the use of a letter of comfort may potentially constitute ‘unconscionable abuse’ is that of a parent company which issues a letter of comfort

³³⁵ F Tsu ‘Analyzing Comfort Letters: The Brazilian Legal Perspective’ (2007) 13(1) *Law & Bus Rev Am* 167 167 available at http://www.heinonline.org/HOL/Page?handle=hein.journals/lbramrca13&div=13&collection=journals&set_as_cursor=0&men_tab=srchresults&terms=Analyzing/Comfort/Letters&type=matchall accessed on 30 September 2014.

³³⁶ G A Wittuhn (note 45 above).

³³⁷ *ibid.*

³³⁸ R Bradgate and F White *Commercial Law* Oxford University Press Oxford 2007 322.

and then proceeds to dispose of its shares in the subsidiary or withdraws its financial support from its subsidiary. In this case the subsidiary probably would not have been self-sufficient yet and would eventually be unable to meet its financial obligations. This would prejudice creditors as they would be left to sue a company which is penniless. The court may find such conduct as constituting unconscionable abuse and eventually piercing the corporate veil to remedy the wrongful conduct by the parent company.

It is possible that the parent company may issue a letter of comfort whilst manipulating the credit of its subsidiary knowing that the letter of comfort may not give rise to legal obligations.³³⁹ The motive for this would be to get finance which would not benefit the investors and stakeholders of the subsidiary.³⁴⁰ If the aggrieved party is successful in proving such abuse, it may be argued that under South African company law, abuse of the corporate structure of a subsidiary may be regarded as ‘unconscionable abuse’. Once the courts draw such an inference, the corporate veil may be pierced in terms of section 20(9) of the Companies Act of 2008.³⁴¹

Another case is when a parent company states that ‘it will provide its subsidiary with sufficient means to fulfil their financial obligations and it will act accordingly during the course of the bank’s loan.’³⁴² This statement may look as if it has similar implications to the one in the above paragraph, but such a statement may impose a duty on the parent company not to financially cripple its subsidiary to the extent that it becomes unable to meet its financial obligations,³⁴³ for example, by taking dividends during the course of the bank loan leaving the subsidiary financially drained.³⁴⁴ If the parent company drags its subsidiary into bankruptcy or causes it to trade whilst insolvent, such conduct may constitute ‘unconscionable abuse’ within the company laws of South Africa. In this case the parent company may be rendered liable for the debt of the subsidiary. The courts of South Africa may then exercise their discretion and pierce the corporate veil to render the parent company liable for the debt of its subsidiary.

³³⁹ A Berle (note 38 above).

³⁴⁰ *ibid.*

³⁴¹ Section 20(9) of the Companies Act 2008.

³⁴² B Szathmary (note 316 above; 299).

³⁴³ *ibid.*

³⁴⁴ *ibid.*

4.5 Conclusion

The chapter discussed the nature of groups of companies and issue of ‘unconscionable abuse’ in the context of groups of companies. The application of section 20(9) of the Companies Act of 2008 was discussed taking into consideration instances that may constitute ‘unconscionable abuse’ in the context of groups of companies. The chapter established that the parent company may manipulate the corporate structure of its subsidiary or subsidiaries and that if the conduct of the parent company constitutes ‘unconscionable abuse’ the courts of South Africa may pierce the corporate veil. There was a consideration of recent cases, that is, the *Exparte Gore* case and the *Van Zyl* case. The *Van Zyl* case, which dealt with piercing of the corporate veil of the trust, was considered so that it provides a guideline as to the application of section 20(9) of the Companies Act to groups of companies because in terms of company law a trust can operate as a parent company of a subsidiary. It has been established that a subsidiary may be formed with the intention to use it to avoid liabilities or obligations and such conduct may constitute ‘unconscionable abuse’ and the courts may pierce the corporate veil in terms of section 20(9) of the Companies Act of 2008.

As discussed above, parent companies at times issue letters of comfort instead of guarantees and it has been established that, due to the uncertainty of the legal status of letters of comfort, these letters have the potential of being abused. The potential abuse of letters of comfort which may lead to creditors suffering loss and this creates the need for a solution to creditors. From the discussion above, it is clear that letters of comfort do not create legally binding contractual obligations, thereby allowing the issuing company to avoid liability for the debt of its subsidiary. However, there are circumstances where the letters of comfort create legal relations.

The chapter established that it is difficult or close to impossible for a creditor to make an application to court for the piercing of the corporate veil basing on a letter of comfort because letters of comfort are not legally binding and the mere issuing of a letter of comfort cannot, in itself, be considered as conduct constituting ‘unconscionable abuse on the part of the parent company. It has been established that the creditor has to base their claim on the conduct of the parent company and in this case there should be a nexus between the conduct of the parent

company and the issuing of the letter of comfort. Once the creditor proves that the conduct of the parent company constituted ‘unconscionable abuse’ of the corporate form, then the courts may exercise their discretion to pierce the corporate veil.

Having established the above, the next chapter concludes the dissertation and provides recommendations for creditors when dealing with letters of comfort. The next chapter will also give recommendations for approaches of the court when dealing with groups of companies especially in cases where there is the use of letters of comfort by the parent company. The next chapter will also provide recommendations for the legislature in relation to the regulation of groups of companies.

CHAPTER 5: CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

The concepts of limited liability and of a company's separate legal existence are intertwined. These fundamental concepts regulate the way in which a company functions. As discussed in chapter 1, limited liability enables shareholders to protect their personal assets in the event that the company fails. In this case, shareholders lose only the capital that they invested. Furthermore, risk may be transferred to the creditors, for example, in the event of liquidation of the company, creditors may bear most of the costs of liquidation. The problem may become more complex in the context of groups of companies because the possibility of parent companies abusing the corporate form of its subsidiary is higher than the possibility of abuse in the context of an individual company. The abuse of the corporate form has been discussed in chapter 2 and courts, together with the legislature, have acknowledged the existence of abuse of the corporate form.

In the event of abuse of the corporate form, there is an exception to the doctrine of limited liability and separate legal personality of a company, namely, the doctrine of piercing the corporate veil as indicated in chapter 2. The doctrine applies in circumstances which justify its application. In South Africa, the piercing of the corporate veil started as a common law remedy and has recently developed into a statutory remedy applying to companies. The new statutory remedy is encapsulated in section 20(9) of the Companies Act of 2008. The remedy has been discussed as a solution available to aggrieved creditors who suffered harm due to the abuse of the corporate form of a company, especially in the context of groups of companies.

This dissertation has set out to explore the doctrine of piercing the corporate veil as a new statutory remedy, paying particular attention to groups of companies. The focus on groups of companies further included the use of letters of comfort which parent companies issue rather than issuing a guarantee to support a loan taken by the subsidiary. The question addressed is whether creditors can apply for the piercing of the corporate veil based on a letter of comfort in circumstances where they suffer harm as a result of the abuse of the nature of the letter of

comfort. The dissertation considers creditors and aims to provide piercing the corporate veil as a solution for the aggrieved creditors when the corporate form has been abused causing them to suffer harm.

5.2 Findings

The dissertation has discussed the meaning of the new statutory remedy and the meaning of ‘unconscionable abuse’ in general. The study deliberated on the procedure taken in applying to courts for the piecing of the corporate veil. The procedure also shed light on the meaning of the statutory remedy in its entirety. It has been established that, unlike the common law remedy, the statutory remedy is readily available in the sense that it can be applied when the circumstances justify it. It has also been established that the statutory remedy has not replaced the common law remedy, but it is complementary to it. In the event that the requirements of the statutory remedy are not met, the common law remedy can be relied on.

In relation to the application of the remedy both in the context of individual companies and groups of companies, it has been highlighted in chapter 3 and 4, that a flexible approach is preferable as compared to the categorisation approach. It has been established that the categorisation approach may open doors for manipulation of loopholes that may be created. A flexible approach in terms of common law was brought to light in the case of *Cape Lubner*³⁴⁵ and such an approach is necessary both for the common law and the statutory remedy because it allows for the courts to look at each case upon its own facts.

Section 20(9) of the Companies Act 2008 has brought clarity and some certainty to the remedy in the sense that courts now have the discretion to pierce the corporate veil. However, the statutory provision does not provide for the meaning of the phrase ‘unconscionable abuse’. The term has been discussed in chapter 3 and it has been established that it is different from the term ‘unconscionable injustice’, which was a test applied in the case of *Hulse-Rueter*.³⁴⁶ ‘Unconscionable abuse’ refers to the nature of the conduct and ‘unconscionable injustice’ refers

³⁴⁵ *Cape Pacific* (note 10 above; 805).

³⁴⁶ *Botha* (note 31 above; 525).

to the result of the conduct. Thus, the former is what helps the courts determine whether the statutory remedy of piercing the corporate veil applies to a specific set of facts or not.

It has been highlighted in chapter 3 that the new statutory remedy is slightly similar to the remedy of piercing the corporate veil applied to close corporations found in section 65 of the Close Corporations Act of 1984. However, the difference between these two provisions is that the term 'gross abuse' is used in section 65 of the Close Corporations Act of 1984 and the corporate veil of a close corporation was pierced in the case of gross abuse of the corporate form. The circumstances under which the corporate veil was pierced in terms of the Close Corporations Act of 1984 serve as guidelines to the interpretation of section 20(9) of the Companies Act of 2008. It has been established that the use of the term 'unconscionable abuse' may also allow for creditors to have unqualified availability of the statutory remedy despite having access to alternative remedies.

Chapter 4 dealt with groups of companies and the application of the statutory remedy in that context. It was established, in chapter 4, that it is possible for the parent company to manipulate the separate legal existence of its subsidiary or subsidiaries and that this manipulation may be seen by courts as the disregard of the separate juristic personality of the subsidiary. If such conduct is proven to have perpetrated, it should constitute 'unconscionable abuse' and the courts of South Africa should pierce the corporate veil.

Chapter 4 included a discussion of the use and possible abuse of letters of comfort by groups of companies, especially the parent company. It has been established that the legal status of letters of comfort is uncertain since they do not create any legal obligations. This allows the issuing company to avoid liability for the debt of its subsidiary because the issuing of a letter of comfort creates a moral obligation which the parent company does not have to legally fulfil. It is rather unfortunate that the corporate veil may not be pierced based on the letter of comfort and it may only be pierced based on the conduct of the parent company, such conduct having to be 'unconscionable conduct'. Examples of conduct which may constitute 'unconscionable abuse' in relation to transactions involving letters of comfort have been highlighted in chapter 4 to

encourage them to apply the remedy and to make them aware of the bases upon which they can apply to the courts to pierce the corporate veil.

5.3 Recommendations

Based on the findings of this dissertation summarised above, recommendations for the benefit of creditors and courts on the interpretation of the new statutory remedy with regard to groups of companies and also the use of letters of comfort will be presented in this section.

5.3.1 Piercing of the corporate veil of groups of companies vs individual companies

There is also the application of the statutory remedy in the context of groups of companies and the rules that apply stem from those that apply in the general context of an individual company. The rules that apply to individual companies are adequate as a starting point when dealing with a group of companies, but it may however be necessary to consider groups of companies in their own context. The reason is that the parent companies benefit from the transactions made by the subsidiary, which encourages them to conduct dangerous and risky activities through subsidiary companies, in some instances, with very little capitalisation and a large sum of debt.³⁴⁷ In some cases, the large debt is supported by a letter of comfort, which has a legal status which is uncertain. When the parent company is not liable for the debt as a surety and has manipulated the credit of the subsidiary creditors lose out on their monies because separate legal existence protects the parent company. This, therefore, means that South African courts need to stay on their guard when dealing with cases involving groups of companies so as to protect the interests of creditors. The dissertation recommends that the corporate veil be pierced because manipulation of subsidiaries and disregard of the separate legal existence of the subsidiary should constitute ‘unconscionable abuse’ and section 20(9) of the Companies Act 2008 should apply.

³⁴⁷ H Anderson (note 309 above; 353).

5.3.2 Conduct of parent companies as the sole basis for piercing of the corporate veil

There are alternative approaches are recommended for creditors to deal with the problem of their inability to piece the corporate veil whilst attempting to base the application on a letter of comfort. Creditors should base their application on the conduct of the parent company or the group of companies as a whole. An example discussed above is that of a parent company which exercises excessive control of the subsidiary to such an extent that the subsidiary loses it freewill to independently make decisions. The excessive control may be exercised to hide some fraud which may have been committed through the use of the subsidiary or the group as a whole. Such conduct should be considered by courts as constituting ‘unconscionable abuse’ and the corporate veil should be pierced if the aggrieved creditor proves that there has been excessive control of the subsidiary exercised to commit and hide fraud.

5.4 Contribution of the study

This dissertation is an exploratory and analytical study aimed at providing guidelines on the application of the new statutory remedy, especially in the context of groups of companies. The dissertation is both descriptive and explanatory. It outlines the development of the remedy of piercing of the corporate veil in South Africa and explains its application in the general context and in the context of groups of companies. It takes into account the use of letters of comfort by groups of companies and explored the legal status of letters of comfort within the corporate laws of South Africa. There was also an exploration of the possibility of the ‘unconscionable abuse’ of letters of comfort and also the possibility of piercing the corporate veil basing on the issuing of the letter of comfort by a parent company. In the event that the corporate veil cannot be pierced basing on a letter of comfort, the conduct of the parent company was recommended as a basis for the application since the test to pierce the corporate veil in terms of section 20(9) of the Companies Act of 2008 is ‘unconscionable abuse’ of the juristic personality of a company. The aim was to bring awareness to creditors on the possibility of piercing the corporate veil and encouraging them to apply the remedy when the circumstances seem to justify it.

It is recommended that further study be conducted on the operation of groups of companies and the possibility of developing the corporate laws of South Africa to accommodate the problems that are associated with groups of companies since they cannot exactly be treated the same as individual companies.

5.5 Conclusion

By piercing the corporate veil the courts ensure that a corporate group seeking the benefits of limited liability also admits the parallel responsibilities.³⁴⁸ This allows for court to remedy the wrong and to restore the aggrieved creditor to their original position.

³⁴⁸ I M Ramsay and D B Noakes 'Piercing the Corporate Veil in Australia' (2001) 19 *Company and Securities L J* 250 264 available at https://law.unimelb.edu.au/files/dmfile/Piercing_the_Corporate_Veill.pdf accessed on 3 November 2014.

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Woolfson v Strathclyde Regional Council (1979) 38 P & CR 521, HL.

Statutes

Consumer Protection Act 68 of 2009.

Rule 6 of the Uniform Rules of Court.

The Close Corporations Act of 1984.

The Companies Act 61 of 1973.

The Companies Act 71 of 2008.

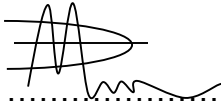
The Constitution of the Republic of South Africa Act 106 of 1996.

RESEARCH ETHICS POLICY : STUDENT'S UNDERTAKING

Research Topic:A CRITICAL ANALYSIS OF THE
PIERCING OF THE CORPORATE VEIL IN SOUTH AFRICAN CORPORATE LAW,
WITH SPECIAL REFERENCE TO THE POSITION IN GROUPS OF
COMPANIES.....

Name of supervisor / module co-ordinator:PROF LUIZ.....

I ..PAUL TATENDA MASHIRI.. (Full Names), hereby acknowledge that I have read and understood the University of KwaZulu-Natal's document entitled *Research Policy V: Research Ethics*. I have acquainted myself with the contents of Appendix A of that document, the University's Code of Conduct for Research, and I undertake to comply with the requirements. I declare that my reseach is confined to literature review, or similar research methods that do not raise any ethical concerns, and therefore does not require ethical clearance.

Signature : 

Date : 04 APRIL 2014.....

Student Number :214581753.....