

REMEDYING ABUSES OF LIMITED LIABILITY IN COMPANY GROUPS

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REMEDYING ABUSES OF LIMITED LIABILITY IN COMPANY GROUPS

CHAPTER 1: INTRODUCTION

Cape Plc was an English company in the business of mining and marketing asbestos. The company operated its international footprint through incorporating subsidiaries in other jurisdictions where it wished to do business. One such subsidiary was incorporated in Texas. The employees of the Texan company became ill with asbestosis and instituted action against Cape Plc and its subsidiaries in Texas. Judgment was awarded against the holding company and its subsidiary for breach of duty of care owing to its employees. Cape Plc however liquidated the Texan subsidiary; all its assets were consequently sold and it ceased doing business. The only chance the plaintiffs had to recover damages was to enforce the judgment in England against the holding company. The English court however refused to do so and strictly upheld the separate legal personality of the holding company.¹ The holding company could therefore not be held liable for the delicts of its subsidiaries and the claimants were left with no entity to enforce their judgment against; whilst the holding company was free to continue operating.

This case demonstrates the concerns that are often raised with regards to company groups. A holding company can incorporate a number of subsidiary companies and exercise complete control over them, but the law will still recognise those subsidiaries as individual, independent companies.²

This thesis will explore the origins of the separate legal personality of the company and the development of the default rule of limited liability of the shareholders of the company. The author will discuss the policy considerations in support of the limited liability of shareholders and investigate how this default rule came to be applicable also to individual companies within a company group; functioning as a single economic entity. The research will show some of the abuses of these principals and possibly unintended consequences of extending separate legal personality and

¹ *Adams v Cape Industries Plc* 1991 1 All ER 929.

² *Adams v Cape Industries Plc* supra (n1).

limited liability to companies operating within a group. The author will then in turn discuss the remedies which the courts have used to address these abuses by disregarding the separate legal personalities of companies within a group. The research will first discuss the common law remedy for piercing of the corporate veil, and then the statutory remedy under section 20(9) of the South African Companies Act³ (the Act).

A pertinent question which the author will seek to address is whether piercing the corporate veil under common law is an efficient remedy by which concerns in corporate groups can be addressed. If this is not the case, consideration will be given as to whether the legislative developments have reformed the law in this regard and now provide a sufficient mechanism by which the concerns in company groups can be remedied. The research will consider the position under South African law with reference to the position in other jurisdictions. The purpose of the comparison is to inform the research against the position in other jurisdictions as the South African judiciary and policy makers often turn to the position in other jurisdictions in coming to a decision or formulating policy.⁴

Throughout this paper, certain assumptions will be used with regards to the meaning of a company group and the research will focus on piercing the corporate veil as a remedy. A preliminary discussion of these two concepts is therefore necessary.

WHAT IS A GROUP?

Under Section 1 of the Act, a group of companies is defined to mean 'a holding company and all of its subsidiaries.' A holding company, in relation to a subsidiary, means a juristic person, one or more other subsidiaries of that juristic person, or one or more nominees of that juristic person or any of its subsidiaries, alone or in any

³ Companies Act 71 of 2008.

⁴ See for example subsection 5(2) of the Act.

combination, which controls that subsidiary as a result of the following circumstances:

- The company is directly or indirectly able to exercise or control the exercise of a majority of the voting rights associated with securities in that company, whether pursuant to a shareholder agreement or otherwise;⁵
- The company 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;⁶ or
- The company holds or controls, alone or in any combination, all the general voting rights associated with issued securities in that company; in which case that company is a wholly owned subsidiary of another juristic person.⁷

Section 2(2) of the Act describes when a person would be considered exercising control over a juristic person. This section reads as follows:

‘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

⁵ Section 1, read together with subsection 2(2)(a) and subsection 3(1)(a)(i), of the Act.

⁶ Section 1, read together with subsection 2(2)(a) and subsection 3(1)(a)(ii), of the Act.

⁷ Section 3(1)(b) of the Act.

(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;

(b) in the case of a juristic person that is a close corporation, that first person owns the majority of the members' interest, or controls directly, or has the right to control, the majority of members' votes in the close corporation;

(c) in the case of a juristic person that is a trust, that first person has the ability to control the majority of the votes of the trustees or to appoint the majority of the trustees, or to appoint or change the majority of the beneficiaries of the trust; or

(d) that first person has the ability to materially influence the policy of the juristic person in a manner comparable to a person who, in ordinary commercial practice, would be able to exercise an element of control referred to in paragraph (a), (b) or (c).'

A further implication for group structures is the concepts of related and inter-related persons.

'For all purposes of this Act—

(a) an individual is related to another individual if they—

- (i) are married, or live together in a relationship similar to a marriage; or
- (ii) are separated by no more than two degrees of natural or adopted consanguinity or affinity;

(b) an individual is related to a juristic person if the individual directly or indirectly controls the juristic person, as determined in accordance with subsection (2); and

- (c) a juristic person is related to another juristic person if—
- (i) either of them directly or indirectly controls the other, or the business of the other, as determined in accordance with subsection (2);
 - (ii) either is a subsidiary of the other; or
 - (iii) a person directly or indirectly controls each of them, or the business of each of them, as determined in accordance with subsection (2).⁸

From the above definitions and provisions, it is apparent that in terms of the Act the holding/subsidiary relationship is based on control.⁹ The concept of a group of companies, being defined as a holding company and its subsidiaries, therefore essentially arises when there is control by one company over the other.

This thesis will therefore consider a company group to be limited to a group consisting of a holding company which can exercise control over a subsidiary company. This control can either be established by the ability to exercise or control the exercise of voting rights in the subsidiary or the ability to appoint the directors who control a majority of the votes at board meetings. The importance of this is that the remedy for piercing the corporate veil, as will appear from the discussion in Chapter 3, is only available where a shareholder, whether a natural or juristic person, is able to control a company. As will appear from the discussion in Chapter 2, abuses within company groups are also more prominent where the holding company controls the subsidiary.

PIERCING vs LIFTING THE CORPORATE VEIL

There is a long standing academic debate on the difference between piercing and lifting of the corporate veil.¹⁰

⁸ Subsection 2(1) of the Act.

⁹ FHI Cassim et al *Contemporary Company Law 2ed* (2012) at 200.

¹⁰ *Ex Parte Gore NNO* 2013 2 All SA 437 at 4.

The term 'piercing' is often used to describe both lifting of the veil and actual piercing of the veil. These concepts are however distinguishable. In *Atlas Marine Co SA v Avalon Maritime Ltd, The Coral Rose (No 1)*¹¹ the court explained this distinction as follows:

'To pierce the corporate veil is an expression that I would reserve for treating the rights or liabilities or activities of a company as the rights or liabilities or activities of its shareholders. To lift the corporate veil or look behind it, on the other hand, should mean to have regard to the shareholding in a company (in other words, to its controllers) for some legal purposes.'¹²

Lifting of the corporate veil, also referred to as 'looking behind the veil', occurs when the court seeks to establish some fact about the shareholders, or the persons who controls the company, because of its relevance in law. Cassim¹³ discusses, as an example of lifting the corporate veil, the case of *Daimler Co Ltd v Continental Tyre and Rubber Co.*¹⁴ In this case a company, incorporated in England with the purpose of selling in England tyres made in Germany, instituted action against a debtor for payment of trade debt. At this time, England and Germany was at war and the debtor raised the defense that it could not pay the debt because it would result in it trading with the enemy. In this regard, it argued that Daimler Co, although incorporated in England, was in fact an alien company because all the directors and shareholders (except one) were German nationals. The court said that in order to determine whether the company was an enemy or not, it had to look at whether the persons in *de facto* control of the company was resident in an enemy country. The court found that even though the company was incorporated in England, it must look behind this veil and determine where the *de facto* controllers of the company were resident. Where the company had been taking instructions from the controllers, resident in the enemy state, the company would also be regarded as an enemy

¹¹ *Atlas Marine Co SA v Avalon Maritime Ltd (No 1)* 1991 4 All ER 769.

¹² *Atlas Marine Co SA v Avalon Maritime Ltd (No 1)* supra (n 11) at 779.

¹³ FHI Cassim et al *Contemporary Company Law* (2012) 46.

¹⁴ *Daimler Co Ltd v Continental Tyre and Rubber Co* 1961 2 AC 307.

company. Although finding that the company was an enemy company because of its owners and decision makers being German, the court did not disregard the company's separate legal personality.

When the court lifts the veil it is merely considering who the directors and shareholders of the company are. It does not mean that the court will ignore the separate legal personality of the company or that the court will treat the company's liabilities as those of the directors and shareholders.¹⁵

Piercing the corporate veil, on the other hand, refers to those cases in which the court disregards the separate legal personality of the relevant company in the matter at hand. Where the court disregards the separate legal personality of the company it treats its shareholders, or those in control of the company, as if they had been acting in partnership; or where there is only a single shareholder who is also the director, as if he or she had acted on his or her own behalf. The consequence of piercing would therefore be that the assets and liabilities of the company become those of the shareholders or controllers personally.

In *Ex Parte Gore*¹⁶ the court states that 'a broad consideration of the case law in several jurisdictions impels the conclusion that nothing really turns on the labels despite the documented debate therein about the nuances in the terminology.'¹⁷ In other words, the question of whether the court is 'piercing' or 'lifting' the veil is an academic debate; the courts have used both terms to describe the remedy provided where the courts disregarded some or all of characteristics of a company's separate legal personality.

¹⁵ FHI Cassim et al *Contemporary Company Law* (2012) 46.

¹⁶ *Ex Parte Gore NNO* 2013 supra (n 10).

¹⁷ *Ex Parte Gore NNO* 2013 supra (n 10) at 4.

For purposes of this paper, the distinction is not of consequence. The focus of this paper will be on providing a remedy whereby liability is placed on a holding company as a result of its subsidiary's separate legal personality being discarded. The essence of a remedy would lie in the ability to hold a holding company liable for the obligations of its subsidiaries.

CHAPTER TWO: THE DOCTRINES OF SEPARATE LEGAL PERSONALITY AND LIMITED LIABILITY

INTRODUCTION

'The foundation of company law rests on the concept that a company has a separate legal personality.'¹⁸

Separate legal personality means that the company is able to obtain rights and incur liabilities in its own right, separate from its shareholders.¹⁹ The profits of the company belong not to its shareholders, but to the company itself.²⁰ Shareholders can only share in profits if the company declares dividends.²¹ Also, the juristic person enjoys perpetuity and survives the passing of its shareholders or any other change in shareholding.²²

One further consequence that may follow from a company's separate persona is that the shareholders of the company have limited liability when it comes to the debts and obligations of the company.²³ This is however up to the shareholders, and they may choose to arrange the liability of the company differently, by for example incorporating a personal liability company.²⁴

Most companies are however incorporated with limited liability, and this is the default rule under the Act.²⁵ Limited liability means that in the event that the company falters

¹⁸ FHI Cassim et al *Contemporary Company Law* (2012) 29.

¹⁹ Section 19(1)(a) of the Companies Act 71 of 2008; R Pennington *Pennington's Company Law* 4ed (1979) 1.

²⁰ FHI Cassim et al *Contemporary Company Law* (2012) 36.

²¹ FHI Cassim et al *Contemporary Company Law* (2012) 36.

²² Section 19(1)(a) of the Act; FHI Cassim et al *Contemporary Company Law* (2012) 36.

²³ Section 19(2) of the Act.

²⁴ In terms of Section 8(2)(c) of the Act a company will be a personal liability company if its Memorandum of Incorporation determines so.

²⁵ Section 19(2) of the Act determines that an incorporator, shareholder or director of a company is not solely liable for any liabilities or obligations of the company except to the extent that the Companies Act or the companies Memorandum of Incorporation determines otherwise. FHI Cassim et al *Contemporary Company Law* (2012) 35; Section 19(2) of the Act.

and is unable to pay its debts, the liability of its incorporators would be limited to the amount invested in the company in terms of their shareholding. If the company is liquidated, the shareholders cannot be held liable for the debts of the company. Conversely, if the company's shareholders are sequestrated, it will not lead to the liquidation of the company.

DEVELOPMENT OF LIMITED LIABILITY AS THE DEFAULT RULE

The idea that a collective group can act on its own behalf can be traced back to the early Roman Empire when at least one third of the population belonged to professional colleges called *collegia*, *corpora*, *societates*, *sodalitates*, or *sodalicia*.²⁶ As far back as Roman times, there was at least a desire for groups to operate together and promote the economic and commercial interests of their members in order to safeguard economic privileges, control markets and have influence over prices.²⁷ Roman laws affecting the recognition of *collegia* were interchangeable and dependent on the whim of those in power.²⁸ Limited liability was not applicable to the *collegia*, although one form of limited liability that existed in Roman law was that of the *paterfamilias*, whose liability extended only to the debts of his employees to the amount entrusted to that employee.²⁹

In medieval England, continental guilds were the common form through which individuals established trade organisations.³⁰ These guilds confined themselves to the disciplines of their members and provided them with assistance to trade with outsiders.³¹ Guilds were occasionally granted charters by the Crown or authority of

²⁶ D Figueroa 'Comparative Aspects of Piercing the Corporate Veil in the United States and Latin America' (2012) (2012) Vol 50 *Duquesne Law Review* 683 at 689.

²⁷ D Figueroa 'Comparative Aspects of Piercing the Corporate Veil in the United States and Latin America' (2012) 689.

²⁸ D Figueroa 'Comparative Aspects of Piercing the Corporate Veil in the United States and Latin America' (2012) 690.

²⁹ D Figueroa 'Comparative Aspects of Piercing the Corporate Veil in the United States and Latin America' (2012) 696.

³⁰ R Pennington *Pennington's Company Law* (1979) 5.

³¹ R Pennington *Pennington's Company Law* (1979) 6.

parliament which enabled the members to obtain a monopoly over a specific discipline or trade.³²

The name 'company' was first given to merchant traders who conducted trade abroad by virtue of charters granted by the Crown.³³ These companies were mostly extensions of the earlier guilds.³⁴ A company traded on behalf of its members, each member contributing towards the merchandise that was to be sold in a foreign country, and taking a proportionate share in the profits.³⁵ Charters and monopoly status over an area of trade or territory usually co-existed.³⁶ As a result, great state-owned corporations emerged, among them the British East India Company, which under its charter had exclusive right to trade in the Indies.³⁷ Although at inception the individual members of the East India Company conducted trade for their individual interest, later members were, in addition to their own interest, allowed to subscribe to a joint stock under the control of the company. A joint pool of assets and profits were then distributed after completion of a voyage.³⁸

In the later part of the 17th century, this form of arranging trade became known as joint stock trading and by the end of the 17th century, all companies of merchant traders had established permanent fixed capitals, represented by shares which were freely transferable, and the capital was placed under the exclusive control of their boards.³⁹

³² R Pennington *Pennington's Company Law* (1979) 6.

³³ RA Stevens *The External Relations of Company Groups in South African Law: A Critical Comparative Analysis* LLD (University of Stellenbosch) (2011) 23.

³⁴ D Figueroa 'Comparative Aspects of Piercing the Corporate Veil in the United States and Latin America' (2012) 694

³⁵ R Pennington *Pennington's Company Law* (1979) 6.

³⁶ D Figueroa 'Comparative Aspects of Piercing the Corporate Veil in the United States and Latin America' (2012) 695; RA Stevens *The External Relations of Company Groups in South African Law* (2011) 23

³⁷ D Figueroa 'Comparative Aspects of Piercing the Corporate Veil in the United States and Latin America' (2012) 695; RA Stevens *The External Relations of Company Groups in South African Law* (2011) 24.

³⁸ W S Holdsworth 'The Early History of Commercial Societies *Juridical Review*' (1916) 28 *Jurid. Rev.* 305 (1916) at 323 - 324

³⁹ R Pennington *Pennington's Company Law* (1979) 6.

Although charters were essential in obtaining a monopoly in respect of foreign trade, charters were not easily or cheaply obtainable.⁴⁰ Consequently, many companies were formed without incorporation and simply established partnerships, the terms of the partnership agreement (later called deeds of settlement) mimicking the terms generally contained in charters.⁴¹ Other traders purchased charters from struggling companies and carried on their own business under this company's name.⁴²

As a result of this unregulated trade, in 1720 parliament passed the Bubble Act.⁴³ Under the Bubble Act, the establishment of corporations except by act of parliament or royal charter was prohibited. There are, however, those who propose that the Bubble Act was introduced to protect the wealth of the South Sea Company.⁴⁴ The South Sea Company, originally given a monopoly over trade in the Spanish South American colonies, had acquired the whole of the national debt of England.⁴⁵ It was said that the Bubble Act was enacted to benefit investment in the South Sea Company by suppressing other companies.⁴⁶ Stock prices in the South Sea Company were initially over-promoted by directors and as investor sentiment fell, as an unintended consequence of the Bubble Act, stock prices fell to a fraction of their worth.⁴⁷ In 1925, the Bubble Act was repealed and in 1944, replaced with the Joint Stock Companies Act. The Joint Stock Companies Act of 1944 was the first to allow incorporation of a company under general enabling legislation.⁴⁸ The act still however did not provide for limited liability.⁴⁹

⁴⁰ R Pennington Pennington's Company Law (1979) 6.

⁴¹ R Pennington Pennington's Company Law (1979) 6.

⁴² R Pennington Pennington's Company Law (1979) 6.

⁴³ RA Stevens *The External Relations of Company Groups in South African Law* (2011) 27.

⁴⁴ R Pennington Pennington's Company Law (1979) 7.

⁴⁵ RA Stevens *The External Relations of Company Groups in South African Law* (2011) 26.

⁴⁶ R Pennington Pennington's Company Law (1979) 7.

⁴⁷ R Pennington Pennington's Company Law (1979) 7.

⁴⁸ ML Djelic 'When Limited Liability was (Still) an Issue: Mobilization and Politics of Signification in 19th Century England' (2013) 35(5-6) *Organization Studies* 567 at 601; RA Stevens *The External Relations of Company Groups in South African Law* (2011) 29.

⁴⁹ PI Blumberg 'Limited Liability and Corporate Groups' (1985 – 1986) 11 *Journal for Corporation Law* 573 at 584.

The political debate at the time was on the one side cautious of the bitter public sentiment towards limited liability as a result of corporate failures such as the South Sea Company and the belief that limited liability would enable further speculation and fraudulent inflation of values and therefore lead to uneconomic promotions.⁵⁰ On the other hand, it was criticised by those who argued that limited liability was essential for accumulation of the substantial capital investment required by the growing industrial order.⁵¹

The Depression of 1845-1848 and public acceptance of limited liability for railways finally tipped the scale in favour of limited liability.⁵² The railway industry was one of the most successful industries in England and needed large amounts of capital investment but with very little investor involvement.⁵³ As a result of the separation between management and investors, few questioned limiting investors' exposure to delictual liability.⁵⁴ In 1855, the Limited Liability Act finally brought to life what may be the source of the modern day limited liability corporation. This act, although accepting the unlimited liability of the members, gave effect to the machinery which would enable members to limit their liability to the amount due by members in accordance with their share.⁵⁵ The Joint Stock Companies Act of 1856 consolidated the former two pieces of legislation and resulted therein that two forms of companies could be established, the limited and the unlimited company.⁵⁶ The Companies Act of 1867 confirmed the principle of limited liability, and continued the trend that ultimately lead to limited liability of shareholders being accepted as the default rule in English company law.⁵⁷

⁵⁰ PI Blumberg 'Limited Liability and Corporate Groups' (1985 – 1986) 584.

⁵¹ PI Blumberg 'Limited Liability and Corporate Groups' (1985 – 1986) 584.

⁵² PI Blumberg 'Limited Liability and Corporate Groups' (1985 – 1986) 584.

⁵³ PI Blumberg 'Limited Liability and Corporate Groups' (1985 – 1986) 584.

⁵⁴ PI Blumberg 'Limited Liability and Corporate Groups' (1985 – 1986) 584.

⁵⁵ HS Cilliers and ML Benade et al *Corporate Law* 3ed (2000) 21.

⁵⁶ HS Cilliers and ML Benade et al *Corporate Law* (2000) 21.

⁵⁷ D Figueroa 'Comparative Aspects of Piercing the Corporate Veil in the United States and Latin America' (2012) 698.

In the late 1890's the landmark case of *Solomon v Solomon and Co Ltd*⁵⁸ cemented both separate legal personality and limited liability in English company law. The famous facts in the Solomon case were briefly that Mr. Solomon was a leather merchant, trading as a sole trader for many years. At a later stage, he however felt the need to secure the benefits of perpetual succession and limited liability⁵⁹ and decided to establish a company to which he sold the business. The company had a share capital of 40 000 shares with a nominal value of £1. He, his wife, daughter and four sons each subscribed for one share. The payment of the purchase price of £39000 was structured to be made as a partial cash payment of £9000, the issuing of 20 000 fully paid shares to Mr. Solomon, and by further issuing debentures to Mr. Solomon for the remaining £10 000. The idea was that the company would remain a family business. Mr. Solomon was the controlling shareholder, holding 20 001 of the 20 007 issued shares. He was also a director and an employee of the company. Unfortunately, the business deteriorated and eventually had to be liquidated. During the liquidation proceedings, it became apparent that if Mr. Solomon were to be paid the value of his debentures, there would be no funds left to pay the company's remaining creditors. The liquidator, on behalf of the creditors, sought to have the company declared an alias of Mr. Solomon or a sham and an attempt for Mr. Solomon to escape liability for the debts of his creditors.

The House of Lords held that a company, duly formed and registered under the relevant legislation, was in law 'a different person altogether' from the person who is the beneficial owner of all the shares. Once a company has so been formed, motives for incorporation are irrelevant when determining the company's rights and liabilities. Therefore, even though it may be that 'after incorporation the business is precisely the same as it was before, and the same persons are managers, and the same hands receive the profits, the company is not in law the agent of the subscriber or trustee for them.'⁶⁰ As there was no fraud on the part of Mr. Solomon, the court held that the secured debentures were valid against the company's creditors.

⁵⁸ *Solomon v Solomon* 1897 A.C. 22 (HL).

⁵⁹ FHI Cassim et al *Contemporary Company Law* (2012) 33.

⁶⁰ *Solomon v Solomon* supra (n 38) Per Lord Macnaghten 51.

*Solomon v Solomon*⁶¹ is still today considered authority for the strict separate legal personality of a company and the fact that the shareholders cannot be held liable for the debts of the company.

By 1890 the separate legal personality of a company and the limited liability of its shareholders was therefore accepted by both the legislature and the courts in England.

SEPARATE LEGAL PERSONALITY AND LIMITED LIABILITY IN SOUTH AFRICAN LEGISLATION

Being a former colony of Britain, South African Company Law has always been influenced by English law.⁶² The Cape Joint Stock Companies Limited Liability Act of 1861 was the first company legislation introduced in South Africa. This act was almost a verbatim adoption of the English Joint Stock Companies Act of 1844 and the Limited Liability Act of 1855.⁶³ The limited liability company in this manner found its way into our law.

Developments in English company law over time would result in the establishment of commissions to research and make recommendations on whether the developments should also be mimicked in South Africa. Development of company law in these two jurisdictions therefore remained linked. So for example, the Companies Act 46 of 1926 had seen many amendments over the years as English company law evolved and finally after the Van Wyk de Vries report (commissioned after the Jenkins Report in England), it was replaced by the Companies Act 61 of 1973.⁶⁴

⁶¹ *Solomon v Solomon* supra (n 38).

⁶² HS Cilliers and ML Benade et al *Corporate Law* (2000) 21.

⁶³ HS Cilliers and ML Benade et al *Corporate Law* (2000) 23

⁶⁴ HS Cilliers and ML Benade et al *Corporate Law* (2000) 24.

Although it seems as if limited liability was considered an automatic consequence of incorporation under previous company law legislation,⁶⁵ the Companies Act of 1926⁶⁶ did not make specific provision for limited liability. The 1926 Companies Act⁶⁷ provided that upon registration of the memorandum of association and articles, the members of the company form a body corporate with perpetual succession and that the body corporate would be capable of exercising all the functions of an incorporated company.⁶⁸ The default form for companies was the unlimited company,⁶⁹ but Companies were able provide for limited liability if they were incorporated as a limited company.⁷⁰ Unlimited companies ceased to be the basic form under the Companies Act of 1973⁷¹ by providing for the conversion of unlimited companies into limited companies.⁷²

The Act differs from its predecessors in that it specifically provides that the shareholders and directors generally are not liable for the company's debts, as a consequence of its incorporation.⁷³ For the first time the law specifically confirms the limited liability of shareholders for the debts of the Company as a default rule and applicable to all companies, unless a company's Memorandum of Incorporation determines otherwise.

Sections 19(1) and (2) of the Companies Act reads as follows:

- 19 (1) 'From the date and time that the incorporation of a company is registered, as stated in its registration certificate, the company –
- (a) is a juristic person, which exists continuously until its name is removed from the company's register in accordance with this Act;

⁶⁵ RA Stevens *The External Relations of Company Groups in South African Law* (2011) 61.

⁶⁶ Companies Act 46 of 1926.

⁶⁷ Companies Act 46 of 1926.

⁶⁸ Section 18(2) of the Companies Act 46 of 1926.

⁶⁹ Section 5, read together with section 18(1), of the Companies Act 46 of 1926.

⁷⁰ RA Stevens *The External Relations of Company Groups in South African Law* (2011) 62.

⁷¹ Companies act 61 of 1973.

⁷² Section 25 of the Companies Act 61 of 1973.

⁷³ Section 19(2) of the Act.

- (b) has all the legal power and capacity of an individual, except to the extent that –
- (i) a juristic person is incapable of exercising any such power, or having any such capacity;...
- (2) A person is not, solely by reason of being an incorporate, shareholder or director of a company, liable for any liabilities or obligations of the company, except to the extent that this Act or the company's Memorandum of Incorporation provides otherwise.'

From the wording of section 19(2), it is clear that the default rule in terms of South African Company law is that a shareholder's liability is limited when it comes to the debts of the company.

THE ROLE OF COMMON LAW

The introduction of legislation that regulates companies is not a complete code of company law and one must also consider the wider backdrop provided by the common law. Legislation regulating companies have confirmed the common law, altered the common law or operated parallel to the common law where the two systems are not in conflict with one another.

The common law applicable to companies in South Africa, although not simple to identify, is modeled largely on English common law.⁷⁴ Many rules of English common law were readily accepted in South Africa with little or no modification, for example the division of power between shareholders and directors, the *ultra vires* doctrine, the rule in *Foss v Harbottle*⁷⁵ and the Turquand rule.⁷⁶ In cases where no guidance can be found in our common law, our courts, because company legislation

⁷⁴ HS Cilliers and ML Benade et al *Corporate Law* (2000) 19.

⁷⁵ *Foss v Harbottle* (1843) 2 Hare 461.

⁷⁶ HS Cilliers, ML Benade *Corporate Law* (2000) 19.

had been taken from the English law, have used English law on the point in issue and have followed English precedents if such an approach was not in conflict with our law.⁷⁷ In this way, the common law remedy for piercing the corporate veil was introduced into South African company law.

ECONOMIC REASONS FOR LIMITED LIABILITY

Like South Africa and the United Kingdom, (discussed above), most jurisdictions today acknowledge limited liability as the default rule applicable to companies.

A commonly cited rationale in support of limited liability as a default rule is based on the economic growth stimulated thereby. Supporters of limited liability state that it encourages economic growth, as it allows investors to limit the risk of investing funds into a business venture,⁷⁸ enabling them to make riskier investments and enabling persons of moderate means to participate in economic markets. They therefore state that there is an economic need for limited liability. Fischel and Easterbrook call this the economic theory of limited liability.⁷⁹

The economic theory submits that limited liability reduces the costs of operating a business for four reasons. Firstly, limited liability reduces monitoring costs for investors.⁸⁰ If investors carried a greater risk, they would have to monitor the directors of the company more directly, resulting in additional costs to appoint agents for monitoring purposes. This would be particularly problematic for public and larger private companies where management is separate from its shareholders or members. In addition, investors would need to monitor who else has shareholding or membership in the company to ensure that they are not left bearing the company's

⁷⁷ HS Cilliers, ML Benade *Corporate Law* (2000) 19.

⁷⁸ FHI Cassim et al *Contemporary Company Law* (2012) 35.

⁷⁹ FH Easterbrook and DR Fischel 'Limited Liability and the Corporation' (1985) 52 *University of Chicago Law Review* 89.

⁸⁰ FH Easterbrook and DR Fischel 'Limited Liability and the Corporation' (1985) 94. See also discussion in RJ Huss 'Revamping Veil Piercing for all Limited Liability Entities: Forcing the Common Law Doctrine in the Statutory Age' (2001) 70 *University of Cincinnati Law Review* 95 at 105.

liability alone. This again is of greater concern in public and larger private companies with extensive and changing membership.

Secondly, limited liability increases managerial efficiency by increasing the transferability of shares.⁸¹ Shareholders can more easily trade in shares if it is a homogenous commodity with no personal liability attached. It also then follows that directors would be encouraged to manage a company more efficiently because they are at risk of being replaced by any new shareholders' own choice of management should the company's affairs not be managed optimally.

Thirdly, limited liability supports diversification of investment portfolios.⁸² If shareholders had a liability attached to their shareholdings, they would have to reduce the number of companies in which they invest to reduce the risk and be able to monitor their investments. Investment decisions as such would become complicated as investors would first need to determine if the company they are investing in has an acceptable risk profile, adequate capitalisation and well-resourced current shareholders. To reduce exposure and the costly, time-consuming monitoring, investors would limit their investments to a small number of companies. This limits an investor's ability to reduce their risk through the diversification of their investments portfolios, which would in turn drive up their required rate of return.

Finally, limited liability creates room for management to make decisions on investments of the company.⁸³ Managers are able to invest in any project, including those that hold a higher risk, because shareholders will not stand to lose more than their investment where such projects fail. Where investors feel the need to monitor a

⁸¹ FH Easterbrook and DR Fischel 'Limited Liability and the Corporation' (1985) 95. See also discussion in RJ Huss 'Revamping Veil Piercing for all Limited Liability Entities: Forcing the Common Law Doctrine in the Statutory Age' (2001) 105.

⁸² FH Easterbrook and DR Fischel 'Limited Liability and the Corporation' (1985) 95. See also discussion in RJ Huss 'Revamping Veil Piercing for all Limited Liability Entities: Forcing the Common Law Doctrine in the Statutory Age' (2001) 105.

⁸³ FH Easterbrook and DR Fischel 'Limited Liability and the Corporation' (1985) 97. See also discussion in RJ Huss 'Revamping Veil Piercing for all Limited Liability Entities: Forcing the Common Law Doctrine in the Statutory Age' (2001) 106.

company's behaviour, they would require continuous access to financial information and business decisions and will intervene in corporate decision making where they feel that investment projects are too risky.

Accepting limited liability as the default rule is however not without its potential disadvantages. Theoretically, companies with limited liability are more likely not to hold and maintain sufficient funds or assets to pay creditors' claims.⁸⁴ Limited liability does not discourage the undercapitalisation of companies and therefore the concerns with regards to limited liability are most prominently experienced by the creditors of the company. When the company fails, the shareholders stand to lose only the amount they invested in the company; which is likely to have been undercapitalised in the first instance. Creditors are therefore left with an empty shell from which they have to collect debts.

A counter argument that has been raised this concern with limited liability, is that from an economic perspective the difficulties for shareholders with an unlimited liability regime exceed the difficulties for creditors with a limited liability regime.⁸⁵ Although limited liability holds risks for the company's creditors, creditors have the capability to protect against the risk of loss; at least in theory. Creditors can for example price for the risk of non-payment when calculating the rates at which services are provided. Those creditors with superior bargaining power can also protect themselves by requiring security over the company's assets, retaining ownership of goods provided on credit, obtaining suretyships from directors etc. Therefore, creditors are assumed to be capable of protecting themselves against the risk of non-payment.⁸⁶

This reasoning however is based on the assumption that all relevant information was available to the creditor, enabling the creditor to accurately price for the risk, and that

⁸⁴ See also discussion in RJ Huss 'Revamping Veil Piercing for all Limited Liability Entities: Forcing the Common Law Doctrine in the Statutory Age' (2001) 107. H Anderson 'Piercing the Corporate Veil on Corporate Groups in Australia' (2009) 33 *Melbourne University Law Review* 333 at 338.

⁸⁵ H Anderson 'Piercing the Corporate Veil on Corporate Groups in Australia' (2009) 339 – 341.

⁸⁶ H Anderson 'Piercing the Corporate Veil on Corporate Groups in Australia' (2009) 339.

creditors do have bargaining power.⁸⁷ This can however not be said where the creditor is a small enterprise providing goods to a larger business. In these cases, they may have limited bargaining power and not necessarily have the economic security to insist on security against non-payment, or the economic conditions and competition on the market might not allow them to do so.⁸⁸ Further, the capability of stronger credit providers to negotiate security puts weaker credit providers at a greater risk. Lack of information can also contribute to incorrect risk pricing.⁸⁹ Larger companies may have complex structures which frustrates the determination of credit risk. Similarly smaller companies may not have the infrastructure to supply all the relevant information. Some creditors may also lack the knowledge and expertise to make accurate assessments of risk. And ultimately, unforeseeable market volatility can always occur.⁹⁰

This reasoning further takes into consideration that not all company creditors voluntarily acquire that status. Involuntary creditors, such as delictual claimants, are also at risk when a company's shareholders are protected from liability for the actions of the company. Delictual claimants, unlike creditors, are not in a position to contractually protect themselves against the risk of harm and therefore may end up with claims against a company which has no means to pay compensation.⁹¹

SEPARATE LEGAL PERSONALITIES & LIMITED LIABILITY WITHIN GROUPS COMPANIES

In the modern world, company groups have become a commercial reality. Historically, forming corporate groups became possible when companies were granted the power to own shares.⁹² Over time, businesses structure developed and began to operate in complex groups. However, a company's ability to own shares in

⁸⁷ H Anderson 'Piercing the Corporate Veil on Corporate Groups in Australia' (2009) 340.

⁸⁸ H Anderson 'Piercing the Corporate Veil on Corporate Groups in Australia' (2009) 340.

⁸⁹ H Anderson 'Piercing the Corporate Veil on Corporate Groups in Australia' (2009) 341.

⁹⁰ H Anderson 'Piercing the Corporate Veil on Corporate Groups in Australia' (2009)341.

⁹¹ H Anderson 'Piercing the Corporate Veil on Corporate Groups in Australia' (2009) 348.

⁹² Blumberg 'Limited Liability and Corporate Groups' (1985-1986) 607-608.

another company only occurred after the political and economic debate surrounding limited liability had been won by those who believed it to be essential for economic growth.⁹³

In England, the courts first recognised the ability for a company to own shares in another company in 1867.⁹⁴ Once it was established that the company's memorandum empowered it to hold shares in another company, the courts acknowledged the limited liability of a juristic shareholder in relation to its subsidiaries' debt without apparent awareness that the holding company would in effect now have two layers of limited liability sheltering it from claims of its subsidiaries' creditors.⁹⁵

Blumberg finds that from neither an academic nor a political perspective, was the application of limited liability to company groups debated.⁹⁶ Extending limited liability to company groups meant that the holding company's shareholders were protected by a second tier of limited liability from the group enterprise obligations. Notwithstanding questioning whether this development was in fact desirable, at the time of extending limited liability extending a second tier of protection was neither anticipated nor intended.⁹⁷

Historically therefore, limited liability preceded company groups and the extension of limited liability to holding companies in company groups also in South African company law, seems to have occurred as a convenience.⁹⁸

⁹³ Blumberg 'Limited Liability and Corporate Groups' (1985-1986) 604.

⁹⁴ Blumberg 'Limited Liability and Corporate Groups' (1985-1986) 608.

⁹⁵ Blumberg 'Limited Liability and Corporate Groups' (1985-1986) 608.

⁹⁶ Blumberg 'Limited Liability and Corporate Groups' (1985-1986) 630.

⁹⁷ Blumberg 'Limited Liability and Corporate Groups' (1985-1986) 604.

⁹⁸ RA Stevens *The External Relations of Company Groups in South African Law* (2011) 60.

REASONS FOR GROUPS

Stephan Bainbridge stated that '[t]here is nothing intrinsically fraudulent about deciding to incorporate or about dividing a single enterprise into multiple corporations, even when done solely to get the benefit of limited liability.'⁹⁹

There are various advantages that come from utilising group structures which explains why they have gained popularity. In 1930, Bonbright and Means could already identify four reasons why groups of companies would be formed, namely:

- to centralise control of previously independent companies;
- to consolidate the financial structure of previously independent companies by the holding company in effect becoming the financier of the subsidiaries under its control;
- to recapitalise the financial structure of one or more companies by substituting the shares of the holding company for shares in the subsidiary; and
- to gain voting control in a subsidiary with very little financial investment.¹⁰⁰

With increasing legislative intervention and regulation of different industries, groups today are used for various reasons in addition to the listed above reasons. One example is to enable an enterprise to operate different types of businesses, each subject to its own set of registration requirements, regulatory scrutiny and reporting requirements (e.g. capital adequacy and licensing requirements for banks, insurers and other financial services providers). It would be too onerous if the enterprise as a whole or each of its business units had to comply with all the regulatory requirements under different legislation.¹⁰¹ Especially for multi-national companies,

⁹⁹ SM Bainbridge 'Abolishing Veil Piercing' (2000 - 2001) 26 *Journal of Corporation Law* 479 at 483.

¹⁰⁰ RA Stevens *The External Relations of Company Groups in South African Law* (2011) 4, quoting from Bonbright & Means *The Holding Company, its Public Significance and its Regulation* (1932) 7.

¹⁰¹ SM Bainbridge 'Abolishing Veil Piercing' (2000-2001) 532.

being able to set up a separate company in each of its trading countries may be the only way to gain access to that market and comply with local legislation. In short, larger enterprises can be operated more proficiently in the form of separate companies, each capable of complying with the regulations applicable to its operations, but ultimately controlled by one holding company.

The incorporation of subsidiary companies can also create a platform for more efficient management of a larger business.¹⁰² Where the business of a company becomes more complex it may be sensible to break up the company in smaller companies that each has its own management structure and is able to focus on the portion of the business for which it is responsible.¹⁰³

A further modern use of subsidiaries is forming Special Purpose Vehicles to facilitate funding agreements. By incorporating a Special Purpose Vehicle, a controlling shareholder can seek outside investment without relinquishing any shares or control of the holding company by offering outside investors a minority share in the subsidiary.¹⁰⁴ In South Africa, company groups are often used to facilitate Black Economic Employment transactions in the same way. Policy makers have also created tax incentives and favourable exchange control regulations in order to encourage the establishment of headquarter companies in South Africa, as a gateway for investment in Africa. Over the past years, National Treasury has confirmed its policy to encourage investors to establish holding companies in South Africa, from where their subsidiaries in Africa can be operated, with the intent to boost local tax revenue, dividends, competitiveness, job creation and economic growth.¹⁰⁵

¹⁰² RA Stevens *The External Relations of Company Groups in South African Law* (2011) 5.

¹⁰³ RA Stevens *The External Relations of Company Groups in South African Law* (2011) 5.

¹⁰⁴ RA Stevens *The External Relations of Company Groups in South African Law* (2001) 5.

¹⁰⁵ National Treasury '2013 Budget Review' 1 available at <http://www.treasury.gov.za/documents/national%20budget/2013/review/Annexure%20W3.pdf> [last accessed 02 December 2015.]

The most prominent reason, however, remains reducing the risk to which the holding company is exposed.¹⁰⁶ Every company within the group of companies has its own separate legal personality and therefore bears its own risks and liabilities. The individual companies within the group do not become liable for the obligations and liabilities for other companies within the group. Where individual companies within the group therefore have limited liability, the commercial risk of the group structure is effectively reduced. Where a holding company controls its subsidiaries through shareholding, subsidiaries can be incorporated with minimal capital to undertake risky business ventures without exposing the whole group to that risk. If the business venture fails, the holding company only loses its investment made in the subsidiary. The rationale is similar to that applied where an entrepreneur invests in a company; the limited liability encourages investments that would otherwise not be made if the shareholder were to have unlimited personal liability if the business venture in question fails.

CONCERNS IN GROUPS

According to Botha¹⁰⁷ the basic characteristic of a group is that:

‘...the management of the different and independent holding and subsidiary companies comprising the group is coordinated in such a way that they are managed on a central and unified basis in the interest of the group as a whole. This management on a unified basis is possible because of the control, implicit in the holding/subsidiary company relations, which the holding company exercises over the subsidiary or subsidiaries. This control makes it possible that the group is managed as an economic unit, in the sense that the different holding and subsidiary companies no longer carry out their commercial activities on a footing of complete economic independence.’

¹⁰⁶ RA Stevens *The External Relations of Company Groups in South African Law* (2001) 5.

¹⁰⁷ DH Botha ‘Recognitions of the Group Concept in Company Law’ (1982) 15 *De Jure* 108.

The management of the different independent holding and subsidiary companies comprising the group is coordinated in a way that actually takes place on a central and unified basis in the interest of the group as a whole. This management on a unified basis is made possible through the holding company's control of its subsidiaries.¹⁰⁸ Through this control, the group is capable of being managed as a single economic entity, in the sense that the holding company and its subsidiary companies no longer carry out their commercial activities independently.¹⁰⁹ This economic interrelationship coupled with control can be used to camouflage the economic reality or location of risk and may lead to abuse.

The concerns with limited liability, as discussed above, are also relevant within company groups. The holding company is not discouraged from undercapitalising its subsidiaries, leaving the creditors of the subsidiary exposed if the company fails. The concern in groups is however augmented by the often complicated structures making it unclear to creditors in which company their risk lies. Group structures intentionally or unintentionally camouflage the economic reality of individual companies within the group and the exact allocation of risk. Without proper due diligence, the creditor may find its exposure lies with an empty shell company within the larger group. Creditors who are not able to insist on ring-fenced security may find that after its due diligence, the company's assets are transferred to another company within the group, and that its exposure thereafter lies with an empty shell company.

Blumberg¹¹⁰ dismisses some of the economic theories in support of limited liability when it comes to company groups, especially in a group that consists of a holding company and its wholly-owned subsidiaries.

¹⁰⁸ It should be remembered that the definition of a group of companies in the Act does require that within the group companies are related and inter-related by virtue of the control entities exercise over each other.

¹⁰⁹ HS Cilliers and ML Benade et al *Corporate Law* (2000) 432.

¹¹⁰ Blumberg, PI 'Limited Liability and Corporate Groups' (1985-1986) 624-626.

Firstly, he states that the justification that limited liability decreases the need for shareholders to monitor managers is not applicable in these types of groups.¹¹¹ It is clear that the holding company would have incentive to monitor the activities of its wholly-owned subsidiaries.

Secondly, the justification that limited liability encourages managers to manage the company at utmost efficiency to the benefit of the shareholders as it promotes the free transfer of shares has less application to holding companies and wholly-owned subsidiaries.¹¹² Where the holding company controls the subsidiary, it is in a position to appoint the subsidiaries' management.

Thirdly, the fact that limited liability is pertinent to the operation of the securities markets is largely irrelevant in the case of a wholly-owned subsidiary, where the structure of the group is of such a nature that all the shares will be owned by the holding company and trade in shares therefore is rendered irrelevant.¹¹³ This justification is still relevant in the case of a partially-owned subsidiary, where there is a market for the trade of shares in the subsidiary. This is, however, limited to the trading of the minority shares and the reasoning is still sound in relation to the majority shareholding of the holding company.¹¹⁴

Finally, the fact that limited liability permits efficient diversification by shareholders, which in turn allows shareholders to reduce their individual risk, is less applicable to holding companies.¹¹⁵ Companies are less risk averse than individuals. The ultimate investors in the subsidiary are, through their shareholding in the holding company, the investors in the holding company. These investors are still capable of diversifying their investment independent of the holding company if the risk of the subsidiaries were to be assumed by the holding company.¹¹⁶

¹¹¹ Blumberg, PI 'Limited Liability and Corporate Groups' (1985-1986) 624.

¹¹² Blumberg, PI 'Limited Liability and Corporate Groups' (1985-1986) 624.

¹¹³ Blumberg, PI 'Limited Liability and Corporate Groups' (1985-1986) 624.

¹¹⁴ Blumberg, PI 'Limited Liability and Corporate Groups' (1985-1986) 624.

¹¹⁵ Blumberg, PI 'Limited Liability and Corporate Groups' (1985-1986) 624.

¹¹⁶ Blumberg, PI 'Limited Liability and Corporate Groups' (1985-1986) 624.

CONCLUSION

The separate legal persona of a company and the limited liability of the shareholders of a company has long been the basis of modern company law. Indeed, without it, the world economy would have looked very different and expansion arguably would have occurred at a much slower rate.

Historically, limited liability was extended to the holding company within a company group as a matter of convenience. The limited liability of companies that operate within a group seems to have come about without consideration of the economic relationship the companies share and that they in actual fact operate as a single entity in the interest of the group as a whole. Limited liability does not make sense where company groups are in fact operated as a single entity as they all operate for the benefit of the group.¹¹⁷ Each company benefits from the integration of activities within the group and the separateness that justifies limiting liability of its shareholders of the individual companies within the group is less clear where interests are intertwined.¹¹⁸ Many of the policy considerations, such as encouraging investment, and economic reasons in favour of limited liability do not apply within groups.

In the modern economy, where the world's largest corporations are operated in a company group structure, the unqualified recognition of limited liability has created fundamental problems and imbalances. Certain concerns, relating for example to the abuse of the corporate structure to escape liability, has however not always been tolerated. These instances and remedies provided to those who suffer as a result of such abuse will be discussed in Chapter 3.

¹¹⁷ KA Strasser and PI Blumberg "Legal Models and Business Realities of Enterprise Groups – Mismatch and Change" 2009 Comparative Research in Law & Political Economy (Research Paper No 18 of 2009) 7.

¹¹⁸IM Ramsay 'Allocating Liability in Corporate Groups: An Australian Perspective' (1998-1999) *Connecticut Journal of International Law* 329 at 343.

CHAPTER 3: THE COMMON LAW REMEDY FOR PIERCING THE CORPORATE VEIL

INTRODUCTION

In the previous chapter, the principles of the separate legal personality of the company and the limited liability of its shareholders were discussed. Although these principles lie at the heart of company law and have been entrenched in statutes, concerns were discussed as to how these characteristics may be abused within a group of companies. The separate legal personality of a company can be used to house the liability of a holding company in a different entity and so enable the holding company to avoid liability for that entity's obligations, although it controls which obligations it may incur.

The courts have played an essential role in developing remedies to address the abuses or inequitable consequences of the separate legal personality of juristic persons and the limited liability of shareholders. One remedy available to address abuses of the separate legal personality of a company is the common law remedy of piercing the corporate veil. This remedy allows a court to disregard the veil of incorporation to determine where the right, liability or obligation truly lies. When the corporate veil is pierced, the court ignores the separate existence of the company and treats the shareholders of the company, as if they had been acting for their own account.

In this chapter, the common law remedy of piercing the corporate veil and the effectiveness of the remedy in addressing abuses within company groups will be discussed.

COMMON LAW REMEDY OF PIERCING THE CORPORATE VEIL

The exact origin of the common law remedy of piercing the corporate is uncertain. The remedy seems to be based on the laws of equity.¹¹⁹ It is however considered trite law that the courts are justified to disregard a company's separate legal personality to allocate liability where it rightly belongs.¹²⁰ This is commonly known as piercing the corporate veil.

In *Botha v Van Niekerk*¹²¹ the court states that:

'[D]ie oortuiging [het] algaande meer aanvaarding gevind by howe sowel as navorsers dat ontwikkeling van die erkenning van die maatskappy as 'n verdere persona in die reg plaasgevind het weens die behoefte daaraan in die verkeer, maar dat nadele kan ontstaan en onreg tot stand kan kom juis deur 'n aandrang op die erkenning van die afsonderlikheid van die regspersoon. Dit kom voor asof besef is dat om 'n volstrekteid te verleen aan die erkenning van die afsonderlikheid van die maatskappy soms inhou dat verder gegaan word as die doel en rede vir die erkenning van die bestaanbaarheid van 'n regspersoon; dat so 'n benadering die heer kan word van onreg in plaas daarvan dat erkenning van regspersoonlikheid bloot die verkeersbehoefte volgens billikheidsmaatstawwe dien; dat dit nie vir voldoening aan die behoeftes van die gemeenskap nodig is om 'n regspersoon so te benader dat totaal onaanvaarbare resultate ontstaan omdat partye toegelaat word om 'n fiktiewe persoon in die alledaagse verkeer te laat optree nie.'¹²²

¹¹⁹ RJ Huss 'Revamping Veil Piercing for All Limited Liability Entities: Forcing the Common Law Doctrine into the Statutory Age' (2001) 108.

¹²⁰ RA Stevens *The External Relations of Company Groups in South African Law* (2011) 63.

¹²¹ *Botha v Van Niekerk and Another* (1983) 4 All SA 157 (W).

¹²² *Botha v Van Niekerk en 'n Ander* supra (n 34) at 161.

Where the corporate veil is pierced, the right and obligations of the company is transferred to the shareholders of the company, disregarding both the separate legal personality of the company as well as the limited liability of the shareholders.

The courts will however not lightly disregard a company's separate legal personality:

'It is undoubtedly a salutary principle that our courts should not lightly disregard a company's separate personality, but should strive to give effect to and uphold it. To do otherwise would negate or undermine the policy and principles that underpin the concept of separate corporate personality and the legal consequences that attach to it. But where fraud, dishonesty or other improper conduct (and I confine myself to such situations) is found to be present, other considerations will come into play. The need to reserve the separate corporate identify would in such circumstances have to be balanced against policy considerations which arise in favour of piercing the corporate veil.'¹²³

In the United Kingdom, some judges have grappled with accepting that the court has the authority to disregard the corporate veil. In *VTB Capital v Nutritek International Corp*¹²⁴ Lord Neuberger discusses the arguments regarding the existence, if at all, of the principle of piercing the corporate veil. The court refers to the case of *Solomon v Solomon*¹²⁵ where Lord Halsbury said that a legally incorporated company 'must be treated like any other independent person with its rights and liabilities appropriate to itself...It is impossible to say at the same time that there is a company and there is not.'¹²⁶ Accordingly, the fact that the precise nature, basis and meaning of piercing the corporate veil are all somewhat obscure, as is the precise nature of circumstances in which the corporate veil will be pierced, supports the argument that

¹²³ *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* 1995 (4) SA 790 (A) at 803H.

¹²⁴ *VTB Capital plc v Nutritek International Corp and Others* 2013 UKSC 5.

¹²⁵ *Solomon v Solomon* supra (n 38).

¹²⁶ *VTB Capital plc v Nutritek International Corp and Others* supra (n 124) at 122; *Solomon v Solomon* supra (n 38) at 30-31.

there is no principled basis upon which it can be said that the court can pierce the corporate veil.¹²⁷ However, on the facts of this case, Lord Neuberger found it unnecessary to decide whether in the absence legislation providing for the court to pierce the corporate veil, the courts have the power to do so.¹²⁸ The court was able to provide relief without piercing the corporate veil.

The South African courts have readily accepted that they are able to pierce the corporate veil in certain circumstances.

Piercing the corporate veil can equally be used to pierce the veil between a company and its shareholders or its holding company. In order to evaluate the effectiveness of this remedy as a tool to address abuses within company groups, it is necessary to look at the circumstances under which the courts will pierce the corporate veil.

REQUIREMENTS FOR PIERCING

Determining the requirements for piercing the veil have always been difficult as the courts have not generally followed consistent principles in determining when they will depart from the principle that a company is a separate legal person.¹²⁹

The courts, to the contrary, have guarded against discerning specific circumstances under which the corporate veil should be pierced; and have always avoided laying down rigid rules.¹³⁰ This is partly attributed to the fact that, as discussed in the previous chapter, the doctrine of limited liability and separate legal personality lies at

¹²⁷ *VTB Capital plc v Nutritek International Corp and Others* supra (n 124) at 123.

¹²⁸ *VTB Capital plc v Nutritek International Corp and Others* (n 124) at 130.

¹²⁹ FHI Cassim et al *Contemporary Company Law* (2012) 48.

¹³⁰ In *Botha v Van Niekerk* supra (n 34) the court attempted to formulate such a test and held that, when considering whether the corporate veil should be pierced, it should be considered whether an unconscionable injustice would result if the corporate veil was not pierced. The supreme court in *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* supra (n 123) at 802 however rejected this test for being too rigid.

the heart of company law;¹³¹ concepts that courts therefore have not been willing to ignore merely because it might in any given case be just or equitable to do so.¹³² As limited liability and separate legal personality of companies are bestowed by policymakers under legislation, another layer of cautiousness exists which the courts first have to consider before it can pierce the corporate veil.¹³³ In *Cape Pacific Ltd v Lubner Controlling Investments* the court considered the remedy of piercing the corporate veil and found the law to be far from settled with regard to the circumstances under which it would be permissible to pierce the corporate veil.¹³⁴ The court also did not consider it necessary or advisable to attempt to set out specific principles. Each case should be considered on the facts.¹³⁵

Domanski points out that the problem with setting categories of conduct which would justify piercing is that it will not allow for piercing in circumstances falling outside of these categories but where piercing may still be justified on the basis of public policy and fairness.¹³⁶ He argues for a more principled approach requiring the court to weigh up those policy considerations justifying piercing against those policy considerations which are stacked against it. Cassim also finds the courts' approach of not setting down a finite test to be commendable.¹³⁷ The danger of setting rules is that a situation may arise where justice or equity calls for the court to pierce the veil, but it will then not be able to grant such relief where certain pre-determined facts are not present.¹³⁸

Veil piercing therefore is considered on a case by case basis with no clear underlying considerations or tests. Guidance as to when the remedy will be available can however be found with reference those cases in which the courts did pierce the corporate veil and can give a better understanding of this remedy.

¹³¹ FHI Cassim et al *Contemporary Company Law* (2012) 48.

¹³² *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* supra (n 123) at 31.

¹³³ *VTB Capital plc v Nutritek International Corp* supra (n 124) 130.

¹³⁴ *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* supra (n 123) at 28.

¹³⁵ *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* supra (n 123) at 29.

¹³⁶ Domanski A 'Piercing the Corporate Veil – A New Direction' 1986 *SALJ* 224.

¹³⁷ FHI Cassim et al *Contemporary Company Law* (2012) 43.

¹³⁸ FHI Cassim et al *Contemporary Company Law* (2012) 43.

As a point of departure, it is required that the shareholders of the company control the company.¹³⁹ Complete control is not necessary. The control must however be to the extent that the shareholders are able to dominate the finances, policies and practices of the company to such degree that it can be found that the company had no separate mind, will or existence of its own.¹⁴⁰ In *Hulse-Reutter v Godde*¹⁴¹ the court held that ‘there must at least be some misuse or abuse of the distinction between the corporate entity and those who control it which results in an unfair advantage being afforded to the latter.’¹⁴² It should therefore at least be that the abusive conduct had been brought about by those in control of the company and that they received an unfair advantage as a result of such conduct.

It should be noted that the definition of company groups as set out in the Act requires there to be related or interrelated (direct or indirect) control by one company over the other.¹⁴³ In the context of group companies, a holding company’s control over its subsidiaries can be assumed; and where two entities are related or interrelated to one another, direct or indirect control may be present.

Control and ownership alone is however not sufficient to disregard the company’s separate personality.¹⁴⁴ Once control is established, other considerations must be taken into account. Williams finds that, after control is established, the courts will turn to determining whether the company is a mere façade to conceal the true facts or a wrongdoing ‘so that the separate existence of the company is being abused.’¹⁴⁵

¹³⁹ RC Williams *Companies 2nd Edition* [Last Updated: 30 November 2012] 87.

¹⁴⁰ RC Williams *Companies 2nd Edition* (2012) 87.

¹⁴¹ *Hulse-Reutter v Godde* 2001 (4) SA 1336 (SCA).

¹⁴² *Hulse-Reutter v Godde* 2001 supra (n 140) at 20.

¹⁴³ Refer to discussion in Chapter 1.

¹⁴⁴ *Solomon v Solomon* supra (n 38) at 37.

¹⁴⁵ RC Williams *Companies 2nd Edition* (2012) 88.

In *Cape Pacific Ltd v Lubner Controlling Investments*,¹⁴⁶ the court gave some guidelines as to the approach that has been followed in piercing cases. Smalberger (J) found it to be a salutary principle that the separate legal personality of a company is an important norm that the courts should not lightly disregard, but rather should strive to give effect to and defend.¹⁴⁷ 'To do otherwise would negate or undermine the policy and principles that underpin the concept of separate legal personality and the legal consequences attached to it.'¹⁴⁸

In some circumstances however, the need to uphold the separate legal personality has to be balanced against policy considerations in favour of piercing the corporate veil.¹⁴⁹

Smalberger (J) identified these circumstances to be where fraud, dishonesty or improper conduct (and the court confined itself to these situations) were found to be present.¹⁵⁰ The court referred to the decision in *The Shipping Corporation of India Ltd v Evdomon Corporation*,¹⁵¹ where it was confirmed that the circumstances under which the court will pierce the corporate veil generally were those which 'include an element of fraud or other improper conduct in the establishment or use of the company or the conduct of its affairs. In this connection the words 'device', 'stratagem', 'cloak' and 'sham' have been used.'¹⁵² In these circumstances, 'the court would be entitled to look to substance rather than form in order to arrive at the true fact, and if there has been a misuse of the corporate personality, to disregard it and attribute liability where it should rightly lie.'¹⁵³

It should be noted that it is not necessary for the company to have been founded in deceit, and never have been intended to operate properly as a company, before its

¹⁴⁶ *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* supra (n 123).

¹⁴⁷ *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* supra (n 123) at 31.

¹⁴⁸ *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* supra (n 123) at 31.

¹⁴⁹ *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* supra (n 123) at 31.

¹⁵⁰ *Cape Pacific Ltd v Lubner Controlling Investments* supra (Pty) Ltd (n 123) at 31.

¹⁵¹ *The Shipping Corporation of India Ltd v Evdomon Corporation and Another* 1994(1) SA 550 (A).

¹⁵² *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* supra (n 123) at 31.

¹⁵³ *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* supra (n 123) at 32.

separate legal personality can be disregarded.¹⁵⁴ If an otherwise legitimately established and operating company is misused in a particular instance for a fraudulent, dishonest or improper purpose, there is no reason why its separate legal personality cannot be disregarded in relation to that specific act.¹⁵⁵

Williams¹⁵⁶ groups the courts' decisions to pierce the corporate veil into three categories; where the separate existence of the company was used to perpetuate a fraud, where the company is the alter ego or an instrumentality of its shareholders, and where, on the facts, the corporate veil should be pierced in the interest of justice or fairness.

Fraud and improper conduct

The presence of fraud has been widely accepted as sufficient justification for piercing the corporate veil.¹⁵⁷ In *Lategan v Boyes*¹⁵⁸ the court held that there was no doubt that the court will pierce the corporate veil where fraudulent use is made of the separate legal personality of the company.¹⁵⁹

Alter ego or instrumentality

A company is not merely an agent for its shareholders,¹⁶⁰ but the courts have found that one policy consideration in favour of piercing is the fundamental doctrine that the law gives regard to the substance rather than the form of things.¹⁶¹ The court will therefore pierce the corporate veil if it appears that the shareholders did not treat the

¹⁵⁴ *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* supra (n 123) at 32.

¹⁵⁵ *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* supra (n 123) at 32.

¹⁵⁶ RC Williams *Companies* 2nd Edition (2012) 88 – 90.

¹⁵⁷ *Lategan and Another NNO v Boyes and Another* 1980 4 SA 191 (T); *Botha v Van Niekerk* supra (n 34).

¹⁵⁸ *Lategan NNO v Boyes* supra (n 155).

¹⁵⁹ *Lategan NNO v Boyes* 1980 4 SA 191 (T) 648.

¹⁶⁰ *Solomon v Solomon* supra (n 38) at 42-43.

¹⁶¹ *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* supra (n 123).

company as a separate entity, but instead treated it as their 'alter ego' or an 'instrumentality' to promote their own interest.¹⁶²

This would occur where the shareholder in control of the company does not separate his or her own interest from that of the company and furthers his or her own interests in conducting business, albeit using the company as a conduit in doing so.

In these instances, the presence of fraud is not essential for veil piercing.¹⁶³ The considering factor is not an intention to defraud, but that the separate personality of the company was used by the shareholders to obtain advantages without treating the company as a separate entity.

In the interest of justice

A third category of piercing is where, on the facts, the corporate veil should be pierced in the interest of justice or fairness. Williams¹⁶⁴ does not expand on this category but it seems to be broad enough to include any circumstance where justice requires that the veil must be pierced.

AVAILABILITY OF OTHER REMEDIES

One principle that the court has been less consistent on is whether the existence of an alternative remedy would bar the aggrieved party from seeking the corporate veil to be pierced.

¹⁶² Cassim states this to rather be a case of lifting the corporate veil, where the shareholders are personally liable as the principal of the company, and although the practical implication is that the separate personality of the company is disregarded in the instance of that transaction, it still otherwise remains intact. See FHI Cassim et al *Contemporary Company Law* (2012) 52.

¹⁶³ *Botha v Van Niekerk* supra (n 34).

¹⁶⁴ RC Williams *Companies* 2nd Edition (2012).

In *Cape Pacific Ltd v Lubner Controlling Investments*¹⁶⁵ the court stated that the existence of an alternative remedy would not bar a party from seeking relief in the form of piercing of the corporate veil. The court states that whilst the existence of an alternative remedy is a factor in determining whether or not a veil piercing order should be granted, it will not bar such relief.¹⁶⁶ The court found that there is no reason why piercing of the corporate veil should be precluded if another remedy exists. It is a general rule that if a person has more than one legal remedy at his disposal, it is his choice under which to institute action and he is not obliged to pursue one over the other.¹⁶⁷ The same should apply in an application for piercing of the corporate veil; the existence of another remedy, or the failure to pursue what would have been an available remedy, should not bar the court from granting the relief by piercing.¹⁶⁸ The existence of another remedy, or the failure to pursue one that was available, is however a relevant factor where policy considerations are being considered.¹⁶⁹ Even so, it cannot be of overriding importance.

In *Hulse-Reutter v Godde*¹⁷⁰ the court departed from the approach in *Cape Pacific*. The court stated that the exceptional nature of the relief sought requires that there must be no other remedy available to the aggrieved party.¹⁷¹ One argument why piercing the corporate veil can never be merely an alternative remedy is that all alternative remedies necessarily assume what an order obtained of piercing denies, that is the existence of the company as a separate entity.¹⁷² This stricter approach

¹⁶⁵ *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* supra (n 123).

¹⁶⁶ *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* supra (n 123) at 38.

¹⁶⁷ *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* supra (n 123) at 37.

¹⁶⁸ *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* supra (n 123) at 37.

¹⁶⁹ *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* supra (n 123) at 38.

¹⁷⁰ *Hulse-Reutter v Godde* supra (n 141).

¹⁷¹ *Hulse-Reutter v Godde* supra (n 141) at 23; See also *Botha v Van Niekerk* (supra n34) where the court states that: "Dit sou ten minste besondere gronde verg; iets wat 'n redelik dwingende noodsaak skep in die belang van geregtigheid om die elementêre van maatskappystigting uit te skryf sodat 'n aandeelhouer of direkteur persoonlik aanspreeklik is op 'n maatskappy se kontrakte. Blote billikheid, op sy beste 'n redelik onhanteerbare perd, is nie voldoende nie. Ek het genoeg vertroue in die regstelsel om te aanvaar dat waar 'n direkteur aanspreeklik gestel word vir 'n maatskappyskuld, dit wel 'n billike resultaat sal wees. Billikheid of vermeende billikheid teenoor een of ander party of 'n oorwig van billikhede, kan egter nóg as regverdiging nóg as riglyn dien." *Botha v Van Niekerk* (supra n 34 at 165).

¹⁷² RC Williams *Companies* 2nd Edition (2012) 87 at footnote 2.

followed in *Hulse-Reutter v Godde*¹⁷³ was supported by the court in *Amlin (SA) Pty Lt v Van Kooj*¹⁷⁴ where the court stressed that because piercing the veil is such a drastic remedy it should be used sparingly and therefore only as a last resorts in circumstances where justice will not otherwise be done between two litigants.¹⁷⁵

The court in *Hulse-Reutter v Godde*¹⁷⁶ did not give a reason for disregarding the approach in *Cape Pacific Ltd v Lubner Controlling Investments*.¹⁷⁷

DOMESTIC PARTNERSHIPS

The courts have on occasion looked behind the corporate veil where it is clear that the intention of the parties was to run a business as a partnership, although they incorporated the business in the form of a company. In *Ebrahim v Westbourne Galleries Ltd*¹⁷⁸ the court gave recognition to the underlining partnership of the parties and found that the true intention of the parties was to establish a partnership, thus disregarding the separate legal personality that the company structure would have brought about. Characteristic of the underlying relationship, such as that the business relationship was formed or continued on the basis of a personal relationship of mutual trust, or the understanding that all the shareholders will participate in the day to day management of the business, are indicative of the parties' true intention with regards to the form in which the business will be operated.¹⁷⁹

¹⁷³ *Hulse-Reutter v Godde* supra (n 141).

¹⁷⁴ *Amlin (SA) Pty Lt v Van Kooj* 2008 (2) SA 558 (C).

¹⁷⁵ *Amlin (SA) Pty Lt v Van Kooj* supra (n 172) at 567J-568C.

¹⁷⁶ *Hulse-Reutter v Godde* supra (n 141).

¹⁷⁷ *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* supra (n 123).

¹⁷⁸ *Ebrahim v Westbourne Galleries Ltd* 1972 2 All ER 492.

¹⁷⁹ *Ebrahim v Westbourne Galleries Ltd* supra (n 176) 492 500.

PIERCING WITHIN THE GROUP CONTEXT

As discussed in Chapter 2, the separate legal personality and limited liability of a holding company as a shareholder is widely recognised in many jurisdictions.

It was pointed out that the economic relationship in company groups is different from the economic relationship between an individual shareholder and a company for various reasons. There is a clear separation of economic interest in the relationship between an individual shareholder and a company where the shareholder intends merely to be an inactive investor, with limited liability equal to his investment. A holding company as shareholder in a subsidiary has the same economic interest as the subsidiary and they both operate in the interest of the group as a whole. In reality, the holding company controls which obligations and risks the subsidiary will accept, and cannot be seen as a mere inactive investor. The economic justifications for limited liability are also not applicable to company groups. It cannot be said that investment by a holding company would be discouraged without limited liability, as the holding company's shareholders are still protected by the limited liability of the holding company itself. It has therefore been said that piercing the corporate veil between a holding company and its subsidiary should be easier as the group is in reality managed as one economic unit and piercing would not result in individual shareholders being held personally liable.¹⁸⁰ The result of piercing between groups can merely be that an additional layer of protection is removed.

The landmark case in this regards is *Adams v Cape Plc*,¹⁸¹ where the court had to consider the argument of piercing the corporate veil between a subsidiary company and its holding company. The facts of this case were briefly discussed in Chapter 1. In this case the court held that the '...law, for better or worse, recognises the creation of subsidiary companies, which though in a sense the creatures of their parent companies, will nevertheless under the general law fall to be treated as

¹⁸⁰ S Brainbridge 'Abolishing Veil Piercing' (2000-2001) 528.

¹⁸¹ *Adams v Cape Industries Plc* supra (n 1).

separate legal entities with all the rights and liabilities which would normally attach to separate legal entities.¹⁸²

The judgment in *Solomon v Solomon*¹⁸³ therefore is of great significance also in defining the relationship between holding company and its subsidiaries.¹⁸⁴ It follows that in the absence of fraud, the holding company and its subsidiaries each has a separate legal personality possessing its own interest, rights, liabilities and obligations.¹⁸⁵ Each company within a group would have to institute action and enforce its own rights.¹⁸⁶ The mere fact that the holding company has control over the subsidiary does not make the subsidiary the holding company's agent.¹⁸⁷

There has been legislative intervention to address concerns surrounding group companies who are able to camouflage individual companies economic and risk realities. This has been said to point to legislative recognition that group companies should be treated differently when it comes to the separate legal personality of the groups. In *DHN Food Distributors Ltd v Tower Hamlets Londen Borough Council*¹⁸⁸ Lord Denning went to far as to express the view that there is a general tendency, evidenced by the statutory requirement for group accounts, that the separate legal personality of companies within a group should more readily be ignored, especially in the case of wholly-owned subsidiaries.¹⁸⁹ The court relied on the idea that the group of companies was a single economic entity.¹⁹⁰ In this case, the land upon which the holding company conducted business was owned by its subsidiary. The land became subject to a compulsory purchase and the court held that the holding

¹⁸² *Adams v Cape Industries Plc* supra (n 1) at 1019.

¹⁸³ *Solomon v Solomon* (supra n 38).

¹⁸⁴ *Adams v Cape Industries Plc* [supra (n 1) at 1019; see also HS Cilliers and ML Benade *Corporate Law* (2000) 432.

¹⁸⁵ *Adams v Cape Industries Plc* [supra (n 1) at 1019; see also HS Cilliers and ML Benade *Corporate Law* (2000) 432.

¹⁸⁶ *Adams v Cape Industries Plc* [supra (n 1) at 1019; see also HS Cilliers and ML Benade *Corporate Law* (2000) 432.

¹⁸⁷ *Adams v Cape Industries Plc* [supra (n 1) at 1019; see also HS Cilliers and ML Benade *Corporate Law* (2000) 432.

¹⁸⁸ *DHN Food Distributors Ltd v Tower Hamlets Londen Borough Council* [1976] 3 All ER 462.

¹⁸⁹ *DHN Food Distributors Ltd v Tower Hamlets Londen Borough Council* supra (n 186) at 467.

¹⁹⁰ *DHN Food Distributors Ltd v Tower Hamlets Londen Borough Council* supra (n 186) at 467.

company was entitled to the compensation for disruption of its business as a consequence of the expropriation.

Cassim however states that (although initially having been more liberal) it seems as if the trend in South Africa has in recent years leaned towards the conservative approach, also when considering whether the veil should be pierced between groups of companies.¹⁹¹ In *Ex Parte Gore*¹⁹² the court states that:

‘Our own jurisprudence contains an *en passant* acknowledgment of the apparent trend during the 1960’s and 70’s towards a readier willingness to ignore the separate personality of individual companies in the group context (see *Ritz Hotel Ltd v Charles of the Ritz Ltd and Another* 1988 (3) SA 290 (A), at 314H-316B), but the more recent conservative trend by the English courts evidenced in *Adams* has been endorsed in subsequent South African judgments: see eg *Wanbach v Maizecord Industries (Edms) Bpk* 1993 (2) SA 669 (A), at 675D-E and *Macadamia Finance BK en ‘n Ander v De Wet en Andere NNO* 1993 (2) SA 745 (A), at 748B-D)¹⁹³

The better view is therefore that although the legislature has recognised and introduced legislation to address certain concerns that are unique to group enterprises, there is no general tendency towards treating groups of companies as a single entity.¹⁹⁴ The English courts, subsequent to the DHN-case, have also not endorsed the principle of a single economic entity.¹⁹⁵

¹⁹¹ Cassim, R ‘Hiding behind the veil’ (2013) 51 *De Rebus* 35-37 at 36.

¹⁹² *Ex Parte Gore NNO* supra (n10).

¹⁹³ *Ex Parte Gore NNO* supra (n10) at 27.

¹⁹⁴ RC Williams *Companies* 2nd Edition (2012) 91.

¹⁹⁵ *Adams v Cape Industries plc* supra (n 1).

Agency

When it comes to disregarding the separate legal personality of companies within a group, the courts have invoked the principles of agency to pierce the corporate veil and transfer liability to the holding company.¹⁹⁶

An example of such a case was that of *Smith, Stone & Knight Ltd v Lord Mayor, Aldermen Citizens of the City of Birmingham*.¹⁹⁷ In this case, a holding company sought to be declared the principal of its subsidiary with regards to a certain transaction, as the subsidiary was barred to claim compensation under the Land Clauses Consolidation Act 1845. The court stated that the mere fact that the holding company held all the shares in the subsidiary company did not result in therein that the subsidiary would always act as the agent on behalf or be the alter ego of its holding company.¹⁹⁸ The court identified several points which tend to establish agency. Firstly, the holding company treats the profits of the subsidiary as its own. Secondly, the holding company appoints the managers of the subsidiary. Thirdly, that the holding company directs the subsidiary in how to conduct its business. And finally, the holding company had complete control over the subsidiary.¹⁹⁹ The court found that the two companies were in fact one and the same entity and held that holding company was therefore entitled to claim compensation for the compulsory acquisition of the premises.²⁰⁰ The courts found that all the factors could be answered in favour thereof that the relationship between the holding company and the subsidiary was intended to be that of a principal and agent.

To provide a remedy under the laws of agency, an agency relationship must first be established under the principles of agency law. The facts of each case will be considered to determine an underlining agency relationship. It can therefore not be

¹⁹⁶ FHI Cassim et al *Contemporary Company Law* (2012) 56.

¹⁹⁷ *Smith, Stone & Knight Ltd v Lord Mayor, Aldermen Citizens of the City of Birmingham* [1939] 4 All ER 116.

¹⁹⁸ *Smith, Stone & Knight Ltd v Lord Mayor, Aldermen Citizens of the City of Birmingham* supra (n 195) at 120.

¹⁹⁹ *Smith, Stone & Knight Ltd v Lord Mayor, Aldermen Citizens of the City of Birmingham* supra (n 195) at 121.

²⁰⁰ *Smith, Stone & Knight Ltd v Lord Mayor, Aldermen Citizens of the City of Birmingham* supra (n 195) at 121.

said that in the context of company groups there is a presumption of agency.²⁰¹ Each company within a group of companies is a separate entity and should be treated as such unless the facts points to an agency relationship.

PIERCING THE CORPORATE VEIL IN OTHER COMMON LAW JURISDICTIONS

In evaluating jurisprudence in other common law jurisdiction and the courts' approaches to piercing the corporate veil, many similarities are found in relation to the South African courts' approach.

The English courts have been cautious to lift/pierce the veil of incorporation and impose liability on those behind it. Nyombi²⁰² attributes this to be because corporate personality is granted by statute. The English courts have not revealed any consistency as to when the remedy of piercing will be granted and each case is determined on its own facts. In *Commissioner of Land Tax v Theosophical Foundations Pty Ltd*²⁰³ the court stated that:

'Authorities in which the veil of incorporation has been lifted have not been of such consistency that any principle can be adduced. The cases merely provide instance in which courts have on the fact refused to be bound by the form or fact of incorporation when justice requires the substance or reality to be investigated.'²⁰⁴

In *Faiza Ben Hashem v Shayif*²⁰⁵ the court listed principles which summarises the English courts' approach to piercing the corporate veil where the company was used as a façade:

²⁰¹ *Smith, Stone & Knight Ltd v Lord Mayor, Aldermen Citizens of the City of Birmingham* supra (n 195).

²⁰² C Nyombi 'Lifting the veil of incorporation under common law and statute' (2014) Vol 56 *International Journal of Law and Management* 66 at 68.

²⁰³ *Commissioner of Land Tax v Theosophical Foundations Pty Ltd* 1966 67 SR (NSW).

²⁰⁴ *Commissioner of Land Tax v Theosophical Foundations Pty Ltd* supra (n 201) at 75.

²⁰⁵ *Faiza Ben Hashem v Shayif* (2008) EWCH 2380 (Fam).

- Ownership and control of a company alone is not sufficient to justify piercing;
- The court may not pierce the veil simply because it is necessary to do so in the interest of justice;
- Piercing the veil can only occur if there was some impropriety;
- Pierce the corporate veil can however also not occur merely because the company is involved in some impropriety. The impropriety must be linked to the use of the company structure to avoid or conceal liability;
- Therefore, for the court to pierce the veil, it must be shown that the wrongdoer was in control of the company and misuse of the company structure as a device or façade to hide impropriety.²⁰⁶

In the United States of America, the remedy of veil piercing has infamously been described to be ‘[[i]like lightning...rare, severe, and unprincipled.’²⁰⁷ Ramsay, in concluding the outcome of an empirical study on the degree to which veil piercing is undertaken by the courts in the United States, finds that veil piercing in the United States can still be described as ‘vague and largely unprincipled.’²⁰⁸ However, the courts in the United States have tended to apply similar factors when deciding the appropriateness of piercing the corporate veil.²⁰⁹ The courts have pierced the corporate veil where the separate legal personality of the company was used to perpetuate a fraud.²¹⁰ Fraud is however not a requirement for piercing.²¹¹ Other general circumstances under which the courts in the United States have pierced the corporate veil was where there was non-compliance with corporate formalities²¹², the

²⁰⁶ *Faiza Ben Hashem v Shayif* supra (n 203) at 195 – 164.

²⁰⁷ R J Huss ‘Revamping Veil Piercing for All Limited Liability Entities: Forcing the Common Law Doctrine into the Statutory Age’ (2001) at 109.

²⁰⁸ IM Ramsay ‘Allocating Liability in Corporate Groups: An Australian Perspective’ (1998-1999) at 356.

²⁰⁹ Rebecca J Huss ‘Revamping Veil Piercing for all Limited Liability Entities: Forcing the Common Law Doctrine into the Statutory Age’ (2001) at 112.

²¹⁰ R J Huss ‘Revamping Veil Piercing for All Limited Liability Entities: Forcing the Common Law Doctrine into the Statutory Age’ (2001) at 112.

²¹¹ R J Huss ‘Revamping Veil Piercing for All Limited Liability Entities: Forcing the Common Law Doctrine into the Statutory Age’ (2001) at 112.

²¹² Critics of this factor has said that it is inappropriate for courts to use this factor to pierce because there is no nexus between the conduct (failing to observe corporate formalities) and the wrong leading to piercing. The argument supporting the application of this factor is that corporate formalities such as record keeping assist the court in

entity was undercapitalised²¹³ and where an entity was merely an instrumentality and in actual fact the alter ego of its incorporators.²¹⁴

In Australia, the courts approach veil piercing cases on an *ad hoc* basis, with underlying policy considerations in mind.²¹⁵ While there is no closed list of circumstances under which the court will pierce the corporate veil, the courts have recognised that the presence of fraud, an agency relationship, unfairness; or where the company is a sham or façade may lead to piercing.²¹⁶

To conclude, it seems therefore that in all common law jurisdictions the approach to veil piercing is unprincipled. While, through jurisprudence, the courts have identified categories or factors, such as when the companies separate legal personality is being used to perpetrate a fraud and the company is merely the alter ego of the shareholders, uncertainty remains and each case is considered on its own facts and merits. This does however allow the courts to develop the remedy and provide relief where justice requires it.

PROBLEMS WITH THE COMMON LAW VEIL PIERCING

The concern with the piercing the corporate veil under common law is that it leaves uncertainty with regards to the circumstances under which the corporate veil would be pierced.²¹⁷ According to Bainbridge, veil piercing achieves, ‘neither fairness nor

determining the conduct of shareholders and the company at the time the cause of action arose. See Rebecca J Huss ‘Revamping Veil Piercing for all Limited Liability Entities: Forcing the Common Law Doctrine into the Statutory Age’ (2001) 113.

²¹³ R J Huss ‘Revamping Veil Piercing for All Limited Liability Entities: Forcing the Common Law Doctrine into the Statutory Age’ (2001) at 114

²¹⁴ Rebecca J Huss ‘Revamping Veil Piercing for all Limited Liability Entities: Forcing the Common Law Doctrine into the Statutory Age’ (2001) at 115.

²¹⁵ *Briggs v James Hardie & Co Pty* (1989) NSWCA 567.

²¹⁶ Ramsay, I and Nokes, DB ‘Piercing the Corporate Veil in Australia’ (2001) 19 *Company and Securities Law Journal* 250-271 at 8.

²¹⁷ Anderson, H ‘Piercing the Veil on Corporate Groups in Australia’ (2009) at 359.

efficiency, but rather only uncertainty and lack of predictability, increasing transaction costs for small businesses.²¹⁸

Investors for example are left with little certainty as to whether incorporating their businesses will limit their investment risk exposure. Without predictability as to when the court will disregard a company's separate legal personality and transfer its liabilities onto its shareholders, investors are unable to discern the risks to which they are exposed or to identify the need to reduce their risk by limiting their investments.

The unpredictability also creates uncertainty for creditors and victims of delicts. Litigating can be a costly exercise and without certainty, litigants may not have the risk appetite to litigate a veil piercing matter.

CONCLUSION

Piercing the corporate veil as a common law remedy has played an essential role in addressing abuses of the separate legal personality and limited liability of the shareholders of a company. The circumstances under which the remedy would be available is however uncertain. The courts have steered clear from formulating specific circumstances under which the court will pierce the corporate veil. The courts approach applications to pierce the corporate veil on a case to case basis. This approach has both been praised and criticised. Whilst some believe that not having rigid rules allows the necessary flexibility to still provide a remedy in those cases where the circumstances do not fall within the prescribed circumstance under which a court may pierce;²¹⁹ others argue that this creates too much uncertainty in the market as the risk of piercing is indeterminable.²²⁰

²¹⁸ Bainbridge, MS 'Abolishing Veil Piercing' (2000-2001) at 481.

²¹⁹ See for example FHI Cassim et al *Contemporary Company Law* (2012) 43.

²²⁰ Brainbridge, MS 'Abolishing Veil Piercing' (2000-2001) at 535.

In cases where the courts are requested to pierce the corporate veil between company groups, they have stringently upheld the separate legal personality of the individual companies within the group. This is in spite thereof that the policy considerations justifying limited liability cannot be applied where the shareholder is a holding company. Although piercing can provide a remedy to address abuses in company groups, it has not been developed to take into consideration that different policy considerations need to be considered when deciding to pierce the veil between company groups.

There would be a great advantage in introducing a statutory remedy for piercing. It has the potential to provide much needed certainty to shareholders with regards to the risk of losing the limitation on their liability; and to creditors and tort claimants as to when they will succeed in claiming relief. This type of certainty will reduce litigation costs. In the next chapter, the statutory remedy for piercing the corporate veil, under Section 20(9) of the Act, will be discussed.

CHAPTER 4: STATUTORY REMEDY FOR PIERCING THE CORPORATE VEIL

INTRODUCTION

In the previous chapter, piercing the corporate veil under the common law was discussed. It was concluded that there are many concerns with the common law remedy for piercing the corporate veil. The courts, in general, treat piercing cases on a case to case basis. Although piercing the corporate veil under common law can provide a remedy to address those cases where there was abuse of the separate legal personality of individual companies within a company group, the remedy does not consider concerns that are specific to groups and that policy considerations justifying limited liability cannot as readily be applied to the holding company within a company group.

In this chapter, the statutory remedy for piercing the corporate veil as set out in section 20(9) of the Act will be discussed. Section 20(9) determines that if, on application by an interested person or in any proceeding in which a company is involved, the court finds that the incorporation of a company, the use thereof or any act by or on its behalf constitutes an unconscionable abuse of the juristic personality of the company as a separate entity, the court may (a) declare that the company is not to be deemed to be juristic person in respect of any right, obligation or liability of the company or of a shareholder of the company; and (b) make any further order it deems appropriate to give effect to such declaration.

The research will focus on determining whether this remedy is sufficient to deter abuses that occur in company groups and provide an adequate remedy in the case where such abuse did occur. A further question that the research will seek to answer is whether the statutory provision to pierce the corporate veil substantially alters the position that prevailed under the common law with regards to when the corporate veil will be pierced.

STATUTORY REMEDY FOR PIERCING THE CORPORATE VEIL UNDER THE COMPANIES ACT

The South African legislature in the Act for the first time introduced in South African Company Law a statutory provision permitting the courts to disregard the separate legal personality of a company.

Section 20(9) of the Act provides the courts with statutory authority to piercing the corporate veil. This section reads as follows:

‘20(9) 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).²²¹

This statutory remedy for piercing the corporate veil is equally applicable where the shareholder is a natural person or a juristic person. It therefore potentially can be a useful remedy in addressing concerns within company groups.

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

OTHER LEGISLATIVE PROVISIONS OF THE COMPANIES ACT 2008

The Act also makes provision for other forms of 'piercing' by imposing personal liability on directors and shareholders under certain circumstances or requiring transparency regarding the relationship between companies within a group. A detailed discussion of these instances is beyond the scope of this topic, but a brief discussion may be useful in forming an understanding of the tone of legislative intervention.

Imposing Personal Liability

- Section 21(2) determines that a person who entered into an agreement on behalf of a company prior to its incorporation will be liable for the obligations created under such agreement if the company is not subsequently incorporated or rejects the agreement after incorporation.
- Section 77(3)(a) provides that a director will be held personally liable if a director acts in the name of the company, signed anything on behalf of the company, or purported to bind the company or authorise the taking of any action by or on behalf of the company, despite knowing the he or she lacked the authority to do so.
- Section 77(3)(b) provides that a director can be held liable for knowingly carrying on the business of the company recklessly.
- Section 77(3)(c) provides that a director can be held liable for the loss, damage or costs sustained by a company if he or she had been party to an act or omission by the company, knowing that such act or omission was calculated to defraud the creditors, employees or shareholders of the company.

- Section 77(3)(d) provides that a director can be held liable for signing, consenting to, or authorising, the publication of financial statements that were false or misleading or the inclusion of any untrue statements in a prospectus despite knowing that such statements were false, misleading or untrue.
- Section 77(3)(e) provides that a director can be held liable for failing to vote against various decision, such as a decision relating to the issuing of unauthorised shares or approving an unlawful distribution.
- Section 218(2) provides that a person who contravenes any provision of the Act is liable to any other person for any loss or damage suffered by that person as a result of that contravention.

These provisions have been described to rather create instances where the corporate veil will be lifted as the veil of incorporation of the company is not completely disregarded under them.²²² They will merely result in the person controlling the company in certain instances being held personally liable for the obligations of the company. Save for sections 21(2) and 218(2), they also provide for the liability of a director, and not the shareholder of the company.

Transparency

The legislature has also introduced specific provisions to address some of the concerns with companies group. The provisions focus on transparency and serve as a deterrent to abuses that may occur within a group structure.

Cassim²²³ lists the following examples of where the legislature intervened to prevent abusive camouflaging:

²²² FHI Cassim et al *Contemporary Company Law* (2012) 63.

²²³ FHI Cassim et al *Contemporary Company Law* (2012) 195.

- Group and consolidated financial statements are required to be produced in respect of a group of companies²²⁴
- The auditor of a holding company has the right to access to all financial statement, current and past, of any subsidiary of that holding company and may require the directors or officers of the holding company or subsidiary company to disclose any information and provide an explanation in connection with any financial statement or in connection with the accounting records, books and documents of the subsidiary as may be necessary in the performance of the auditors' duties²²⁵
- The annual financial statement of a company must include a report by the company, or of the group of companies, if the company is part of a group²²⁶

The Act further introduced valuable protection mechanisms to minority shareholders and creditors by requiring shareholder approval or that a solvency and liquidity test first be performed for certain intra group transactions. Section 41 of the Act, for example, determines that before a company issues shares to certain persons, which persons include the holding company and subsidiary companies of the company issuing the shares, shareholder approval is generally required. Under Section 48, the conditions under which a company may acquire shares in its holding company are strictly regulated. The Act further prohibits a company from directly or indirectly paying any fine on behalf of a director of the company or of its holding or subsidiary company who has been convicted of an offence in terms of any law.²²⁷ And finally, Section 95 requires that in certain circumstances, where a company

²²⁴ Section 30 of the Act read with the definition of 'financial statement' in section 1.

²²⁵ Section 91(1)(b) of the Act.

²²⁶ Section 30(3)(b) of the Act.

²²⁷ Section 87(3) of the Act read with the definition of related company in section 2(1)(c).

offers to holders of the company's securities securities in the company of any other company within the group of companies, a prospectus is required.²²⁸

Although these provisions can provide protection to minority shareholders and creditors, involuntary creditors such as delictual claimants do not benefit from these protective measures.²²⁹

As discussed in Chapter 3, it has been argued that legislative intervention implies a general tendency that separate legal personalities of companies within a group may be more easily disregarded. However, the better view is still that legislative recognition that a group of companies may constitute a single economic entity does not imply a general tendency towards treating groups of companies as a single entity.²³⁰ Legislative intervention can rather be attributed to the fact that company law had to be developed to address some of the concerns with group structures.²³¹

It is accepted that 'save [for] where the wording or purpose of a particular statute or contract justifies the treatment of a holding company and a subsidiary as one corporate entity the mere fact that a group of companies constitutes a single economic unit does not in itself justify the treatment of the group as a single entity.'²³² Cassim concludes that the fact that the legislature only in specific instances introduced single economic rules to apply to groups can only mean that the legislature found that only in those circumstances would it be necessary to consider the group as a whole.²³³

The above interventions addressed the need for increased transparency. Even when these provisions are complied with, the separate legal personalities of the companies remain intact. Transparency may however serve to deter those in control

²²⁸ See section 95 of the Act.

²²⁹ RA Stevens *The External Relations of Company Groups in South African Law* (2011) at 218.

²³⁰ RC Williams *Companies* 2nd Edition (2012) 91.

²³¹ FHI Cassim et al *Contemporary Company Law* (2012) 195.

²³² FHI Cassim et al *Contemporary Company Law* (2012) 195.

²³³ FHI Cassim et al *Contemporary Company Law* (2012) 55.

of the company from abusing the separate legal personalities of individual companies within a group.

Ex PARTE GORE: FACTS OF THE CASE

In the case of *Ex parte Gore*²³⁴ the court for the first time considered an application for piercing of the corporate veil under section 20(9) of the Act. Although section 20(9) does not find specific application to company groups, the relief sought was to pierce the corporate veil within a group of companies. The case therefore provides insight into the possible impact that Section 20(9) may have on group enterprises.

The applicants in this case were the liquidators of one or more companies forming part of a group of companies, referred to as the King Group. The group's holding company was King Finance Holdings Limited ('KFH'), which was also in liquidation. The majority of KFH's shares were held by the King brothers through family trusts. The three brothers were directors of KFH and most of its subsidiaries and at all times exercised control over the group.

Although only one company within the group, King Services (Pty) Ltd, was a licensed financial service provider, the group was used to conduct the business of a financial services provider by way of investment in commercial and residential immovable properties. Investments were structured in the form of a share purchase agreement, where the investor would purchase shares in one of the companies within the group. The purchase of the shares was coupled with a loan to the company in which the investor was purchasing shares. Investigations into the group established that the King brothers operated the business as if it was only the holding company. Loans made to subsidiaries were allocated by the controllers to any member of the company with no regard to the individual identity of the company and with grossly inadequate recordkeeping. The flow of funds seemed to have been based on a need for the King brothers to sustain the scheme by allocating loans to

²³⁴ *Ex Parte Gore NNO* supra (n 10).

any company requiring money to pay out investors who wanted to withdraw their investments. The group also contravened other provisions of the Act by inter alia offering shares in a private company to the public and issuing unauthorised shares.

As a result of the dishonest and chaotic administration of the affairs of the group, the liquidators of the companies were not able to identify the actual entities within the group against which the individual investors held a claim. They therefore applied to the court to pierce the corporate veil between the holding company and its subsidiaries in order to treat the assets of the group as the assets of the holding company for purposes of the investors' claims.²³⁵ The application was brought under the common law, alternatively in terms of section 20(9) of the Act.

On the facts it was clear that the controllers in effect operated the whole group as one entity through the holding company.²³⁶ For practical purposes the King brothers made no distinction when it came to dealing with investors' funds between KFH and the subsidiary companies.²³⁷ The court found that this disregard by the controllers of the separate legal personalities of the individual companies in the King Group was so extensive that the group was in fact a 'sham'.²³⁸ The court found this to be an unconscionable abuse by the controllers of the separate legal personalities of the subsidiaries of the group and the case was accordingly brought within the ambit of s 20(9).²³⁹ The court ordered that the subsidiaries in the King Group not be deemed to be juristic persons in respect of any obligations they had to investors in the King Group and their shareholder, the holding company, therefore be treated as the only company within the group.²⁴⁰

²³⁵ *Ex Parte Gore NNO* supra (n 10) at 2.

²³⁶ *Ex Parte Gore NNO* supra (n 10) at 8.

²³⁷ *Ex Parte Gore NNO* supra (n 10) at 12.

²³⁸ *Ex Parte Gore NNO* supra (n 10) at 15.

²³⁹ *Ex Parte Gore NNO* supra (n 10) at 33.

²⁴⁰ *Ex Parte Gore NNO* supra (n 10) at 37.

MEANING OF 'UNCONSCIONABLE ABUSE'

Section 20(9) determines that the court may pierce the corporate veil if the incorporation of a company, the use of a 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. Before a court can therefore consider exercising its discretion in favour of piercing the corporate veil,²⁴¹ it must be found that there had been an unconscionable abuse of the separate juristic personality of the company in question.

Interpreting by reference to the Interpretation provisions of the Act:

Section 20(9) is not specific as to what would constitute 'unconscionable abuse'. The court in *Ex parte Gore*²⁴² points out that the Act needs to be interpreted with reference to section 7 of the Act, read together with section 5 of the Act. Section 5(1) of the Act requires the Act to be interpreted and applied in a manner that gives effect to the purposes set out in section 7 of the Act. Section 7 sets out very broad purposes; such as to promote the development of the South African economy,²⁴³ to promote innovation and investment in the South African markets,²⁴⁴ and to reaffirm the concept of the company as a means of achieving economic and social benefits.²⁴⁵

Cassim criticises these provisions and states that whilst the objective of the Act may be properly expanded on in a policy document, it becomes problematic when such broad objectives are inserted in the Act itself.²⁴⁶ It is difficult to determine how

²⁴¹ See below discussion on discretion.

²⁴² *Ex Parte Gore NNO* supra (n 10).

²⁴³ Section 7(f) of the Act.

²⁴⁴ Section 7(c) of the Act.

²⁴⁵ Section 9(d) of the Act.

²⁴⁶ Cassim, FHI 'The Companies Act 2008: An Overview of a Few of its Core Provisions' (2010) 22 *South African Mercantile Law Journal* 157 at 158 – 159.

exactly the court should give effect to such wide objectives.²⁴⁷ In the DTI Policy Document,²⁴⁸ it is however emphasised that the new Act is not intended to jettison unreasonably the body of corporate jurisprudence built up over more than a century.²⁴⁹ Where the current law meets these objectives, it should remain part of the future company law regime.²⁵⁰ Cassim states this to be a conservative middle-path approach and that it will cause difficulties and conflict throughout the Act in blending the old with the new philosophical trends in modern company law.²⁵¹ In *Ex Parte Gore*,²⁵² the court found there not to be any conflict between the common law remedy and the new statutory remedy for piercing the corporate veil.²⁵³ In the case of section 20(9) of the Act, it should therefore not be problematic to blend the position before its introduction with the position thereafter. The broad purposes set out in Section 7 of the Act do however not provide assistance to the courts when interpreting the meaning of the words ‘unconscionable abuse’.

Interpreting by reference to similar provisions in other legislation:

Academics²⁵⁴ suggest that in interpreting the meaning of ‘unconscionable abuse’ one should turn to the courts’ interpretation of section 65 of the Close Corporations Act²⁵⁵ as this section contains a similarly worded provision. Section 65 of the Close Corporations Act reads as follows:

²⁴⁷ Cassim, FHI ‘The Companies Act 2008: An Overview of a Few of its Core Provisions’ (2010) at 158 – 159.

²⁴⁸ South African Company Law for the 21st Century: Guidelines for Corporate Law Reform (n5) at 13 Government Gazette 23 June 2004 (Notice 1183 of 2004); see also FHI Cassim et al *Contemporary Company Law* 3.

²⁴⁹ Cassim, FHI ‘The Companies Act 2008: An Overview of a Few of its Core Provisions’ (2010) at 158 – 159.

²⁵⁰ Cassim, FHI ‘The Companies Act 2008: An Overview of a Few of its Core Provisions’ (2010) at 158 – 159.

²⁵¹ Cassim, FHI ‘The Companies Act 2008: An Overview of a Few of its Core Provisions’ (2010) at 158 – 159.

²⁵² *Ex Parte Gore NNO* supra (n 10).

²⁵³ *Ex Parte Gore NNO* supra (n 10) at 33.

²⁵⁴ See Cassim, R ‘Piercing the Corporate Veil ‘unconscionable abuse’ under the Companies Act 71 of 2008’ (2012) *De Rebus* 22 at 23; Subramaniam, D ‘“Unconscionable abuse” – Section 20 (9) of the Companies Act 71 of 2008’ (2014) *Obiter* 150 at 157.

²⁵⁵ Close Corporations Act 69 of 1984.

‘Whenever a Court on application by an interested person, or in any proceeding 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, obligation 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.’

In *Airport Cold Storage (Pty) Ltd v Ebrahim*²⁵⁶ the court, in relation to section 65, states that:

‘Liability under this section depends on a finding of "gross abuse of the juristic personality of the corporation as a separate entity". However, no attempt has been made in the section to indicate the facts or circumstances that would qualify as a gross abuse of the juristic personality of the corporation as a separate entity. The courts are required, in other words, to give content to the open-ended concept of "gross abuse", based on the facts of each particular case. This exercise does not take place in a vacuum, however, and it is axiomatic that the principles and categories developed with regard to piercing the corporate veil in the context of company law will serve as useful guidelines in this context.

The starting point is that veil piercing will be employed "only where special circumstances exist indicating that it (i.e. the company or close corporation) is a mere façade concealing the true facts". Fraud will obviously be such a special circumstance, but it is not essential. In certain circumstances, the corporate veil will also be pierced "where the controlling shareholders do not

²⁵⁶ *Airport Cold Storage (Pty) Ltd v Ebrahim* 2008 (2) SA 303.

treat the company as a separate entity, but instead treat it as their “alter ego” or “instrumentality” to promote their private, extra-corporate interests²⁵⁷

In this case, the court concluded that due to the legislature not specifically providing for the type of conduct that would constitute gross abuse, the courts need to turn the common law remedy for piercing the corporate veil to find what conduct would constitute gross abuse.

In *Ex Parte Gore*²⁵⁸ the court notes that there is a difference between section 20(9) of the Act and section 65 of the Close Corporation Act in the description of the abuse.²⁵⁹ In terms of the section 65 of the Close Corporations Act the separate legal personality of a corporation would be pierced in instances of a ‘gross abuse’ of the corporation’s separate legal personality, whereas under section 20(9) of the Act the separate legal personality of a company will be pierced in instances of ‘unconscionable abuse’ of its separate legal personality. The court finds that the term ‘unconscionable abuse’ is less extreme than the term ‘gross abuse’.²⁶⁰ The court gave no specific reasons as to why it found that the word ‘gross’ sets a more stringent test than the word ‘unconscionable’. However, if this approach is to be followed, by casting a net wider, it can at least be said that the type of conduct which the courts held to be a gross abuse of the separate legal personality of a closed corporations under section 65 of the Close Corporations Act would also constitute conduct which will constitute an unconscionably abuse under section 20(9).

In *Airport Cold Storage (Pty) Ltd v Ebrahim*²⁶¹ it was held that conducting the business of the various closed corporations (incorporated by family members) with scant regard to the separate legal personality of the individual corporate entities constitute a gross abuse of the corporate personality of all of the entities.²⁶²

²⁵⁷ *Airport Cold Storage (Pty) Ltd v Ebrahim* supra (n 254) at 11 – 12.

²⁵⁸ *Ex Parte Gore* NNO 2013 supra (n10).

²⁵⁹ *Ex Parte Gore* NNO 2013 supra (n 10) at 34.

²⁶⁰ *Ex Parte Gore* NNO 2013 supra (n 10) at 34.

²⁶¹ *Airport Cold Storage (Pty) Ltd v Ebrahim* supra (n 254).

²⁶² *Airport Cold Storage (Pty) Ltd v Ebrahim* supra (n 254) at 78 – 79.

Further circumstances which the courts have considered to constitute a gross abuse of a corporation's separate legal personality was, for example, in *Haygro Catering CC v Van der Merwe*²⁶³ and *TJ Jonck CC t/a Bothaville Vleismark v Du Plessis NO*.²⁶⁴ In *Haygro Catering CC v Van der Merwe*²⁶⁵ the court held that the members of the corporation were liable for the debts of the corporation where the corporation failed to display the name of the corporation at its business premises and on its other documents and correspondence as is required in terms of section 23 of the Close Corporations Act.²⁶⁶ The display of the corporation details would have alerted creditors to the separate legal personality of the business; and the limited liability of the owners of the business. The court found that the failure to display the name of the corporation constituted a gross abuse of the separate legal personality of the corporation under section 65 of the Close Corporations Act.²⁶⁷

In *TJ Jonck CC t/a Bothaville Vleismark v Du Plessis NO*,²⁶⁸ a member of a corporation made a number of large loans to a corporation knowing that the corporation was insolvent and would not be able to pay back the loans. He also authorised the registration of a notarial bond over the movable property, equipment and stock, of the corporation as security for his loans. When the corporation fell into default on the loan, he attached the corporation's equipment and stock in terms of the notarial bond. Thereafter, he continued to conduct the business of the corporation from the same premises, just under a new name, using the equipment and stock of the corporation. The court held the member personally liable for the debt of the corporation under section 64 of the Close Corporations Act²⁶⁹ as he had

²⁶³ *Haygro Catering CC v Van der Merwe and Others* 1996 (4) SA 1063 (C).

²⁶⁴ *TJ Jonck Bk h/a Bothaville Vleismark v Du Plessis NO and Another* 1997 JOL 1466 (O).

²⁶⁵ *Haygro Catering CC v Van der Merwe and Others* supra (n 161).

²⁶⁶ Section 23 of Close Corporations Act 69 of 1984; see section 30(7) of the Act for a similar provision applicable to companies.

²⁶⁷ Close Corporations Act 69 of 1984.

²⁶⁸ *TJ Jonck Bk h/a Bothaville Vleismark v Du Plessis NO and Another* supra (n 262).

²⁶⁹ Section 64(1) of the Close Corporations Act makes further provision for the personal liability of those in control of the corporation. The section determines that: "If it at any time appears that any business of a corporation was or is being carried on recklessly, with gross negligence or with intent to defraud any person or for any fraudulent purpose, a Court may on the application of the Master, or any creditor, member or liquidator of the corporation, declare that any person who was knowingly a party to the carrying on of the business in any such manner, shall be personally

been conducting the business of the corporation fraudulently or recklessly.²⁷⁰ However, the court also observed that the actions of the member had constituted gross abuse of the separate legal personality of the corporation as envisaged in section 65 of the Close Corporations Act.²⁷¹

This type of conduct may therefore also be considered an unconscionable abuse of the separate juristic personality of a company.

Common law

A preliminary question is whether the introduction of the statutory provision for piercing the corporate veil repealed the common law remedy for piercing the corporate veil. The legislature gave no express intention, as was done in section 165(1)²⁷² of the Act, to indicate that that was the intention.²⁷³ However, the legislature also does not give an express indication that it was not the intention to replace the common law, as was done in section 161(2) of the Act.²⁷⁴ The court in *Ex Parte Gore*²⁷⁵ concludes that section 20(9) is rather supplemental than substitutive of the common law.²⁷⁶

In *Ex Parte Gore*²⁷⁷ the court did however find that the statutory remedy for piercing the corporate veil in section 20(9) of the Act differs in some respects to the common

liable for all or any of such debts or other liabilities of the corporation as the Court may direct, and the Court may give such further orders as it considers proper for the purpose of giving effect to the declaration and enforcing that liability." Section 77(3)(b) of the Act, read together with section 22(1), provides that a director can be held liable for knowingly carrying on the business of the company recklessly.

²⁷⁰ *TJ Jonck Bk h/a Bothaville Vleismark v Du Plessis NO and Another* supra (n 262) at 16.

²⁷¹ *TJ Jonck Bk h/a Bothaville Vleismark v Du Plessis NO and Another* supra (n 262) at 16.

²⁷² Section 165(1) reads as follows: "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."

²⁷³ *Ex Parte Gore NNO* supra (n 10) at 31.

²⁷⁴ Section 161(2) reads as follows: "The right to apply to a court in terms of this section is in addition to any other remedy available to a holder of a company's securities (a) in terms of this Act; or (b) in terms of the common law, subject to this Act." See also *Ex Parte Gore NNO* supra (n 10) at 31.

²⁷⁵ *Ex Parte Gore NNO* supra (n 10) at 37.

²⁷⁶ *Ex Parte Gore NNO* supra (n 10) at 7 34

²⁷⁷ *Ex Parte Gore NNO* supra (n 10).

law remedy of piercing the corporate veil.²⁷⁸ The court states that the term ‘unconscionable abuse’ ‘postulates conduct in relation to the formation and use of companies diverse enough to cover all the descriptive terms like “sham”, “device”, “stratagem” and the like used in that connection in the earlier cases...’²⁷⁹

The circumstances under which the courts held that a company was a sham or merely a façade and pierced the corporate veil under the common law would also constitute conduct which can be seen as unconscionable abuse of the separate legal personality of a company. The term ‘unconscionable abuse’ can however also include a broader variety of conduct and is not limited to such conduct which justified piercing under the common law.²⁸⁰ The court considered the wide language of section 20(9) as indicative of the legislature’s appreciation of the fact that this provision might find application in widely varying factual circumstances.²⁸¹ It concludes that section 20(9) had broadened the basis upon which the courts in South Africa would be prepared to disregard the separate legal personalities of companies.²⁸²

In coming to this conclusion, the court looked at the current common law approach, and with specific regard given to the approach followed in the English courts.²⁸³ According to the court in *Hashem v Shayif*²⁸⁴ the impropriety must be linked to the use of the company structure to avoid or conceal liability; and that it is necessary to show both control of the company by the wrongdoer and impropriety in the sense of a misuse of the company as a device or façade to conceal wrongdoing.²⁸⁵ The court in *Ex Parte Gore*²⁸⁶ found that it would have been difficult to justify disregarding the separate legal personalities in the case of the Kings group as in this case it was not

²⁷⁸ *Ex Parte Gore NNO* supra (n 10) at 34.

²⁷⁹ *Ex Parte Gore NNO* supra (n 10) at 34.

²⁸⁰ *Ex Parte Gore NNO* supra (n 10) at 34.

²⁸¹ *Ex Parte Gore NNO* supra (n 10) at 32.

²⁸² *Ex Parte Gore NNO* supra (n 10) at 33.

²⁸³ *Ex Parte Gore NNO* supra (n 10) at 33.

²⁸⁴ *Hashem v Shayif & Another* 2008 EWHC 2380 (Fam).

²⁸⁵ For a full discussion on the factors the court considered in *Hashem v Shayif* (supra n 285), see *Ex Parte Gore NNO 2* supra (n 10) at 22.

²⁸⁶ *Ex Parte Gore NNO* supra (n 10)

apparent that the improprieties in dealing with investor's funds were so done to conceal the true facts.²⁸⁷ The facts in *Ex Parte Gore*²⁸⁸ should be distinguished from the facts in the *Hashem v Shayif*²⁸⁹ in that within the King Group, the separate legal personality of the companies within the group was not as such abused to conceal the improprieties, it was rather ignored.²⁹⁰ In *Ex Parte Gore*,²⁹¹ the separate personas of the companies were not used to conceal wrongdoing.²⁹²

This finding of the court seems to be in conflict with the court's approach in *Airport Cold Storage v Ebrahim*.²⁹³ In the later case, the court stated that '[t]he starting point is that veil piercing will be employed 'only where special circumstances exist indication that it [the juristic entity] is a mere façade concealing the true facts'.²⁹⁴ Fraud will obviously be such a special circumstance, but it is not essential.²⁹⁵ In certain circumstance, the corporate veil will also be pierced 'where the controlling shareholders do not treat the company as a separate entity, but instead treat is as their "alter ego" or "instrumentality" to promote their private, extra corporate interest.'²⁹⁶ When applying this approach to the fact in *Ex Parte Gore*,²⁹⁷ it may be said that the holding company treated its subsidiaries' business as if it was the business of the holding company. The subsidiaries within the group were the alter egos of the holding company and were used to promote its business. Even with no intention to defraud or conceal the facts, there was no separation of the business of the subsidiaries and the holding company. The subsidiaries were merely alter egos of the holding company and instrumentally used to promote the interest of the holding company.

²⁸⁷ *Ex Parte Gore NNO* supra (n 10) at 33.

²⁸⁸ *Ex Parte Gore NNO* supra (n 10).

²⁸⁹ *Hashem v Shayif & Another* supra (n284).

²⁹⁰ *Ex Parte Gore NNO* supra (n 10) at 33.

²⁹¹ *Ex Parte Gore NNO* supra (n 10) at 37.

²⁹² *Ex Parte Gore NNO* supra (n 10) at 33.

²⁹³ *Airport Cold Storage (Pty) Ltd v Ebrahim* supra (n 254).

²⁹⁴ *Airport Cold Storage (Pty) Ltd v Ebrahim* supra (n 254) at 25.

²⁹⁵ *Airport Cold Storage (Pty) Ltd v Ebrahim* supra (n 254) at 25.

²⁹⁶ *Airport Cold Storage (Pty) Ltd v Ebrahim* supra (n 254) at 25.

²⁹⁷ *Ex Parte Gore NNO* supra (n 10).

Stevens²⁹⁸ argues that Section 20(9) allows piercing on a narrower basis when compared to the common law.²⁹⁹ He finds that compared to the flexible approach set out in *Cape Pacific Ltd v Lubner Controlling Investments*³⁰⁰ '[t]he statutory test [of proving an unconscionable abuse] would, had it not been for the common law test, have made it more difficult to pierce the corporate veil.'³⁰¹ Under the common law, the courts have always steered away from setting rigid rules. This resulted therein that under the common law there are no fixed categories or principles that must be present when the court pierced the corporate veil.³⁰² Given this flexibility under the common law remedy, it seems doubtful that the Section 20(9) broadened the basis of the common law remedy.

Similar concerns have been raised with regards to two provisions in the Chinese Companies Act.³⁰³ The Chinese legislature in 2006 introduced a statutory remedy for piercing of the corporate veil. Article 20 of the Chinese Companies Act³⁰⁴ determines that:

'Where any of the shareholders of a company evades the payment of its debts by abusing the independent status of juridical persons or the shareholder's limited liabilities, and thus seriously damages the interests of any creditors, it shall bear joint liabilities for the debts of the company.'

Art 64 of the Chinese Companies Act,³⁰⁵ which applies to limited liability companies with a single shareholder, determines that:

²⁹⁸ RA Stevens *The External Relations of Company Groups in South African Law* (2011).

²⁹⁹ RA Stevens *The External Relations of Company Groups in South African Law* (2011) at 171.

³⁰⁰ *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* supra (n 123).

³⁰¹ RA Stevens *The External Relations of Company Groups in South African Law* (2011) at 171.

³⁰² Cassim et al *Contemporary Companies Law* (2012) 48.

³⁰³ Companies Act 2006 P.R.C. Company Law.

³⁰⁴ Companies Act 2006 P.R.C. Company Law.

³⁰⁵ Companies Act 2006 P.R.C. Company Law.

‘If the shareholder of a one-person limited liability company is unable to prove that the property of the one-person limited liability company is independent from his own property, he shall bear joint liabilities for the debts of the company.’

Wu³⁰⁶ criticises the shortfalls of these statutory piercing provisions. He states that the provisions do not provide sufficient guidance to the courts as to how they should proceed with analysing a case where veil piercing is sought. He further states that the scope of the provisions is unclear, or alternatively too narrow. These shortcomings mean that the uncertainty remains for shareholders, as well as creditors. In addition, these provisions may have brought uncertainty to the courts as to how far their powers with regards to piercing stretch as the court may consider themselves bound to only pierce where the requirements of Section 20 and/or Section 63 have been met.³⁰⁷

Wu’s criticism of the Chinese Company Law is equally applicable to section 20(9) of the Act. Section 20(9) fails to identify the conduct which constitutes unconscionable abuse of the separate legal personality of a company. The type of conduct which will lead to piercing therefore remains open for interpretation. When compared to the position under the common law, no more certainty has therefore been established as to when the courts will pierce the corporate veil.

A further complication under Section 20(9) of the Act is that, even where it was found that there was an unconscionable abuse of the separate legal personality of a company, the court still has discretion to provide relief under this section. Section 20(9) determines that the court ‘may’ make a declaration that the company is not to be deemed a juristic person in respect of any right, obligation or liability of the

³⁰⁶ Wu, M ‘Piercing China’s Corporate Veil: Open Questions from the New Company Law’ (2007) 117 *The Yale Law Journal* 329 at 330.

³⁰⁷ In *Ex Parte Gore NNO* (supra n 10) the court finds that Section 20(9) is supplemental to the common law piercing remedy, and our courts are unlikely to find themselves bound to only pierce the corporate veil where section 20(9) requirements are met.

company. According to Schoeman³⁰⁸ the use of the word 'may' in this section denotes that the court has an discretion whether or not to pierce the corporate veil, in addition to making any order to enforce the piercing of the corporate veil.³⁰⁹ The legislature did not, complimentary to section 20(9), indicate factors that the court should consider in exercising its discretion to pierce the corporate veil. To this extent, section 20(9) has not deviated from the common law position under which the court considered each application on its own facts.³¹⁰

A discretionary decision would require the court to look at the facts presented in each case. So, for example, the court in exercising its discretion under section 81 of the Act, with regards to an application for winding up of a solvent company, must be exercised on judicial grounds and the court should have regard to the fact of the case before it.³¹¹ Past decision on the circumstances under which the court favourably exercised this discretion, can serve as guidelines.³¹² Similarly, when exercising their discretion under Section 20(9), the courts should consider past decisions where the courts decided to pierce the corporate veil. As the statutory remedy for piercing the corporate veil is a new remedy, it is likely that decisions under common law will play an important role.³¹³

Evaluation

On analysis of the statutory remedy for piercing the corporate veil, it reveals that it remains uncertain when the remedy is available and determining which type of conduct should result in piercing the veil remains open to interpretation by the courts. The statutory remedy does not clarify the uncertainty for which the common

³⁰⁸ Schoeman, N 'Piercing the Corporate Veil under the New Companies Act: Is s20(9) read with s218 a codification of the common law concept or it is further reaching' (2010) 26 *De Rebus* 28 - 29.

³⁰⁹ Schoeman, N 'Piercing the Corporate Veil under the New Companies Act: Is s20(9) read with s218 a codification of the common law concept or it is further reaching' (2010) at 28 - 29.

³¹⁰ Schoeman, N 'Piercing the Corporate Veil under the New Companies Act: Is s20(9) read with s218 a codification of the common law concept or it is further reaching' (2010) at 28 – 29.

³¹¹ *Kyle v Maritz & Pieterse Inc* (2002) 3 All SA 223 (T) 225.

³¹² *Kyle v Maritz & Pieterse Inc* supra (n 311).

³¹³ Cassim, R 'Piercing the Corporate Veil 'unconscionable abuse' under the Companies Act 71 of 2008' (2012) at 24; see in general *Airport Cold Storage (Pty) Ltd v Ebrahim* supra (n 254).

law remedy is criticised. It follows that, where the statutory remedy under section 20(9) does not contain factors that would lead to piercing, the remedy also does not make provision therefore that when it comes to piercing the veil between company groups, different policy considerations come into play.

PIERCING NO LONGER AN EXCEPTIONAL REMEDY?

In *Ex parte Gore*³¹⁴ the court states that section 20(9) has brought about the situation where piercing the corporate veil should no longer be regarded to be an exceptional or drastic remedy; one which should not be granted only because it is just or convenient to do so.³¹⁵ The court states that section 20(9) affords a 'firm, albeit flexibly defined' basis for piercing the corporate veil.³¹⁶ This basis erodes the foundation of the view held under common law that piercing the corporate veil should be approached with great reservation.³¹⁷ The courts states that '[b]y expressly establishing its availability simply when the facts of the case justify it, the provision detracts from the notion that the remedy should be regarded as exceptional, or drastic.'³¹⁸

Under common law, one of the policy considerations weighing against making an order to pierce the corporate veil is that separate legal personality is bestowed on a company by the legislature. By introducing a statutory remedy for piercing the corporate veil, the legislature indicates that it does not consider the veil of incorporation to be impenetrable.

This again, differs from the approach the court followed in *Airport Cold Storage v Ebrahim*.³¹⁹ In *Airport Cold Storage v Ebrahim*,³²⁰ the court still regarded the remedy

³¹⁴ *Ex Parte Gore NNO* supra (n 10).

³¹⁵ *Ex Parte Gore NNO* supra n 10 at 34.

³¹⁶ *Ex Parte Gore NNO* supra n 10 at 34.

³¹⁷ *Ex Parte Gore NNO* supra n 10 at 34.

³¹⁸ *Ex Parte Gore NNO* supra n 10 at 34.

³¹⁹ *Airport Cold Storage (Pty) Ltd v Ebrahim* supra (n 254).

³²⁰ *Airport Cold Storage (Pty) Ltd v Ebrahim* supra (n 254).

for piercing the corporate veil to be exceptional³²¹ and relied on past reasoning under the common law in coming to a decision to pierce the corporate veil under section 65 of the Close Corporation Act.³²² It remains to be seen, given the courts' discretion to grant a remedy in terms of section 20(9), whether the courts will follow the liberal approach in *Ex parte Gore*³²³ or the more conservative approach in *Airport Cold Storage v Ebrahim*.³²⁴

PIERCING AS A REMEDY OF LAST RESORT

Although under the common law, and as was discussed in Chapter 3, the position had not always been clear whether piercing the corporate veil may be done where the plaintiff has other remedies to his or her aid, the introduction of section 20(9) may have brought about some clarity on this matter.

In *Ex parte Gore*,³²⁵ the court states that the unqualified availability of the remedy in terms of section 20(9) militates against an approach that piercing the corporate veil should only be granted in absence of an alternative remedy.³²⁶

Although, under common law some argued that piercing the corporate veil should only be granted as a last resort remedy,³²⁷ the preferred approach is that the existence of an alternative remedy should not preclude an order for piercing of the corporate veil.³²⁸ The existence of another remedy, or the failure to pursue one that was available, is however a relevant factor where policy considerations are being weighed up.³²⁹

³²¹ *Airport Cold Storage (Pty) Ltd v Ebrahim* supra (n 254) at 21.

³²² *Airport Cold Storage (Pty) Ltd v Ebrahim* supra (n 254) at 24.

³²³ *Ex Parte Gore NNO* supra (n 10).

³²⁴ *Airport Cold Storage (Pty) Ltd v Ebrahim* supra (n 254).

³²⁵ *Ex Parte Gore NNO* supra (n 10).

³²⁶ *Ex Parte Gore NNO* supra (n 10) at 34.

³²⁷ See for example *Hulse-Reutter v Godde* supra (n 141).

³²⁸ *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* supra (n 123).

³²⁹ *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* supra (n 123) at 38.

The introduction of Section 20(9) may bring about a more liberal approach where the courts no longer weigh against a plaintiff the fact that he or she has another remedy available to him or her. Section 20(9) however does not direct the court with regards to factors it must or must not consider when exercising its jurisdiction. And it may be that the courts will still consider the availability of another remedy in exercising their discretion.

WHO MAY INVOKE SECTION 20(9)?

Interested person

Section 20(9) determines that ‘an interested’ person may invoke this provision. According to the court in *Ex Parte Gore*,³³⁰ there is no mystique attached to the meaning of this term.³³¹ The *locus standi* of a person seeking to make an application in terms of section 20(9) should be determined by the well-established principles, as stated in *Jacobs en ‘n Ander v Waks en Andere*,³³² and where related to a right in the Bill of Rights, section 38 of the Constitution.³³³

Mero moto

In *National Union of Metalworkers of South Africa v Lee Electronics (Pty) Ltd*,³³⁴ the Labour Court of Appeal was requested to pierce the corporate veil between a group of companies in order for it to be considered that a member of the applicant union would be regarded to be an employee of the third respondent. The first and second respondents both manufactured and distributed radios and television sets, and both companies were wholly owned by the third respondent. The applicant contended that after the first responded closed its business and dismissed its employees; the

³³⁰ *Ex Parte Gore NNO* supra (n 10).

³³¹ *Ex Parte Gore NNO* supra (n 10) at 35.

³³² *Jacobs en ‘n Ander v Waks en Andere* 1992 (1) SA 521 (AD) 533J – 534E

³³³ *Ex Parte Gore NNO* supra (n 10) at 35.

³³⁴ *National Union of Metalworkers of South Africa v Lee Electronics (Pty) Ltd and others* 2013 2 BLLR 155 (LAC).

first respondent's business was secretly continued by the second respondent. The second respondent thereafter selectively reemployed individual employees once working for the first respondent. The appellants argued that by virtue of the third respondent's controlling interest in the first and second respondents, the third respondent was at all material times the employer of all the employees of the group. Through closing the first respondent, the third respondent attempted to subvert the employee's labour rights.

The Court noted that this case gave rise to the question as to when the corporate veil of companies may be pierced. Referring to the section 20(9), the court states that if it finds that the incorporation of a company constitutes an unconscionable abuse of its juristic personality, it may declare the company not to be a juristic person in respect of any right, obligation or liability and make any order deemed necessary. The court however found that the applicant in the case seemed not to have relied on this provision, but rather on the common law, and therefore it was unable to make a finding based on section 20(9). On the facts, the court found that no evidence was presented that the first respondent's business had transferred to the second respondent and held that the third respondent therefore had not abused the corporate entities of the two companies.

It is submitted that the court erred in finding that it was not able to consider providing relief under section 20(9). Under section 20(9), the court may in proceeding before invoke relief under section 20(9), and was able to do so *mero moto*.³³⁵

The court's reliance on the common law in this case may be indicative thereof that the courts will rely on the case law developed under the common law and may turn to the common law, notwithstanding that section 20(9) provides a legislative mechanism to pierce the corporate veil.

³³⁵ Section 20(9) of the Act; *Ex Parte Gore NNO* supra (n 10) at 35.

ORDER THAT THE COURT MAY MAKE

The court may declare a company not to be a juristic person in respect of certain rights, obligations or liabilities 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.³³⁶ Such a declaration was made in *Ex Parte Gore*,³³⁷ where the court found that all the subsidiary companies should be deemed not to be juristic persons in respect of any obligation by such companies to the investors.³³⁸

According to Cassim, a court does not have the power to intervene under section 20(9) where the unconscionable abuse is not in respect of any such right, obligation or liability.³³⁹ Cassim argues that there must be a nexus between the abusive conduct and right, obligation or liability incurred by the company as a result of such conduct.³⁴⁰

*Ex parte Gore*³⁴¹ the court stated that paragraph 20(9)(b) affords the court the very widest powers to grant consequential relief.³⁴² The order made under section 20(9)(b) should however always have the effect of fixing the right, obligation or liability in issue of the company somewhere else.³⁴³ In *Ex parte Gore*³⁴⁴ the courts, after declaring that all the companies in the King Group was to be regarded as one single entity, consequently made an order that all assets of the subsidiaries should be transferred into one account and investors should be called to submit claims against the single entity and not against individual subsidiaries.³⁴⁵

³³⁶ Section 20(9)(b) of the Act.

³³⁷ *Ex Parte Gore NNO* supra (n 10).

³³⁸ *Ex Parte Gore NNO* supra (n 10) at 37.

³³⁹ Cassim, R 'Piercing the Corporate Veil 'unconscionable abuse' under the Companies Act 71 of 2008' (2012) at 24.

³⁴⁰ Cassim, R 'Piercing the Corporate Veil 'unconscionable abuse' under the Companies Act 71 of 2008' (2012) at 24.

³⁴¹ *Ex Parte Gore NNO* supra (n 10).

³⁴² *Ex Parte Gore NNO* supra (n 10) at 34.

³⁴³ *Ex Parte Gore NNO* supra (n 10) at 34.

³⁴⁴ *Ex Parte Gore NNO* supra (n 10).

³⁴⁵ *Ex Parte Gore NNO* supra (n 10) at 37.

SUMMARY

From the above analysis it seems clear that section 20(9) cannot be considered to have improved on that for which the common law remedy had been criticised. Whilst in *Ex parte Gore*³⁴⁶ the court may have stated that the statutory remedy for piercing the corporate veil is an extension of the common law, the common law had never been developed to specify circumstances under which the corporate veil will be pierced.³⁴⁷ The courts have always guarded against setting such rigid rules.

It may prove that the flexibility that section 20(9) allows for is preferable. The flexibility ensures that the remedy can be applied and developed to find application as required in the interest of justice.

Section 20(9) has been used by the court to pierce the corporate veil between companies within a group in the *Ex Parte Gore*³⁴⁸ case. Section 20(9) did however not improve the common law remedy for piercing the corporate veil. Also within the group context, section 20(9) does not address the concerns that have been raised in groups of companies.

The South African company law in this regard therefore does not provide specific mechanisms to address concerns that are specific to groups. Although the legislature has introduced some group specific regulation, these do not point to the legislature's intention to treat company groups as single entities. By introducing section 20(9) as a statutory remedy which enables plaintiffs to pierce the corporate veil, although applicable also to pierce the veil within company groups, the legislature has not addresses those concerns that are unique to company groups. As a remedy, it has also not improved the position as has existed under the common law.

³⁴⁶ *Ex Parte Gore NNO* supra (n 10).

³⁴⁷ *Ex Parte Gore NNO* supra (n 10) at 33.

³⁴⁸ *Ex Parte Gore NNO* supra (n 10).

CHAPTER 5: FINAL EVALUATION

The limited liability of the shareholders of companies has been essential to economic development. It enabled fundraising from the public without exposing the investors to unlimited risks and claims if the venture funded did not succeed. A review of the history of limited liability reveals however that it preceded the company group. When company law started enabling a company to hold shares in another company, the limited liability of the holding company occurred almost incidental. No thought went into the clearly different policy and economic considerations that exist in the context of a group of companies. The limitation of the liability of a holding company brought about that the shareholders of the holding company have two layers of protection from claims by the subsidiary company's creditors. The holding company will however have control over its subsidiary and all the economic benefits will be enjoyed by the group as a whole.

A prominent concern with the separate legal personality of a company and the limited liability of shareholders is that it can be abused by those in control of the company. Shareholders' investments are protected from the company's creditors, but they are also able through exercising control to insist on returns on their investments, leaving the company undercapitalised and unable to pay its creditors.

The common law remedy for piercing the corporate veil enables the court to provide relief where there was an abuse of the separate legal personality of the company in this manner. The courts are however conservative in affording relief under this remedy, as the separate legal personality of the company is seen to lie at the heart of company law. Within company groups, although briefly the courts seemed to recognise the unique economic relationship between a holding company and its subsidiaries, the courts have strictly upheld the separate legal personality of individual companies within a group. When piercing the veil between companies in groups, the courts have not developed rules unique to this relationship. The courts have never specified the exact requirements for providing relief, resulting therein that this remedy is expensive to litigate and investors uncertain of the durability of their limited liability.

The statutory remedy for piercing the corporate veil, similar to the common law remedy, did not create more certainty as to the type of conduct that would enable the court to hold the shareholders of a company liable for the company's obligations. The wording of this section is likely to be interpreted in line with common law decisions on which type of conduct would justify relief. As a result, it is doubtful that the courts will approach statutory veil piercing between company groups differently.

The South African company law landscape does not provide a remedy to address concerns that are specific to company groups. Addressing abuses of the separate legal personality of subsidiary companies within groups therefore remain problematic.

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