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# CHAPTER 1: GENERAL INTRODUCTION

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## 1.1 Background of Study

The cornerstone of company law is founded on the separate legal personality of a company.<sup>1</sup> Separate legal personality can be defined with reference to section 19(1) of the Companies Act 71 of 2008 (hereafter, 'the current Companies Act') which provides that a company has all the rights and liabilities that a natural person has except those that a juristic person cannot fulfil or enforce.<sup>2</sup> This separate legal personality can be described through a metaphor, as a 'veil' that separates the company from its controllers and holders.<sup>3</sup>

Piercing of the corporate veil is an exception to this principle, namely the separate legal personality of a company. Straughton LJ in *Atlas Maritime Co SA v Avalon Maritime Ltd, The coral rose (No1) case*,<sup>4</sup> defined piercing of the corporate veil as an instance where the separate legal personality of the company is absorbed and the entity's liabilities, rights and obligations are attributed to its shareholders and directors.<sup>5</sup> Piercing of the corporate veil should be differentiated from lifting of the corporate veil that takes place when the courts look at who is actually controlling the business and does not necessarily mean ignoring the separate legal personality of a business.<sup>6</sup> This can be for purposes of determining the nationality of the controllers of the company. For example, the courts lifted the corporate veil in *Daimler Co Ltd v Continental Tyre and Rubber Co Great Britain Ltd*,<sup>7</sup> where a company (the Continental Tyre and Rubber Company) formed in England had German resident shareholders and directors. The company sold tyres to Daimler Co Ltd (an English company). When war broke out between England and Germany in 1914 it had to be established whether the company was an 'alien enemy company' or not, by looking at who controlled the company. When the court lifted the corporate veil they found the company to be an alien company. The court in this case did not pierce the corporate veil and thus ignore the company's legal personality, they merely looked at who controlled the company in order to avoid trading with the 'enemy'.

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<sup>1</sup> Cassim FHI *et al* (2012) 29.

<sup>2</sup> *Ibid.*

<sup>3</sup> Cohen J (2006) LLM Dissertation University of Cape Town 20.

<sup>4</sup> (1991) 4 ALL ER 769 (CA).

<sup>5</sup> *Ibid* at 779. See also *Amlin (SA) Pty Ltd v Van Kooij* 2008 (2) SA 558 (C) 10 where the court described piercing the corporate veil as "opening the curtains" of the company in order to see what is happening inside.

<sup>6</sup> Cassim FHI *et al supra* n1 at 46. See also in *Atlas Maritime Co SA v Avalon Maritime Ltd, The coral rose (No1)* 1991 4 ALL ER 769 (CA) at 779.

<sup>7</sup> (1916) 2 AC 307.

Under common law there is no fixed indication of when the corporate veil will be pierced. The courts have pierced the corporate veil when there was an evasion of a contractual duty,<sup>8</sup> fraud<sup>9</sup> or improper use of a company. These are not the only instances when the courts can pierce the corporate veil. This form of piercing of the corporate veil in terms of the common law will be referred to as ‘judicial piercing’.

The second type of piercing is statutory piercing which is found in Section 20(9) of the current Companies Act. It provides that-

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

Section 20(9) is similar to section 65 of the Close Corporation Act 69 of 1984 (hereafter the ‘CC Act’) that provides for piercing the corporate veil of a close corporation if there is ‘gross abuse’ of its separate legal personality.

What an ‘interested person’ or ‘unconscionable abuse’ is, has not been defined in the current Companies Act and this mini-thesis endeavours to clarify these concepts. The CC Act also, in its definition section, does not provide meaning of the concepts ‘interested person’ and ‘gross abuse’.

This mini-thesis provides a critical analysis of the doctrine of piercing the corporate veil at common law as well as the interpretation of the statutory piercing provisions as entrenched in section 20(9) of the current Companies Act. Furthermore, a comparison between the statutory piercing provisions under section 65 of the CC Act and section 20(9) of the current Companies Act is offered. A comparative analysis with Australia and the United Kingdom is also offered.

## 1.2 Purpose of Study

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<sup>8</sup> See for example, *Gilford Motors v Horne* 1933 Ch 935 (CA) where a former managing director of a company had signed a restraint of trade clause in terms of which he agreed not to engage in business related to that company. After he left the employment of the company he incorporated a company that engaged in similar business to the company in which he was the managing director. The court held that the company was being used as a ‘device’ to contravene the restraint of trade clause.

<sup>9</sup> See for example *Le Bergo Fashions CC v Lee* 1998 (2) SA 608 (C) at 613 where Lee signed a restraint of trade clause in her personal capacity and used her company (where she was the only shareholder and director) to compete with the applicant. The court held that she used the company to evade the restraint of trade clause.

The main purpose of this mini-thesis is to examine the common law instances where the courts have pierced the corporate veil and the challenges encountered in the process. Secondly an analysis of the legislature's intervention in offering the current statutory piercing provision in terms of section 20(9) and the long existing section 65 is also offered. Analysis of the undefined words namely 'interested person', 'gross abuse' and 'unconscionable abuse', in these two statutory piercing provisions is addressed.

This thesis aims to provide a critical analysis of the interpretation of section 20(9) of the current Companies Act, with regard to its effectiveness in achieving clarity on the circumstances under which courts can disregard the separate juristic personality of artificial persons. This will be done by making a comparison with Australia and the United Kingdom.

### 1.3 Research Questions

The following research questions are addressed in this mini-thesis in order to achieve the purpose of the study as mentioned in 1.2 above:

1. When will the court pierce the corporate veil and when will they not?
2. Should veil piercing be directed by the categorisation approach?
3. Whether judicial piercing is a remedy of last resort or not?
4. What does the current Companies Act provide with regard to the piercing of the corporate veil doctrine?
5. Who has *locus standi* to seek the remedy in terms of section 20(9) of the current Companies Act?
6. What is meant by an 'interested person' in terms of section 20(9) of the current Companies Act?
7. What is meant by 'unconscionable abuse' in terms of section 20(9) of the current Companies Act?
8. What is the distinction between section 20(9) and section 65?
9. Is statutory piercing the corporate veil regarded as an exceptional remedy of last resort?
10. Is S20(9) of the current Companies Act replacing common law judicial piercing of the corporate veil?
11. Can the courts extend corporate veil piercing to groups of companies?
12. What are the foreign trends in dealing with the doctrine of veil piercing in selected jurisdictions, namely United Kingdom and Australia?

### 1.4 Delineation and Limitation of Study

This mini-thesis does not take into account legal development on the doctrine of piercing the corporate veil that occurred after 01 June 2015.

## 1.5 Methodology

This mini-thesis follows a qualitative literature research based methodology. This is where reliance is on primary sources in the form of legislation and case law and on secondary sources in the form of articles, dissertations and textbooks. A comparative approach in line with section 5(2) of the Companies Act<sup>10</sup> is used to evaluate the research problem and answer the research questions. A critical analysis of section 20(9) and section 65 as well as a comparative study on selected foreign jurisdictions namely, United Kingdom and Australia is offered.

## 1.6 Structure (Overview of Chapters)

Chapter 1 provides the general introduction of the thesis, chapter 2 covers the judicial piercing of the corporate veil, chapter 3 deals with the statutory veil piercing, chapter 4 covers veil piercing in groups of companies, chapter 5 pertains to the comparative approach and finally chapter 6 provides conclusions and recommendations.

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<sup>10</sup> Which encourages reliance on foreign company law when interpreting the Act.

# CHAPTER 2: JUDICIAL PIERCING OF THE CORPORATE VEIL

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## 2.1 Introduction

As already mentioned in Chapter one, the cornerstone of company law is the separate legal personality of a company.<sup>1</sup> The company's assets and liabilities are separate from its controllers and holders. Piercing of the corporate veil is an instance where the separate legal personality of the company is absorbed and its liabilities, rights and obligations are attributed to the company's shareholders and directors.<sup>2</sup>

This chapter deals with judicial piercing of the corporate veil. Firstly, the principle of separate legal personality with reference to case law will be discussed. Secondly, a critical analysis of the common law principles dealing with the doctrine of piercing the corporate veil will follow. This chapter seeks to answer the first three questions listed in chapter one,<sup>3</sup> namely, when will the court pierce the corporate veil and when will they not? Should veil piercing be directed by the categorisation approach? And whether piercing the corporate veil at common law is a remedy of last resort or not?

## 2.2. The concept of separate legal personality

Separate legal personality can be defined with reference to section 19(1) of the current Companies Act which provides that a company has all the rights and liabilities that a natural person has except those that a juristic person cannot fulfil or enforce. This is also affirmed by section 8(4) of the Constitution of the Republic of South Africa 108 of 1996 (hereafter 'the Constitution') which provides that a juristic person is entitled to the same rights as a natural person as far as it is possible for the juristic person to exercise those rights. This is subject to section 36 of the Constitution which states that the rights entrenched in the Bill of Rights are not absolute and may be limited if it is justifiable and reasonable in an open and democratic society based on human dignity, equality and freedom, taking into account a number of factors.<sup>4</sup>

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<sup>1</sup> Cassim FHI *et al* (2012) at 29.

<sup>2</sup> *Atlas Maritime Co SA v Avalon Maritime Ltd, The coral rose (No1)* (1991) 4 ALL ER 769 (CA) at 779.

<sup>3</sup> See 1.3 above.

<sup>4</sup> The factors to be taken into account are the nature of the right; the importance of the purpose of the limitation; the nature and extent of the limitation; the relation between the limitation and its purpose; and Less restrictive means to achieve the purpose. (Section 36 (1) (a)-(e)).

From this principle of separate legal personality flows consequences such as (to name but a few) the fact that the shareholders of a company cannot be held liable for the debts of the company, the company can be a party to litigation in its own name, the assets and property of the company belong to it and not to its shareholders, the profits of the company belong to it and the company does not get dissolved when its shareholders cease to form part of it.<sup>5</sup>

This concept was coined in the case of *Salomon v Salomon*<sup>6</sup> where the House of Lords held that the company was a separate legal person and it does not matter what its controller's intentions were in incorporating the company.<sup>7</sup> The separate legal personality of a company was affirmed by Lord Macnaghten who pointed out that "[t]he company is at law a different person altogether from the subscribers to the memorandum; and [it] is not in law an agent of the subscribers or trustee for them."<sup>8</sup>

The South African case of *Dadoo Ltd v Krugersdorp Municipal Council*,<sup>9</sup> further emphasised this principle of separate legal personality by stating that it is of crucial basis not just an artificial concept.<sup>10</sup> The court held that the principle entailed that a company upon its incorporation is distinct from its shareholders.<sup>11</sup> The company does not take on the nationality of its incorporators or shareholders.<sup>12</sup>

### 2.3. Analysis of common law principles dealing with piercing the corporate veil

The separate legal personality of a company is susceptible to abuse. The doctrine of piercing the corporate veil was introduced to try and deal with such abuse.<sup>13</sup> Piercing of the corporate veil has the result that the holders and controllers of the company will become liable for the actions of the company. There are various ways in which the separate legal personality can be abused such as, (to name but a few) where a director uses the separate legal personality of a company to circumvent his fiduciary duty<sup>14</sup> and also where the separate legal personality of a company is used to

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<sup>5</sup> Cassim FHI *et al supra* n1 at 29.

<sup>6</sup> (1897) AC 22.

<sup>7</sup> At 24.

<sup>8</sup> At 50.

<sup>9</sup> (1920) AD 550.

<sup>10</sup> At 550.

<sup>11</sup> *Ibid.*

<sup>12</sup> *Ibid* at 556.

<sup>13</sup> Cassim FHI *et al supra* n1 at 29.

<sup>14</sup> See *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168, where the court refused to recognise the separate legal personality of a subsidiary company used by Robinson as a device to evade the fiduciary duties he owed to the company where he was a director.



circumvent one's contractual duty.<sup>15</sup> In *Ebrahim v Airports Cold Storage (Pty) Ltd*<sup>16</sup> the liquidators of a corporation that no longer had assets upon its liquidation sought to have the members of the corporation personally liable for outstanding debts of the corporation. The court held that the separate legal personality of a corporation may be withdrawn if it is being abused.<sup>17</sup>

At common law, the courts have generally considered piercing of the corporate veil in various instances such as those addressed below in 2.3.1. These instances are not a closed list, as there are currently no fixed categories wherein the courts will pierce the corporate veil.<sup>18</sup> Paragraph 2.3.2 below addresses the question of whether at common law there should be categorisation of instances when the court will pierce the corporate veil or whether such categorisation is not necessary.

The court in *Cape Pacific v Lubner controlling Investments* (hereafter '*Cape Pacific case*')<sup>19</sup> laid down general principles on how to deal with piercing the corporate veil at common law.<sup>20</sup> That court stated that courts should not easily pierce the corporate veil, to avoid undermining the policy and principles of the concept of separate legal personality<sup>21</sup> and; that the courts do not have a general discretion to pierce the corporate veil whenever it considers it just to do so.<sup>22</sup>

### 2.3.1. Common law instances of veil piercing:

#### 2.3.1.1 Abuse of the corporate veil to avoid compliance with one's fiduciary obligation

In *Robinson v Randfontein Estates Gold Mining Co Ltd*<sup>23</sup> Robinson (hereafter 'R'), a director of a holding company tried to evade his fiduciary duties to act in good faith, in the best interest of the company and the duty to avoid conflict of interest, by using

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<sup>15</sup> See *Gilford Motors v Horne 1933 Ch 935 (CA)* where a former managing director of a company had signed a restraint of trade clause in terms of which he agreed not to engage in business related to that company. After he left the employment of the company he incorporated a company that engaged in similar business to the company in which he was the managing director. The court held that the company was being used as a 'device' to contravene the restraint of trade clause. See also *Le Bergo Fashions CC v Lee 1998 (2) SA 608 (C)* where Lee signed a restraint of trade clause in her personal capacity and used her company (where she was the only shareholder and director) to compete with the applicant. The court held that she used the company to evade the restraint of trade clause.

<sup>16</sup> 2009 1 ALL SA 330 (SCA).

<sup>17</sup> At 15.

<sup>18</sup> Cassim FHI *et al supra* n1 at 43.

<sup>19</sup> 1995 2 All SA 543 (A).

<sup>20</sup> These principles are not categories of when a court should or should not pierce the corporate veil as each case must be decided on the merit of its facts.

<sup>21</sup> *Cape Pacific v Lubner supra* n19 at para 801.

<sup>22</sup> At 552.

<sup>23</sup> 1921 AD 168.

a subsidiary company to usurp a corporate opportunity<sup>24</sup> pursued by the holding company.<sup>25</sup> The court pierced the corporate veil of the subsidiary company and saw it as being part of the holding company to which R owed his fiduciary obligations.<sup>26</sup>

### 2.3.1.2 Abuse of the corporate veil to circumvent a contractual duty

In *Die Dros (Pty) Ltd v Telefon Beverages CC*<sup>27</sup> a close corporation was used by a natural person who was subject to a restraint of trade clause to engage in activities restricted by the restraint of trade clause. The court held that the corporate veil will be pierced where the separate legal personality of a company or close corporation is used to evade a restraint of trade clause.<sup>28</sup> A similar holding was also made in the case of *Gilford Motors v Horne*<sup>29</sup> where a former managing director of a company had signed a restraint of trade clause in terms of which he agreed not to engage in business related to that company. After he left the employment of the company he incorporated a company that engaged in similar business to the company in which he was the managing director. The court held that the company was being used as a 'device' to contravene the restraint of trade clause.<sup>30</sup>

### 2.3.1.3 Abuse of the corporate veil through fraud

In *Orkin Bros. Limited v Bell*<sup>31</sup> the company was used to purchase goods on credit whilst being aware that the company would be unable to pay it back as the company was insolvent. The courts lifted the veil and found the directors to be liable for the debt.<sup>32</sup> In *The Shipping Corporation of India Ltd v Evdomon Corporation*<sup>33</sup> the

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<sup>24</sup> The company wanted to purchase land; R purchased the land through the subsidiary and resold it to the company at a profit.

<sup>25</sup> *Robinson supra* n23 at 168.

<sup>26</sup> *Ibid* at 194-195.

<sup>27</sup> 2003 (4) SA 207 (C).

<sup>28</sup> At 24.

<sup>29</sup> 1933 Ch 935 (CA).

<sup>30</sup> At 956. See also *Le Bergo Fashions CC v Lee* 1998 (2) SA 608 (C) at 613 where Lee signed a restraint of trade clause in her personal capacity and used her company (where she was the only shareholder and director) to compete with the applicant. The court held that she used the company to evade the restraint of trade clause. See also *Jones v Lipman* (1962) 1 ALL ER 442 at 445 where Lipman (hereafter 'L') entered into a contract with Jones ('J') for the sale of land. L wanted to be released from the contract but Jones refused and said he would claim for specific performance. To overcome J's prospective specific performance L incorporated a company to which he transferred the land. The court pierced the corporate veil and held that the company was merely a sham that L used to circumvent his contractual ability. See also *Cattle-breeders Farm (Pty) Ltd v Veldman* (1974) 1 ALL SA 289 (RA) at 173 where Mr Veldman tried to use a company to evict his wife from their matrimonial home. The court pierced the corporate veil and held that Mr Veldman and the company were one person.

<sup>31</sup> 1912 AD 198.

<sup>32</sup> At 107.

<sup>33</sup> 1994 (1) SA 550 (A).

government of India owed Evidomon money. Evidomon wanted to pierce the corporate veil between the company and its controllers namely the government and therefore attach the property of a company that was wholly owned by the government. The court pointed out that the grounds for piercing the corporate veil can be fraud, dishonesty or improper conduct. The judge pointed out that in the current case there was no basis to pierce the corporate veil as there was no fraud.<sup>34</sup>

### 2.3.2 Instances of piercing the corporate veil: Categorisation or not?

The courts have not followed a consistent approach on when to pierce the corporate veil and when not to. Therefore there is uncertainty at common law with regards to the principles determining when the courts will pierce the corporate veil and when they will not.<sup>35</sup> This has brought about the question of whether there should be categorisation of the instances when the court should pierce the corporate veil or not.

In the case of *Cape Pacific case*, Lubner Controlling Investments (Pty) Ltd (hereafter 'LCI') and Gerald Lubner Investments (hereafter 'GLI') were owned by a certain Lubner. LCI entered into an agreement to sell its shares and loan account in Findon Investment (Pty) Ltd to Cape Pacific Ltd. LCI however breached this contract and transferred the shares to GLI instead. LCI argued that Cape Pacific Ltd could not claim specific performance but could only claim damages as the shares were no longer in LCI's possession. The court in this case pierced the corporate veil between LCI and GLI as it was evident that LCI was using the separate legal personality between it and its sister company to evade its contractual duties to transfer the shares to Cape Pacific Ltd.<sup>36</sup>

Smalberger JA in his judgment pointed out that "the law is far from [being] settled with regard to the circumstances which it would be permissible to pierce the corporate veil."<sup>37</sup> He then submitted that the facts and substance of each case must be considered and that the substance instead of the form of things namely, the way things appear.<sup>38</sup> The court in *Hulse-Reutter v Godde*<sup>39</sup> confirmed that the instances allowing for piercing the corporate veil are not fixed.<sup>40</sup> This case dealt with holding directors of the company accountable for the use of the company as a scapegoat to carry out unlawful corporate behaviour such as fraud.

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<sup>34</sup> At 25.

<sup>35</sup> Cassim *et al supra* n1 at 48.

<sup>36</sup> *Ibid.*

<sup>37</sup> *Ibid* at 802.

<sup>38</sup> *Ibid.*

<sup>39</sup> 2001 (4) SA 1336 (SCA).

<sup>40</sup> At 20.

Dauids in his article, mentions that the reason there is no general test to determine if a particular situation amounts to piercing of the corporate veil is due to the fact that the courts have relied on certain categories to determine instances when piercing the corporate veil can be used as a remedy for example when there is fraud, agency or evasion of a legal obligation.<sup>41</sup>

Domanski submits that not having a category of instances when the court will pierce the corporate veil has led to an inconsistency on when the piercing of the corporate veil will occur. He argues that this approach has introduced an uncertainty in the law.<sup>42</sup>

Mthembu in his dissertation submits that having categories may be problematic if there is an instance that is not catered for in a category but fairness, equity and justice provides for the corporate veil to be pierced.<sup>43</sup> He also points out that categorising may lead to a rigid approach.<sup>44</sup>

I submit that the courts when piercing the corporate veil under common law should follow a two-way approach. This entails that firstly, the courts be guided by existing categories. This will eliminate uncertainty and promote fairness as the corporate veil will be pierced when a particular category is applicable. Secondly, in light of flexibility and where no other remedy is available, the courts should be entitled to exercise a fettered discretion based on what they deem fit, reasonable and justifiable to pierce the corporate veil taking into account the facts of each case and the level of abuse of the corporate personality status of the entity.

### 2.3.3 Remedy of last resort?

Piercing the corporate veil is a drastic remedy as it ignores the separate legal personality of a company which is the cornerstone of company law. It is thus important to establish if such remedy can be used when there are other remedies available or if such remedy should be used as a remedy of last resort.

In the *Cape Pacific* case the court held that piercing of the corporate veil is not a remedy of last resort but the availability of other remedies should be taken into consideration.<sup>45</sup> In *Hulse-Reutter v Godde*<sup>46</sup> the court, however, held that since the remedy of piercing the corporate veil is so severe it should be sought as a last resort

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<sup>41</sup> Davids L.C. (1994) *TSAR* at 155.

<sup>42</sup> Domanski (1986) *SALJ* (103) at 224.

<sup>43</sup> Mtembu LV (2002) LLM Dissertation University of Natal at 74.

<sup>44</sup> *Ibid* at 74.

<sup>45</sup> At 805.

<sup>46</sup> 2001 (4) SA 1336 (SCA).

measure.<sup>47</sup> The court in *Amlin (SA) Pty Ltd v Van Kooij*<sup>48</sup> also held that piercing the corporate veil should be used as a last resort remedy.<sup>49</sup>

Therefore from the different holdings of the above mentioned cases it is clear that at common law it is uncertain whether piercing the corporate veil is a remedy of last resort or not. I submit that piercing the corporate veil should not be relied on lightly if there are other remedies available. It should be considered a remedy of last resort, since it has adverse consequences such as holding the controllers and/or the holders of the company personally liable for the actions of the company.

## 2.4 Conclusion

At the heart of company law is the separate legal personality of a company from which flows consequences such as the company litigating in its own name and owning assets in its own right. Separate legal personality can be abused, for example by evading contractual or fiduciary obligations. In order to curb such abuse, the doctrine of piercing the corporate veil can be sought as a remedy.

Judicial veil piercing has no specified categories of instances wherein the courts will pierce the corporate veil.<sup>50</sup> The courts have generally pierced the corporate veil where there is fraud, evasion of contractual or fiduciary duties. Lack of categorisation has caused uncertainty as to when the corporate veil will be pierced and when will it not be pierced. Having fixed categories can however result in creating a rigid system.<sup>51</sup> I submit, as indicated above that a two way approach that allows the courts to use existing categories and their discretion be followed, which will cater for certainty and flexibility.<sup>52</sup>

The doctrine of piercing the corporate veil has now been codified. Section 20(9) of the current Companies Act has introduced statutory piercing of companies' corporate veils. Legal statutory piercing of the corporate veil is discussed in Chapter 3 of this dissertation.

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<sup>47</sup> At 23.

<sup>48</sup> 2008 (2) SA 558 (C).

<sup>49</sup> At 23.

<sup>50</sup> The Supreme Court of Appeal in the *Cape Pacific v Lubner* case implied that our law does not have set categories of instances determining when a court will pierce the corporate veil and therefore there is no categorising approach.

<sup>51</sup> Mthembu LV supra n43.

<sup>52</sup> See paragraph 2.3.2.

# CHAPTER 3: STATUTORY PIERCING OF THE CORPORATE VEIL

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## 3.1 Introduction

The doctrine of piercing the corporate veil under common law is overloaded with uncertainties. There are no fixed instances of when the courts should or should not pierce the corporate veil. The legislature has tried to address this dilemma by codifying the doctrine under section 20(9) of the current Companies Act.

Section 7 of the current Companies Act, *inter alia*, states that, transparency and meticulous governance of business enterprise is the purpose that the current Companies Act promotes. The legislature in line with this purpose has provided for statutory piercing of the corporate veil in terms of section 20(9) of the current Companies Act. Section 20(9) encourages ‘meticulous governance of the business enterprise’ by offering a remedy to ‘interested persons’ to pierce the corporate veil of a business enterprise where there is ‘unconscionable abuse’. Therefore, where the business enterprise is governed meticulously there should not be any ‘unconscionable abuse’ of the corporate personality.

Section 20(9) provides for piercing the corporate veil by “an interested person” when there has been ‘unconscionable abuse’ of the separate legal personality of the company through its incorporation, use of the company as a juristic person and any act by or on behalf of the company. The section applies either by means of an application by “an interested person” or by means of an action proceedings involving the company where the court may *mero motu* pierce the corporate veil.

Statutory piercing of the corporate veil is not a new instrument in South African law. The CC Act provides for the piercing of the corporate veil of a close corporation where there is ‘gross abuse’ of the juristic personality of the close corporation as a separate legal personality.<sup>1</sup> This section is similar to section 20(9) of the current Companies Act in that both sections aim to pierce the corporate veil of an entity (be it a company or a close corporation) where there is some kind of abuse of the entity’s separate legal personality. This chapter offers a comparison between these two sections with the aim of interpreting the sections considering the undefined words contained in these statutory provisions.

This chapter looks at who has the *locus standi* to seek the remedy of statutory piercing of the corporate veil. Furthermore, this chapter provides an analysis of the interpretation of the undefined term ‘interested person’. An outline of the grounds for piercing the corporate veil and remedies available is offered. Chapter 3 aims to

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<sup>1</sup> At section 65.

answer the research question whether piercing the corporate veil in terms of the current Companies Act is a remedy of last resort and finally whether section 20(9) of the current Companies Act replaces the common law principles discussed in chapter 2 of this thesis. In essence, this chapter seeks to answer research questions 4-11 listed in Chapter 1 of this dissertation.

### 3.2. Comparison of section 20(9) of the Companies Act and section 65 of the Close Corporation Act

Section 20(9) of the current Companies Act provides as follows,

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

Whereas section 65 of the CC Act provides,

“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.”

It can be seen from the above provisions that the two sections are similar. Both sections provides for piercing the corporate veil by an ‘interested person’ when there is some kind of abuse of the separate legal personality of an entity.<sup>2</sup> The current Companies Act deals with the separate legal personality of a company, whilst the CC Act deals with that of a close corporation.

The fundamental difference between the two sections is the ground for piercing the corporate veil. In terms of the current Companies Act, the corporate veil will be pierced if there is an ‘unconscionable abuse’, whereas in terms of the CC Act the

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<sup>2</sup> “Unconscionable abuse” in terms of section 20(9) and “gross abuse” in terms of section 56.

corporate veil will be pierced if there is ‘gross abuse’. Both these terms are not defined in either one of the Acts. I submit that failure by the legislature to define these terms in both Acts is a shortcoming, as now definition and interpretation of the terms are left to the courts.<sup>3</sup>

### 3.2.1. Locus Standi

*Locus standi* deals with who can approach the court to implement the remedy of piercing the corporate veil. For a person to have *locus standi* in a matter they have to have a direct interest in it.<sup>4</sup> The interest must be real and not merely academic.<sup>5</sup> This means that the interest must not be a hypothetical interest.

In line with section 157 of the current Companies Act<sup>6</sup>, an application in terms of section 20(9) can be instituted in various forms; firstly directly by an interested person, in the second place through a representative action, thirdly through a public interest action and lastly through the Companies Intellectual Property Commission or the Take Over Regulation Panel.

In terms of both section 20(9) of the current Companies Act and section 65 of the CC Act an ‘interested person’ may bring an action for the piercing of the corporate veil. Both Acts have failed to define who an ‘interested person’ is. Guidance can be sought from the principles of the interpretation of statutes, in terms of which the literal meaning of the words must be applied.<sup>7</sup> Section 5(1) of the current Companies Act provides that the current Companies Act must be interpreted and applied in a way that gives effect to the purposes set out in section 7. In terms of section 5(2) where appropriate, foreign company law may be considered.

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<sup>3</sup> 3.2.2 will discuss how the courts have thus far interpreted these terms.

<sup>4</sup> See also *Jacobs v Waks* 1992 (1) SA 521 (A) at 533-4.

<sup>5</sup> *Dalrymple v Colonial Treasurer* 1910 TS 372 at 390. See also *Jacobs v Waks* 1992 (1) SA 521 (A) at 533-4.

<sup>6</sup> This sections provides that where an application in terms of the current Companies Act is inter alia, to be brought before the court, the person who will have the locus standi to bring such an application is a person-

“(a) directly contemplated in the particular provision of this Act;

(b) acting on behalf of a person contemplated in paragraph (a), who cannot act in their own name;

(c) acting as a member of, or in the interest of, a group or class of affected persons, or an association acting in the interest of its members; or

(d) acting in the public interest, with leave of the court.

(2) The Commission or the Panel, acting in either case on its own motion and in its absolute discretion, may—

(a) commence any proceedings in a court in the name of a person who, when filing a complaint with the Commission or Panel, as the case may be, in respect of the matter giving rise to those proceedings, also made a written request that the Commission or Panel do so; or

(b) apply for leave to intervene in any court proceedings arising in terms of this Act, in order to represent any interest that would not otherwise be adequately represented in those proceedings.”

<sup>7</sup> Botha C (2009) at 47.



Taking into account the similarities between section 20(9) and section 65, the interpretation of 'interested person' in terms of section 65 should be used as an aid to give meaning to the phrase 'interested person' in terms of section 20(9).<sup>8</sup>

The court in *Ex Parte Gore NO and Others NNO* (hereafter '*Ex Parte Gore*')<sup>9</sup> interpreted the term 'interested person' used in section 20(9) stating that the definition is to not be 'mystified' and in order to qualify as an 'interested person' the person must have direct and sufficient interest in the remedy sought.<sup>10</sup> *In casu*, forty one liquidators, liquidating the companies were found to be 'interested persons' in terms of the section 20(9).

The court held that-

"The standing of any person to seek a remedy is in terms of provisions of well-established principle (...) and of course if the facts happen to implicate a right of the Bill of Rights, section 38 of the Constitution (will apply)."<sup>11</sup>

The court in *Jacobs v Waks*<sup>12</sup> held that to determine whether a person had direct interest depends on the facts of each case.<sup>13</sup> Therefore where piercing the corporate veil is involved in terms of section 20(9) the court has to use its discretion to determine whether a particular individual is an interested person namely do they have sufficient and direct interest in the matter?<sup>14</sup>

*TJ Jonck BK h/a Bothaville Vleismark v Du Plessis NO*<sup>15</sup> held that the term 'interested person' as found in section 65 of CC Act should not be interpreted narrowly, however it should not be interpreted widely either so as to include indirect interest.<sup>16</sup> There must be some direct and financial interest, for example a creditor of a close corporation is an 'interested person'.<sup>17</sup>

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<sup>8</sup> Cassim FHI *et al* (2012) at 59.

<sup>9</sup> (2013) 2 All SA 437 (WCC).

<sup>10</sup> At para 35. See also *Mc Pieterse construction CC t/a CMR construction v Faulhaber* (2013) SGHC at 24, which held that to have locus standi, the party must have a direct and substantial interest in the matter and legal capacity to litigate. The parties initiating the proceedings must state and prove that it has locus standi in the matter.

<sup>11</sup> At para 35. Section 38 of the Constitution provides that, "Anyone listed in this section has the right to approach a competent court, alleging that a right in the Bill of Rights has been infringed or threatened, and the court may grant appropriate relief, including a declaration of rights. The persons who may approach a court are: (a) anyone acting in their own interest; (b) anyone acting on behalf of another person who cannot act in their own name; (c) anyone acting as a member of, or in the interest of, a group or class of persons; (d) anyone acting in the public interest; and (e) an association acting in the interest of its members.'

<sup>12</sup> 1992 (1) SA 521 (A).

<sup>13</sup> At 534D. See also *Voget and 2 others v Kleynhans* 2002 (WC) 41 at 6.

<sup>14</sup> Cassim R (2014) *SA Mercantile Law Journal* at 313.

<sup>15</sup> 1998 (1) SA 971 (O).

<sup>16</sup> At 987.

<sup>17</sup> *Ibid.*

In *Abseq Properties (Pty) Ltd v Maroun Square Shopping Centre (Pty) Ltd and others*<sup>18</sup> the court pointed out the fact that the expression “interested person” was not a new concept in legislation.<sup>19</sup>

Lichtenberg J, in *Boshoff v Nel*<sup>20</sup> interpreted the term “person interested” as found in section 34(3) of the Civil Proceedings Evidence Act 25 of 1965 which concerns the admissibility of documentary evidence as to the facts in issue by a “person interested”. He held that the interest should not be limited to financial interest but should also include personal interest provided it was not too remote.<sup>21</sup>

In *South African Football Association v Sandton Woodrush (Pty) Ltd*<sup>22</sup> as per Spoelstra J dealt with “interested person” contained in section 24(1) of the Trade Marks Act 194 of 1993 held that this expression referred to a person with a substantial interest in having a mark removed from the register.<sup>23</sup>

In *Ex Parte Stubbs NO: in re wit extensions Ltd*<sup>24</sup> Slomowitz AJ found the expression “interested person” as contained in section 73(6) (a) of the Companies Act 61 of 1973 to have the widest connotation possible including a person with a financial interest in the matter.<sup>25</sup>

Does this monetary interest also apply for the interpretation of section 20(9) considering that the sections are worded in a similar way? *Jacobs v Waks case*<sup>26</sup> states that monetary interest is not a requirement.<sup>27</sup> *Ex Parte Gore* accepts the principles in the *Jacobs case*<sup>28</sup> meaning that it also accepts that monetary interest is not required for one to be regarded as an ‘interested person’ in terms of section 20(9) of the current Companies Act. Therefore, it would seem that in order to qualify as an ‘interested person’ in terms of section 65 the party must have some financial interest in the matter, whereas with section 20(9) such interest does not seem to be necessary.<sup>29</sup>

I submit that a wider approach be followed. The meaning of ‘interested person’ should not be limited to instances where there is a financial interest but the focus should remain on the person seeking the remedy having a direct interest in the matter. This is when there is a direct link between a person and the issue. This could be an employee, creditor, shareholder, director, commissioner of South African

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<sup>18</sup> (2012) SGHC.

<sup>19</sup> At 13.

<sup>20</sup> 1983 (2) SA 41 (NC).

<sup>21</sup> At 44F-G.

<sup>22</sup> 2002 (2) SA 236 (T).

<sup>23</sup> At 239C-F.

<sup>24</sup> 1982 (1) SA 526 (W).

<sup>25</sup> At 531B-C.

<sup>26</sup> 1992 (1) SA 521 (A).

<sup>27</sup> At 535.

<sup>28</sup> *Ex Parte Gore* at 34.

<sup>29</sup> *Cassim R (2014) SAMLJ at 315.*

Revenue of Services or even a competitor. None of these ‘interested persons’ should be limited from seeking the ‘justice’ of having the corporate veil pierced merely because there is no monetary interest.

### 3.2.2. Grounds for piercing the corporate veil

The corporate veil in terms of section 20(9) of the current Companies Act can be pierced when the incorporation of the company amounts to an ‘unconscionable abuse’ of its separate legal personality, the use of the company amounts to ‘unconscionable abuse’ of its separate legal personality, or any act by or on behalf of the company that amounts to ‘unconscionable abuse’ of its separate legal personality.

Whereas, the corporate veil in terms of section 65 of the CC Act can be pierced when the incorporation of the close corporation amounts to a ‘gross abuse’ of its separate legal personality, the use of the close corporation amounts to ‘gross abuse’ of its separate legal personality, or any act by or on behalf of the close corporation that amounts to ‘gross abuse’ of its separate legal personality.

‘Gross abuse’ was interpreted in the *court a quo* in *Airport Cold Storage (Pty) Ltd v Ebrahim & others*<sup>30</sup> where there was reckless and fraudulent trading. The court found that the separate legal personality of the Close corporation was abused and pierced the corporate veil based on the facts of the case.<sup>31</sup>

This was reiterated in *Ebrahim v Airports Cold Storage (Pty) Ltd*<sup>32</sup> where the Supreme Court of Appeal found the reckless and fraudulent trading of a close corporation to be ‘gross abuse’ of the corporate veil, allowing for the separate legal personality of the company to be set aside.<sup>33</sup>

In *Mncube v District Seven Property Investments CC*<sup>34</sup> the court held that ‘gross abuse’ in terms of section 65 will be present where there is some despicable use of the close corporation separate legal personality.<sup>35</sup> Cassim correctly submits that this is as vague as “unconscionable abuse” in terms of section 20(9) because there is no indication of what is meant by ‘despicable abuse’ either.<sup>36</sup>

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<sup>30</sup> [2007] JOL 19990 (C).

<sup>31</sup> At page 31.

<sup>32</sup> 2008 (6) SA 585 (SCA).

<sup>33</sup> At Par 3. The Supreme Court held that section 64 of the Close Corporation Act should be applied and it is unnecessary to consider section 65.

<sup>34</sup> [2006] JOL 17381(D).

<sup>35</sup> At Par 14.

<sup>36</sup> Cassim FHI et al (2012) at 60.

In *Haygro Catering BK v Van der Merwe*<sup>37</sup> it was held that the failure to display the close corporation name in its premises, documents or correspondence amounted to gross abuse of the separate legal personality of the close corporation.<sup>38</sup> The members of the Haygro Catering close corporation were held to be jointly and severally liable with the close corporation

In *Hülse-Reütter v Godde*<sup>39</sup> Scott JA held that for piercing of the corporate veil to be granted there has to be an abuse or misuse of the separate legal personality of the entity by its controllers and such misuse grants the controllers an unfair advantage.<sup>40</sup> This is not a requirement in terms of section 20(9) of the current Companies Act, which merely requires ‘unconscionable abuse’.<sup>41</sup>

In *TJ Jonck BK h/a Bothaville Vleismark v Du Plessis NO*<sup>42</sup> the court held that where a member provides loans to a close corporation knowing the corporation will be unable to pay back the loan and conducts the corporation recklessly it can amount to “gross abuse” of the close corporation.<sup>43</sup>

The way the courts have interpreted ‘gross abuse’ in terms of section 65 of the CC Act may serve as a useful guideline in interpreting the meaning of ‘unconscionable abuse’ in terms of section 20(9) of the current Companies Act.<sup>44</sup>

However, in *Ex Parte Gore* it was held that the term ‘unconscionable abuse’ allows for a wide interpretation than ‘gross abuse’ as found in section 65. In the words of Binns-Ward J–

“The newly introduced statutory provision affords a firm, albeit very flexibly defined, basis for the remedy, which will inevitably operate, I think, to erode the foundation of the philosophy that piercing the corporate veil should be approached with an à priori diffidence. By expressly establishing its availability simply when the facts of a case justify it, the provision detracts from the notion that the remedy should be regarded as exceptional, or “drastic”. This much seems to be underscored by the choice of the words “unconscionable abuse” in preference to the term “gross abuse” employed in the equivalent provision of the Close Corporations Act the latter term having a more extreme connotation than the former.”<sup>45</sup>

At common law, the court in *Botha v Van Niekerk*<sup>46</sup> considered when the corporate veil may be pierced. In this case Botha entered into a contract to purchase a house.

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<sup>37</sup> 1996 (4) SA 1063 (C).

<sup>38</sup> At 1070. Failure to display the name of a close corporation in its premise, documents or correspondence is in contravention of section 23 of the Close Corporation Act.

<sup>39</sup> 2001 (4) SA 1336 (SCA).

<sup>40</sup> At 20.

<sup>41</sup> See also Cassim FHI *et al* (2012) at 60 for a similar submission.

<sup>42</sup> 1998 (1) SA 971 (O).

<sup>43</sup> At para 986.

<sup>44</sup> Cassim FHI *et al* (2012) at 62.

<sup>45</sup> At 34-35.

<sup>46</sup> 1983 (3) SA 513 (W).

He was then substituted by a company which he solely owned. The seller wanted to enforce the contract against Botha and thus sought for the corporate veil between the company and Botha to be pierced arguing that the company was Botha's guise. Flemming J held that the company was not liable and mentioned that Botha would only be liable where there is 'onduldbare onreg' (meaning 'unconscionable injustice') on his conduct.<sup>47</sup>

The court in *Cape Pacific case*<sup>48</sup> rejected the 'unconscionable injustice' test formulated by Flemming J in *Botha v Van Niekerk* because it was not flexible.<sup>49</sup> It was stated that-

"With due respect to the learned judge I would avoid, in a matter such as the present, what is perhaps too rigid a test and opt for a more flexible approach one that allows the facts of each case ultimately to determine whether the piercing of the corporate veil is called for. It seems implicit in the trial judge's finding that the remedy of piercing the corporate veil is only available where a plaintiff has no other remedy at his disposal. No authority was quoted for this proposition. Nor did the respondents, who support it, refer us to any."<sup>50</sup>

I submit that the legislature amends the current Companies Act to provide a definition of 'unconscionable abuse' to avoid confusion on what constitutes unconscionable abuse. The meaning of unconscionable abuse could include acts such as fraud, embezzlement of funds or the use of the company to carry out unlawful and improper conduct. The list should not be exhaustive. This will be to avoid confusion on what exactly entails 'unconscionable abuse'.

### 3.3.1. Available remedies

Both section 20(9) of the current Companies Act and section 65 of the CC Act allow the courts to disregard the company's (or close corporation's) separate legal personality and to make any further orders it sees fit in giving effect to an order for disregarding of the corporate personality. The courts are given wide discretion in terms of section 20(9) and section 65 by allowing them to make any further orders they deem appropriate. This is read from the use of the word "may" in both sections.

Both section 20(9) and section 65 allow for the remedy of piercing the corporate veil to be instituted either through action proceedings which the company (or close corporation) already form part of, or through an application procedure.

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<sup>47</sup> *Ibid* at 523-525f.

<sup>48</sup> *Op cite* 1994 (4) SA 790 (A).

<sup>49</sup> At 556.

<sup>50</sup> *Ibid*.

### 3.3.2 Is the doctrine of piercing the corporate veil still a remedy of last resort?

It is important to determine if piercing of the corporate veil can only be considered as a remedy of last resort considering the possibility of having more than one remedy available including piercing the corporate veil.

In chapter 2 of this dissertation, it was pointed out that, piercing the corporate veil is under common law considered a remedy of last resort.<sup>51</sup> The court in the *Ex parte Gore* expressed the point that under the current Companies Act the remedy of piercing the corporate veil is no longer a remedy of last resort.<sup>52</sup> Therefore it can be concluded that the availability of other remedies other than piercing the corporate veil does not preclude a person from relying on the remedy of piercing of the corporate veil.

### 3.4. Does the Companies Act replace the common law principles?

There is no express abolishment of the common law principles dealing with the doctrine of piercing the corporate veil. In fact, section 158(a) of the current Companies Act provides that when determining an issue presented in terms of the current Companies Act or when making an order, “a court must develop the common law as necessary to improve the realization and enjoyment of rights established by this (Companies) Act”.

*Ex parte Gore* held that section 20(9) supplements the common law rather than substitute it.<sup>53</sup>

*“The introduction of the statutory provision has given rise to some debate on whether the subsection has replaced the common law on piercing the corporate veil. Certainly there is no express intention apparent to that effect, as for example to be seen in s 165(1) of the Act (concerning derivative actions), but, equally, there is no express indication that the intention is not to displace the common law, like that to be found in s 161(2)(b).”*<sup>54</sup>

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<sup>51</sup> See *Hulse-Reutter v Godde* 2001 (4) SA 1336 (SCA).

<sup>52</sup> *Ex parte Gore* at 34.

<sup>53</sup> At 34. See also Lewis A (2013) *Moneyweb’s Tax Breaks* at 3.

<sup>54</sup> *Ex Parte Gore* NNO 2013 (3) SA 382 (WCC) at 30

Section 20(9) of the current Companies Act will not be available when there is no 'unconscionable abuse' of the separate legal personality of a company. In such instance, the common law will then apply.<sup>55</sup>

Section 20(9) does not override the common law principles pertaining to piercing the corporate veil but that the common law principles can be used as an interpretation tool of the section.<sup>56</sup>

### 3.5. Conclusion

Section 20(9) of the current Companies Act is a codification of the doctrine of piercing the corporate veil. This section did not repeal common law piercing of the corporate veil. The common law principles will still be applicable where section 20(9) does not apply, namely where there is no unconscionable abuse. Section 20(9) provides that a court can disregard a company's separate legal personality *inter alia* on application by an 'interested person' if there is unconscionable abuse of such separate legal personality.

There is no definition in the current Companies Act of who an 'interested person' is or what 'unconscionable abuse' is. The courts still need to deal with the interpretation of these terms and could possibly rely on existing judicial precedent created in the interpretation of the term 'gross abuse' in terms of section 65 of the CC Act, as guideline in interpreting 'unconscionable abuse' in section 20(9). I submit that an amendment of the section is necessary. This can be achieved by providing definitions of the undefined terms to avoid confusion.

In light of case law, a person will have the *locus standi* to pierce the corporate veil if they have a direct and sufficient interest in doing so. In terms of section 65 of the CC Act, the ground to pierce the corporate veil is when there is 'gross abuse' of the separate legal personality, whereas in section 20(9) of the current Companies Act there has to be 'unconscionable abuse'.

Courts have held that there is 'gross abuse' where there is fraud, failure to display the close corporation's name, where there is despicable abuse and where there is misuse of the close corporation.<sup>57</sup>

A company has a separate legal personality from which follows that where there is a group of companies related to each other, each company should have a separate legal personality from other companies in the same group. The next chapter addresses veil piercing in group of companies

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<sup>55</sup> Cassim FHI *et al* (2012) at 58.

<sup>56</sup> Cassim R (2013) De Rebus at 34.

<sup>57</sup> See paragraph 3.2.2.

# CHAPTER 4. GROUP OF COMPANIES

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## 4.1 Introduction

Group of companies can be defined as a holding company and its subsidiaries.<sup>1</sup> A holding company (also referred to as a parent company) is defined in section 1 of the current Companies Act as a juristic person that controls a subsidiary as a result of any of the provisions contained in section 2(2)(a)<sup>2</sup> or 3(1)(a). Section 3 of the Current Companies Act provides that a subsidiary company is a subsidiary of another company, if that other company has control over the subsidiary, whether through being able to elect majority of the subsidiary's directors or having majority voting rights associated with issue of the subsidiary's securities.

The general rule is that each company in a group of companies is a separate legal being in its own right. This means that each company has and is accountable for its own rights, assets and liabilities separate from the other companies in the group.<sup>3</sup> This is reiterated by *Ritz Hotel Ltd v Charles of the Ritz Ltd*<sup>4</sup>, which held that the acts of the holding company are not those of the subsidiary company and vice versa.<sup>5</sup>

This chapter discusses the grounds for piercing of the corporate veil of companies in a group and answers research question 11 as listed in chapter 1, namely, can the courts extend corporate veil piercing to groups of companies?

## 4.2. Grounds for piercing the corporate veil of companies in a group

Each company in a group of companies has its own separate legal personality.<sup>6</sup> When this veil is pierced, the group will be regarded as a single entity.<sup>7</sup> This means that the holding company will be liable for the debts of the subsidiary company and vice versa.

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<sup>1</sup> Section 1 of the current Companies Act.

<sup>2</sup> Section 2(2)(a) of the current Companies Act provides, "For the purpose of [subsection \(1\)](#), a person controls a juristic person, or its business, if—

(a) in the case of a juristic person that is a company—

(i) that juristic person is a subsidiary of that first person, as determined in accordance with section 3 (1) (a); or (ii) that first person together with any related or inter-related person, is— (aa) directly or indirectly able to exercise or control the exercise of a majority of the voting rights associated with securities of that company, whether pursuant to a shareholder agreement or otherwise; or (bb) has the right to appoint or elect, or control the appointment or election of, directors of that company who control a majority of the votes at a meeting of the board".

<sup>3</sup> Cassim FHI et al (2012) at 54.

<sup>4</sup> 1988 (30 SA 290 (A).

<sup>5</sup> At 314.

<sup>6</sup> Cassim R, (2013) De Rebus at 36. See also Cassim FHI et al (2012) at 53.

<sup>7</sup> Cassim FHI et al (2012) at 54.



The courts have pierced the corporate veil between companies in a group for different reasons such as fraud or abuse of the separate legal personality of a company.

### 4.2.1 Abuse of Control

A holding company can abuse the control it has over its subsidiary and in such instances the courts can interfere and pierce the corporate veil.<sup>8</sup>

In *Amlin SA (Pty) Ltd v Van Kooij*<sup>9</sup> the plaintiff claimed the repayment of a loan it had advanced to the respondent. The respondent argued that the money given to it by the appellant did not constitute a loan but a repayment of a debt that the appellant's holding company owed to the respondent. The appellant accordingly argued that it and its holding company were two separate entities. The court pierced the corporate veil between the holding company and the subsidiary<sup>10</sup> because it appeared that the same person was in control of both companies and was trying to hide behind the corporate veil.<sup>11</sup> Therefore the subsidiary company was held liable for its holding company's debt that was due to the respondent.

In the United Kingdom, *DHN Food Distributors Ltd v Tower Hamlets London Borough Council*<sup>12</sup> a business was divided into various corporations. One subsidiary held the real property in the form of land of the group, another subsidiary held the business vehicles whilst the parent company held the rest of the business assets. The subsidiaries were wholly owned by the parent company and had the same directors as the parent company. The parent company held all the shares in the two subsidiaries. The court held that this group composition should be treated as one entity on the basis of the degree of control that one corporation had on another. There was no distinction between the companies in the group.<sup>13</sup>

In *VTB Capital Plc v Nutritek International Corp & Others*<sup>14</sup> the court of appeal confirmed the principle laid in *Faiza Ben Hashem v Shayif*<sup>15</sup> that ownership and control are not enough to justify piercing of the corporate veil but there also has to be impropriety or abuse of the company.<sup>16</sup> The main concern in *VTB Capital v Nutritek* was whether piercing the corporate veil could result in non-contracting parties becoming contractually bound to agreements entered into by a separate entity that

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<sup>8</sup> Pretorius JT et al 6th edition (1999) at 434.

<sup>9</sup> 2008(2) SA 558 (C).

<sup>10</sup> *Ibid* 30.

<sup>11</sup> *Ibid* 24.

<sup>12</sup> (1976) 1 WLR 852.

<sup>13</sup> At 860.

<sup>14</sup> [2012] EWCA Civ 808.

<sup>15</sup> [2008] EWHC 2380 (FAM).

<sup>16</sup> At 159.

they controlled or that controlled them. The court held that this was not possible and upheld the privity of contract.<sup>17</sup>

However, in the Australian case *Briggs v James Hardie & Co Pty Ltd*<sup>18</sup> the plaintiff claimed damages for the effects of asbestosis which he contracted when he was employed in asbestos mine. The company that owned the asbestos mine was owned by James Hardie Corporation and another corporation.<sup>19</sup> The plaintiff brought his action against both holding companies. The court in this case held that the mere control of a company by another or the mere existence a holding company and subsidiary company scenario does not entitle the courts to pierce the corporate veil between the companies.<sup>20</sup>

This was reiterated in *Heytesbury Holdings Pty Ltd v City of Subiaco*<sup>21</sup> where the court held that mere control of a subsidiary company does not warrant piercing of the corporate veil.<sup>22</sup>

I submit that courts must not pierce the corporate veil between companies merely because the holding company has control over the subsidiary company. By virtue of the definition of a holding company, namely that it controls a subsidiary either through being able to elect directors of the subsidiary or control majority of votes derived from the shares held in the subsidiary company there is control. The courts should pierce the corporate veil where there is abuse of the control for example controlling the subsidiary in such a way that is detrimental to the subsidiary.

#### 4.2.2. Abuse of the separate legal personality

*Ex Parte Gore* was the first judgment to adjudicate on section 20(9). The facts of the case are that the holding company operated the business of the group in such a way that it undermined the separate legal personality of each company in the group. The liquidators sought to have the corporate veil pierced, so that the assets of the subsidiary companies can be regarded as that of the holding group to satisfy the claims of investors. The application was brought in terms of the common law and the current Companies Act was pleaded in the alternative. The court held that the remedy of piercing the corporate veil in terms of section 20(9) of the current Companies Act should be brought where there is illegitimate use of the separate

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<sup>17</sup> At 93.

<sup>18</sup> (1989) 7 ACLC 841.

<sup>19</sup> The mine later became wholly owned by James Hardie Corporation.

<sup>20</sup> (1989) 7 ACLC 841 at 855.

<sup>21</sup> (1998) 19 WAR 440.

<sup>22</sup> *Ibid* at 451.

legal personality of a company which adversely affects a third party in a way that should not be permitted.<sup>23</sup>

The court pierced the corporate veil between the holding company and its subsidiaries because of the way the holding company operated the business of the company undermining the separate legal personality of each company in the group.<sup>24</sup> The holding company was liable for the liabilities of its subsidiaries.

### 4.2.3. Agency

Sometimes a subsidiary company acts as an agent of the holding company. The courts must pierce the corporate veil and hold the principal company liable, applying the principles of the law of agency.

In *Atlas Maritime Co SA v Avalon Maritime Ltd, The coral rose (No1)*<sup>25</sup> a subsidiary bought a defect vessel coral rose and received money from its holding company to repair the vessel. The subsidiary then concluded an oral contract of sale of the vessel with the plaintiff but later on denied the existence of the contract. The plaintiff *inter alia* claimed damages and applied for a mareva injunction which was granted in the *court a quo* and resulted in the subsidiary's funds frozen. The subsidiary wanted the funds unfrozen so it could repay its holding company. In the *court a quo*, the court held that there was no creditor and debtor relationship between the holding company and the subsidiary but rather a relationship of agent and principal because the subsidiary's operations were absolutely funded and managed by the holding company. The court held that it was clear from looking behind the corporate veil that the creditor would be the holding company of the 100% wholly owned subsidiary.<sup>26</sup>

The subsidiary took the matter on appeal. The court on appeal upheld the court a *quo*'s decision not to discharge the mareva injunction but based on different reasons. The court on appeal held that the relationship of debtor and creditor can be inferred from the facts.<sup>27</sup> It also held that the relationship of agent and principal were only present where there is consent from the principal and agent.<sup>28</sup> The appeal was dismissed. The court did not pierce the corporate veil between the groups but did not dismiss the mareva injunction because it would result in an advantage to the holding company at the expense of the plaintiff.<sup>29</sup>

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<sup>23</sup> At 34.

<sup>24</sup> *ibid.*

<sup>25</sup> (1991) 4 ALL ER 769 (CA).

<sup>26</sup> *Ibid* at 2.

<sup>27</sup> *Ibid* at 774.

<sup>28</sup> See also *Garnac Grain Co Inc v H m F Faure & Fairclough Ltd* (1967) 2 ALL ER 353 at 358.

<sup>29</sup> (1991) 4 ALL ER 769 (CA) at 777.

The court in *Adams v Cape Industries plc*<sup>30</sup> held that where there is a group of companies there is no presumption of agency being applicable and that the holding and subsidiary companies are two separate legal entities.<sup>31</sup> The court held that the separate legal personality of a company must not be disregarded just because it is fair to do so.<sup>32</sup>

Meagher JA in *Briggs v James Hardie*, held that without proof of an agency agreement between the holding company and the subsidiary, the subsidiary company will not be regarded as the agent of the holding company.<sup>33</sup>

In *Smith, Stone & Knight Ltd v Birmingham Corporation*<sup>34</sup> one corporation was the subsidiary of another corporation. The subsidiary conducted its business in the parent company's factory. The local municipality initiated steps for compulsory acquisition of the factory. The parent company argued that it wholly owned the subsidiary and thus claimed compensation for removal costs and disturbance of its business. There was a statute that provided that the local municipality could avoid paying the compensation if it could prove the separate legal personality of the subsidiary. The entire subsidiary's assets and all its shares except five were owned by the parent company. On these facts the court held that the subsidiary was merely an agent of the parent company and thus the parent company was entitled to the compensation. Six guiding questions were identified in this case, namely-

“(1) who was really carrying on the business? (2) Were the profits treated as the profits of the parent company? (3) Was the parent company the head and the brain of the trading venture? (4) Did the parent company decide what should be done and how much investment to make in the business? (5) Did the parent company make a profit based on its skill and direction? and (6) Was the parent company in effectual and constant control?”<sup>35</sup>

The court held that it was a question of fact in each case whether a holding company is acting as an agent for its subsidiary company. If there is agency, the controlling company will be liable for the acts of its subsidiary.<sup>36</sup> This means that the subsidiary company is deemed an agent of the holding company.

### 4. 3. Conclusion

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<sup>30</sup> (1991) 1 ALL ER 929.

<sup>31</sup> *Ibid* at 1020.

<sup>32</sup> 1991 1 ALL ER 929 (CA) 1019.

<sup>33</sup> At 556.

<sup>34</sup> (1939) 4 ALL ER 116.

<sup>35</sup> *Ibid* at 121.

<sup>36</sup> At 123.

The general rule is that a holding company has a separate legal personality from its subsidiaries. Piercing of the corporate veil can be an exception to this rule having the result that the subsidiary and the holding company are one company.

The courts have *inter alia* pierced the corporate veil between companies in a group where there was abuse of control, abuse of the separate legal personality of each company and when the subsidiary company was acting only as an agent of the holding company.

I submit that the holding company must have control over the subsidiary and there must be at least abuse of the separate legal personality of the company for piercing of the corporate veil to be used as a remedy. Mere control should not be enough to have the veil pierced. For example piercing of the corporate veil can also be implemented where there is agency, the company being used as a 'façade' or 'unconscionable abuse' as provided for by section 20(9) of the current Companies Act. The common law instances of piercing the corporate veil may also find application if the instances are relevant to the given set of facts.

The doctrine of piercing the corporate veil is found in different jurisdictions. Chapter 5 provides a comparison of the doctrine as found in Australia and the United Kingdom to that of South Africa.

# CHAPTER 5. COMPARATIVE APPROACH

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## 5.1. Introduction

The fundamental challenge faced by our courts at common law with regards to the remedy of piercing of the corporate veil is uncertainty on when the doctrine will be applicable and when it will not. This problem is also prevalent in the United Kingdom and Australia.

This chapter provides a comparative approach of this doctrine as found in the jurisdiction of Australia and the United Kingdom. The aim of the chapter is to address research question 12 contained in chapter 1 of this dissertation, namely what are the foreign trends in dealing with the doctrine of veil piercing in Australia and the United Kingdom?

## 5.2. Grounds for piercing the corporate veil

The courts have generally pierced the corporate veil for similar instances as our judicial piercing namely fraud, evasion of contractual obligations and fiduciary duties.

The English court in *Woolfson v Strathclyde Regional Council*<sup>1</sup> held that “it is appropriate to pierce the corporate veil only where special circumstances exist indicating that it is a mere façade concealing the true facts.”<sup>2</sup>

A few grounds of when the corporate veil was pierced in Australia and the United Kingdom will now be discussed.

### 5.2.1. Abuse of the corporate veil to circumvent a contractual duty

The English case of *Gilford Motors v Horne*<sup>3</sup> is an example of where the corporate veil was pierced because the company was formed as a ‘mask’ to the effective carrying on of business by Mr Horne in contravention of his restraint of trade clause.<sup>4</sup> This was an evasion of a contractual obligation.<sup>5</sup>

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<sup>1</sup> 1978 SLT 159.

<sup>2</sup> At 161.

<sup>3</sup> 1933 Ch 935 (CA).

<sup>4</sup> At 956.

<sup>5</sup> See also *Le Bergo Fashions CC v Lee* 1998 (2) SA 608 (C) at 613 where the court pierced the corporate veil between a company and Lee because she used the company to evade a restraint of trade clause. See also *Jones v Lipman* (1962) 1 ALL ER 442 at 445 where the court pierced the corporate veil because the company was merely a sham that Lipman used to circumvent his contractual obligation.

### 5.2.2. Abuse of the corporate veil to avoid compliance with one's fiduciary obligation

In the English case *Robinson v Randfontein Estates Gold Mining Co Ltd*<sup>6</sup> the court pierced the corporate veil because Robinson had contravened his fiduciary duties to act in good faith and in the best interest of the company by using a subsidiary company to perform on his behalf and usurp a corporate opportunity the company was pursuing.<sup>7</sup>

### 5.2.3. Abuse of the corporate veil through fraud

The Australian court in *Faiza Ben Hashem v Shayif*<sup>8</sup> held that the corporate veil can only be pierced when there is fraud. The fraud must be linked to the use of a company to avoid liability. For a court to be able to pierce the corporate veil, control of the company by the wrongdoer and misuse of the company as a 'sham' to conceal wrongdoing should be proved. A company can be a 'sham' even though it was not incorporated with such intent to use it as a 'sham' as long as at the moment in question it is used as a 'sham'.<sup>9</sup>

In the English case *Re Darby, Ex Parte Broughton*<sup>10</sup> the courts indicated that the corporate veil will be pierced in instances of fraud.<sup>11</sup> In this case Darby incorporated a company in the Channel Islands which sold property to another company Darby had incorporated and registered in Wales at an abnormal profit. When the company went into liquidation, the liquidator claimed the profit from Darby. The court pierced the corporate veil between Darby and the Channel Islands Company because it found the company to be a sham.<sup>12</sup>

In the English case *Re Bugle Press Ltd*<sup>13</sup> a company was used to cover fraud. Two shareholders wanted to buy out the third shareholder who refused. The two shareholders then formed a company which made an offer to purchase all the shares of the company with the three shareholders. The court pierced the corporate veil of this company stating that was a 'sham'.<sup>14</sup>

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<sup>6</sup> 1921 AD 168.

<sup>7</sup> At 194-195. See chapter 2 for discussion on the case.

<sup>8</sup> [2008] EWHC 2380 (FAM).

<sup>9</sup> At 159-164.

<sup>10</sup> [1911] 1 KB 95.

<sup>11</sup> At 103.

<sup>12</sup> *Ibid.*

<sup>13</sup> [1961] Ch 270 (CA).

<sup>14</sup> At 289.

Anderson correctly submits that the corporate veil in Australia will be pierced where there is fraud or a company is used as a 'sham' to avoid compliance with a legal obligation.<sup>15</sup>

### 5.3. Categorisation or not?

In Chapter 2 of this dissertation, reference is made to the fact that South African courts do not follow the categorisation approach in determining veil piercing by the courts as this will lead to uncertainties. The same approach seems to be followed in Australia and the United Kingdom.

Rodgers AJA in Australian case *Briggs v James Hardie*<sup>16</sup> held that there is no unified principles regulating when the corporate veil will be pierced.<sup>17</sup> The court held that the circumstances in which the court will pierce the corporate veil are uncertain.<sup>18</sup> The New South Wales court of Appeal held that there is no set principle of when the doctrine of piercing the corporate veil will be applicable.<sup>19</sup>

In the English case *Prest v Petrodel Resources Limited*,<sup>20</sup> the Supreme Court held that the law relating to the doctrine of piercing the corporate veil is unsatisfactory and confused, and found that it was impossible to discern 'any coherent approach, applicable principles, or defined limitations to the doctrine'.<sup>21</sup>

In English case *VTB Capital Plc v Nutritek Corp*<sup>22</sup> the court stated that:

*"The notion that there is no principled basis upon which it can be said that one can pierce the veil of incorporation receives some support from, the fact that the precise nature, basis and meaning of the principle are all somewhat obscure, as are the precise nature of circumstances in which the principle can apply."*<sup>23</sup>

I submit that both the Australian and English system should follow the two way approach proposed in chapter 2 of this dissertation. In terms of this approach the courts when applying the remedy of piercing of the corporate veil must firstly, be guided by existing categories, and secondly the courts should exercise a fettered discretion based on what they deem fit, reasonable and justifiable to pierce the corporate veil taking into account the facts of each case and the level of abuse of the corporate personality status of the entity.

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<sup>15</sup> Anderson H, (2009) 33 Melbourne University Law Review AT 354.

<sup>16</sup> 1989 16 NSWLRJ 549.

<sup>17</sup> At 567.

<sup>18</sup> *Ibid.*

<sup>19</sup> At 567.

<sup>20</sup> [2013] 2 AC 415.

<sup>21</sup> At 64.

<sup>22</sup> [2013] UKSC 4.

<sup>23</sup> At 123.



## 5.4. Remedy of last resort?

In South Africa, under judicial piercing, it is uncertain whether or not piercing of the corporate veil is a remedy of last resort; but it has been decided in terms of *Ex Parte Gore*<sup>24</sup> that the remedy in terms of the current Companies Act is not a remedy of last resort.<sup>25</sup>

In The United Kingdom, *Ben Hashem v Al Shayif*<sup>26</sup> held that the corporate veil should only be pierced if it is necessary to do so and not just because it is in the interest of justice to pierce the corporate veil.<sup>27</sup>

Later on, the United Kingdom Supreme Court in *Prest v Petrodel Resources Ltd*<sup>28</sup>, where Michael and Yasmin Prest were getting divorced. Michael wholly owned and controlled companies forming part of the Petrodel group of companies. Two such companies (Petrodel Resources Ltd and Vermont Petroleum Ltd) owned residential property in the United Kingdom. The question before the court was whether it (the court) had the power to transfer the properties to Yasmin considering the fact that the properties legally belonged to the companies and not Michael. The court in this case refused to pierce the corporate veil because Michael was not evading the law or avoiding a legal obligation and there was another available remedy. It was held that piercing the corporate veil is a remedy of last resort.<sup>29</sup> Yasmin could have relied on section 24(1) of the English Matrimonial Causes Act to transfer the companies to her as an alternative remedy.

Lloyd LJ in United Kingdom's *VTB Capital plc v Nutritek International Corp*<sup>30</sup>, held that piercing the corporate veil could be relied on even if there are other available remedies.<sup>31</sup> However, Lord Neuberger<sup>32</sup> and Lord Sumption<sup>33</sup> disagreed and held that piercing of the corporate veil is a remedy of last resort.

## 5.5. Statutory Piercing?

In South Africa, the current Companies Act has codified piercing the corporate veil in section 20(9). Section 65 of the CC Act codified piercing of the corporate veil for close corporations.

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<sup>24</sup> (2013) 2 All SA 437 (WCC).

<sup>25</sup> At 34.

<sup>26</sup> (2009) 1 FLR 115.

<sup>27</sup> At 164.

<sup>28</sup> (2013) UKSC 34.

<sup>29</sup> At 62.

<sup>30</sup> (2012) EWCA civ 808).

<sup>31</sup> At 79.

<sup>32</sup> At 35.

<sup>33</sup> At 62.

Australian company law is regulated by the Corporation law of 2001. There is however no specific provision in the legislation like the one contained in South Africa's section 20(9) dealing with piercing of the corporate veil. A form of piercing of corporate veil is however alluded to in section 588V which imposes liability on a holding company of a subsidiary where such subsidiary trades while it is insolvent.<sup>34</sup>

There is no statutory codification of the doctrine of piercing the corporate veil in the United Kingdom.

I submit that Australia and the United Kingdom should consider codifying the remedy of piercing the corporate veil to avoid uncertainty. I further submit that definition of concepts used should be provided to avoid the current uncertainties our system finds itself in with the provisions of section 20(9) of the current Companies Act.

## 5.6. Conclusion

What is common in all these jurisdictions (South Africa, Australia and England) is that the circumstances upon which the corporate veil will be pierced by courts under common law judicial piercing are uncertain.<sup>35</sup> The courts have generally pierced the corporate veil where there was fraud, evasion of contractual obligations and fiduciary duties.

The remedy of piercing of the corporate veil is generally considered to be a remedy of last resort as it has drastic consequences such as holding the shareholders liable for the debts of the company.

Unlike South Africa, Australia and the United Kingdom have not codified the remedy of piercing the corporate veil yet. Statutory veil piercing may avoid uncertainties if the legislatures make clear provisions and provide definitions of concepts used.

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<sup>34</sup> Section 588G,EF,V-X also provides for director's personal liability- which is similar to section 77 of the current Companies Act.

<sup>35</sup> Subramanien D *Obiter* (2014) at 154.

# CHAPTER 6: CONCLUSIONS AND RECOMMENDATIONS

This dissertation provided a discussion of the doctrine of piercing of the corporate veil as an exception to the principle of separate legal personality. There is a distinction between judicial piercing and statutory piercing of the corporate veil. Judicial piercing refers to the common law instances of piercing of the corporate veil, whilst statutory piercing refers to piercing of the corporate veil in terms of statutory law, namely section 20(9) of the current Companies Act.

Judicial veil piercing has no specified categories of instances wherein the courts will pierce the corporate veil.<sup>1</sup> The courts have generally pierced the corporate veil where there is fraud, evasion of a contractual or fiduciary duties. Lack of categorisation has caused uncertainty on when the corporate veil should be pierced. Having fixed categories can however result in a rigid system.<sup>2</sup> I recommend that a two way approach that allows the courts to use existing categories and their discretion be followed, which will cater for certainty and flexibility.<sup>3</sup>

Piercing of the corporate veil is a drastic remedy. I recommend that the remedy be relied on lightly if there are other remedies available. It should be considered a remedy of last resort, since it has adverse consequences such as holding the controllers and/or the holders of the company personally liable for the actions of the company.

Section 20(9) of the current Companies Act is a codification of the remedy of piercing of the corporate veil. The section provides that a court can disregard a company's separate legal personality *inter alia* on application by an 'interested person' if there is 'unconscionable abuse' of such separate legal personality. This section did not repeal common law piercing of the corporate veil. The common law principles will still be applicable where section 20(9) does not apply, namely where there is no unconscionable abuse of the corporate veil.

There is no definition in the current Companies Act of who an 'interested person' is or what 'unconscionable abuse' is. The courts still need to deal with the interpretation of these terms and could possibly use how the courts have dealt with the phrase 'gross abuse' in terms of section 65 of the Close Corporation Act, as a guideline in

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<sup>1</sup> The Supreme Court of Appeal in the Cape Pacific v Lubner case implied that our law does not have set categories of instances determining when a court will pierce the corporate veil and therefore there is no categorising approach.

<sup>2</sup> Mthembu LV (2002) LLM Dissertation University of Natal at 74.

<sup>3</sup> See paragraph 2.3.2.

interpreting 'unconscionable abuse'. Section 65 of the Close Corporation is phrased in similar terms as section 20(9) of the Companies Act.

I submit that failure by the legislature to define these terms in both the Close Corporations Act and the current Companies Act was a shortcoming, as the task of interpreting these terms is left to the courts. I recommend amendment of the current Companies Act by providing definitions of the undefined concepts, namely 'unconscionable abuse' and interested person in order to avoid confusion. The meaning of unconscionable abuse could include acts such as fraud, embezzlement of funds or the use of the company to carry out unlawful and improper conduct. The list should not be exhaustive. This will be to avoid confusion on what exactly entails 'unconscionable abuse'. An interested person can include someone who has a direct interest in the matter such as a creditor, employee, shareholder, director or even a competitor of the company.

In a group of companies, each company as a general rule has a separate legal personality from other companies in the same group. Piercing of the corporate veil can be an exception to this rule having the result that the subsidiary and the holding company as one entity.

I recommend that the corporate veil between companies should not be pierced merely because the holding company has control over the subsidiary company because by virtue of the definition of a holding company, (namely that it controls a subsidiary either through being able to elect directors of the subsidiary or control majority votes derived from the shares held in the subsidiary company) there is control. The courts should pierce the corporate veil where there is abuse of the control for example controlling the subsidiary in such a way that is detrimental to the subsidiary. For example piercing of the corporate veil can also be implemented where there is agency, the company being used as a 'façade' or 'unconscionable abuse' as provided for by section 20(9) of the current Companies Act. The common law instances of piercing the corporate veil may also find application if the instances are relevant to the given set of facts.

The doctrine as found in Australia and the United Kingdom is similar to the position in South Africa in that there are no coherent principles of when the corporate veil will be pierced and the courts have relied on similar categories to justify piercing of the corporate veil.

South Africa has codified the remedy of piercing the corporate veil, whilst Australia and the United Kingdom do not provide for such remedy in their legislations. I recommend that both Australia and the United Kingdom should consider codify the doctrine of piercing of the corporate veil to provide for certainty.

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