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**UNIVERSITY OF CAPE TOWN  
FAULTY OF LAW**

DEPARTMENT OF COMMERCIAL LAW

**JUSTIFICATIONS FOR PIERCING THE CORPORATE VEIL**

by

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Submitted to the University of Cape Town in partial fulfilment of the requirement  
for the Master of Law Degree.

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## 1. CHAPTER ONE

### 1.1 Introduction

According to the decision in *Salomon*<sup>1</sup> a company is recognised as a legal entity separate and distinct from its shareholders. The court said:

“The company is at law a different person altogether from the subscribers to the memorandum; and although 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 subscribers or trustee for them.”<sup>2</sup>

Although this fundamental rule has had a considerable influence in company law worldwide, it cannot be absolute and, as such, must allow for exceptions where the courts may disregard the separate legal personality of the company.<sup>3</sup>

The general rule is that a court will pierce the corporate veil

“only where special circumstances exist indicating that it is a mere façade concealing the true facts, so that the separate existence of the company is in some sense being abused or, at least, is not being maintained in the full sense, with the result that separates between the company and its members does not in fact exist. However the courts uniformly exercise significant discretion, and fail to offer a clear standard for veil piercing.”<sup>4</sup>

Besides company law, this research paper also considers other areas of law where this principle has been applied. These include labour law, criminal (corporate liability) and maritime law.

The first part of this research paper investigates the reasons for the inconsistency of the application of the rule against piercing the corporate veil and considers if the traditional justifications for the rule as an exception remedy are valid. This part of research paper will begin with a discussion of the principle of separate liability, and its advantages and disadvantages will be considered. The application of the doctrine by the South African courts will also be discussed, and it will be

<sup>1</sup> *Salomon v Salomon and Co Ltd* [1987] AC 22 (HL).

<sup>2</sup> *Ibid* Lord MacNaughten at 51.

<sup>3</sup> EJ Cohn and C Smiths -Lifting the Veil In the Company Laws of the European Continentø(1963) 12 *The International and Comparative Law Quarterly* at 189.

<sup>4</sup> Sandra K. Miller -Piercing the corporate veil among affiliated companies in the European Community and the U.S.: A comparative Analysis of U.S, German and U.K.Veil piercing Approaches (1998) 36 *American Business Law Journal* at 77.

investigated whether inconsistency is due to the lack of established guidelines that could help the courts when dealing with cases involving piercing the corporate veil.

The second part of the research paper considers the application of the principle of the corporate veil in the context of labour law. In today's business world an employer can take the form of a natural person, a partnership, a not for profit company, a limited liability company and an association of groups of companies. Some these forms have proved to be complex when identifying the true employer. For instance where an employee has been unfairly dismissed and wishes to bring a claim against the employer, it is uncertain whether the parent company or its subsidiary is the employer. The identification of the true employer becomes increasingly challenging in the global context, with multinational companies establishing subsidiaries in foreign countries.<sup>5</sup>

With regard to labour law, this research paper will investigate whether the constitutional right to fair labour practices constitutes a stronger justification for piercing the corporate veil than in other instances. The conclusion reached is that the constitutional right to fair labour practices is strong and justifiable and the courts are prepared to uphold the constitutional rights of employees.

The third part of deals with the maritime context where these principles apply to the operation by an individual ship owner of more than one vessel and sometimes a substantial fleet of vessels, the operations of which are managed and conducted centrally, although each is owned by a separate corporate entity.<sup>6</sup> This research paper will investigate the contention that the reliance initially placed on the concept of piercing or lifting the corporate veil to justify the introduction of the true associated ship arrest was misplaced.<sup>7</sup> An evaluation will be undertaken as to whether the justification for the departure from fundamental principles of company law embodied in the true associated ship arrest is lacking, and as such is a myth

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<sup>5</sup> Tamara Cohen 'Placing Substance over form-Identifying The True Parties To An Employment Relationship' (2008) 29 *ILJ* 863 at 870.

<sup>6</sup> Malcolm J. Wallis 'The Associated ship and South African Admiralty Jurisdiction' PhD dissertation University of Kwazulu Natal (2010) at 100.

<sup>7</sup> *Ibid* at 103.

which should be laid to rest and this language to describe the purpose or nature of the associated ship arrest provisions should cease.<sup>8</sup>

This discussion will also consider the new provisions of the associated ship and comes to the conclusion that the introduction of the company law jurisprudence of piercing the corporate was the correct approach and that it should not be done away with.

The fourth part of the reach paper deals with criminal liability of corporations. Being an artificial rather than natural person, a corporation is said not to be able to commit unlawful conduct, intentionally or negligently.<sup>9</sup> The unlawful act and culpability of the individual servant or agent are then imputed to the corporate body.<sup>10</sup> South Africa's current approach to criminal liability of corporation is based on a derivative model of liability. This has been criticised, with some academics are in favour of the organisational model of corporate liability which, unlike the derivative model, which focuses on individual fault, instead looks to policies, institutional practices and corporate culture.

Having considered both derivative and organisational models of corporate liability, this paper ends of by arguing that there is a need to consider adopting a more organisational model. In making this recommendation support for this proposition will be taken from other jurisdictions which have currently adopted organisational models of corporate liability. Australia will be considered as it is one of the countries that has adopted the organisational model of corporate liability. The United Kingdom will also be considered as it recently passed an act which specifically deals with corporate liability and has also been a source of influence in South African Law.

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<sup>8</sup> Ibid.

<sup>9</sup> Jonathan Burchell *Principles of Criminal law* 3ed (2005) at 562.

<sup>10</sup> Louise Jordaan 'New Perspective on the Criminal liability of Corporate bodies' (2003) 48 *Acta Juridica* at 48.

## 2. CHAPTER TWO: GENERAL PRINCIPLES AND APPLICATION IN SOUTH AFRICA

### 2.1 Separate personality

The concept of separate legal personality of the company is in tandem with the doctrine of limited liability, although separate personality was a consequence of the Joint Stock Companies Act of 1844, it took 53 years before the courts began addressing the implications of this separation in detail.<sup>11</sup> Limited liability is a concept whereby shareholders' financial liability is limited to the amount of capital invested in the business and does not extend to personal assets. This principle is vital, as it oils the wheels of commerce. It enables business concerns to organise large amounts of capital from an extensive selection of investors who were reasonably reluctant to risk their whole personal fortunes in their investments. This effectively caps the investors' risk and consequently, the potential for profit maximisation by the investors is unlimited.<sup>12</sup>

In *Foss v Harbottle*,<sup>13</sup> the court confirmed the idea that when a wrong is committed against a company, the company itself would be the plaintiff in the proceeding and not the members. This principle is also found in the *Salomon* case<sup>14</sup> where it was held that the company is a separate legal person. In other words, the separate legal personality of a company enhances a different legal existence to the shareholders.<sup>15</sup>

A company may sue and be sued in its own name and holds property separately from its shareholders, as such the shareholders do not own the assets of the company, nor are they liable for its debts.<sup>16</sup> As mentioned earlier it is this separate personality that makes companies more attractive to various investors, as the liability rests within the company, rather than the shareholders, directors, and the members of the company. This separate entity forms the basis for limited liability of shareholders liability of shareholders; their liability is limited to the actual value of the shares

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<sup>11</sup> Jacqui Cohen "Veil piercing a necessary Evil? A critical study on the doctrines of Limited liability and the corporate veil" LLM Dissertation University of Cape Town (2006) at 7.

<sup>12</sup> Paul L. Davies, *Gower and Davies Principles of Modern Company Law* 7ed (2003) at 176.

<sup>13</sup> *Foss v Habottle* (1843) 2 Hare 43; 67 E.R. 189.

<sup>14</sup> *Salomon* (note 1).

<sup>15</sup> Jacqui (note 11).

<sup>16</sup> *Ibid* at 4.

allocated to them.<sup>17</sup> Lord Halsburg, held, "Once the company is legally incorporated it must be treated like any other independent person with its rights and liabilities appropriate to itself, and the motive of those who took part in the promotion of the company are absolutely irrelevant in discussing what those rights and liabilities are."<sup>18</sup>

This having been stated it's important to bear in mind that the court can still disregard the separate corporate personality in exceptional circumstances. It is necessary to have a clear understanding of the arguments both for and against the doctrine of limited liability.<sup>19</sup>

On the one hand, if limited liability is viewed as unsound, then a liberal view will be taken towards veil piercing, whilst on the other hand, if viewed as a fundamental principle that should not be fettered, one would be more willing to restrict and limit the use of the doctrine of veil.<sup>20</sup>

## 2.2 Advantages of limited liability

Limited liability protects the company and its members, and it also facilitates commercial ventures in which the company may be interested.<sup>21</sup> The principal argument in favour of limited liability stems from the common law rule of liability for joint-partners and several liabilities, where any one partner may be held liable for the entire amount of the firm's debt.<sup>22</sup>

This appears to be the general European rule as well.<sup>23</sup> Under these conditions there are three economic arguments in favour of limited liability: (1) it fosters economic growth by encouraging investors to take risks; (2) it facilitates the efficient spread of risks among corporations and their voluntary creditors; and (3) it avoids the enormous litigation costs that would be required for creditors to seek recovery from shareholders.<sup>24</sup> Limited liability reduces the transaction costs of collection.<sup>25</sup>

Under a rule exposing equity investors to additional liability, the greater the wealth of other shareholders, the lower the probability that any one shareholder's assets will

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<sup>17</sup> Ibid.

<sup>18</sup> Salomon at 30.

<sup>19</sup> Jaqui (note 11 ) at 8.

<sup>20</sup> Stephen M. Bainbridge "Abolishing Veil Piercing"(2001) 26 *J. Corp Journal of Corporate Law Spring* 479 at 487.

<sup>21</sup> Stephen B Presser "Thwarting the killing of the Corporation: Limited Liability, Democracy and Economics" 87 *Nw. U. L. Rev.* 148 at 177.

<sup>22</sup> Shaw Livermore "Unlimited Liability in Early American Corporations" 43 *Journal of Political Economy* (1935) 674-687.

<sup>23</sup> William J. Carney "Limited Liability" 620(1999) at 669. Available at <http://encyclo.findlaw.com/5620book.pdf> [ Accessed on 22 November 2010].

<sup>24</sup> Ibid .

<sup>25</sup> Ibid at 678.

be needed to pay judgement.<sup>26</sup> Thus existing shareholders would have an incentive to engage in costly monitoring of other shareholders to ensure that they do not transfer assets to others or sell to others with less wealth. It also makes the identity of other shareholders irrelevant and thus avoids these costs.<sup>27</sup>

Limited liability allows supplementary skilful diversification. Investors can diminish risk by owning a diversified portfolio of assets; firms can elevate investment at lower costs because investors need not bear the extraordinary risk associated with non-diversified holdings.<sup>28</sup> It has been asserted that limited liability avoids the need for corporate creditors to bringing expensive and cumbersome individual collection suits against numerous scattered shareholders of corporations that have defaulted on their obligations.<sup>29</sup> By including limited liability in corporation law, the law in effect creates an efficient contract term applicable to all transactions.<sup>30</sup>

It eliminates the necessity for shareholders to incur the expense of contracting around liability.<sup>31</sup> Where standard contract clauses are available as in the English insurance industry before the adoption of limited liability in The Companies Act, 1862, such costs are trivial.<sup>32</sup> However, where standard contract clauses are not available, limited liability in corporation law save the costs that otherwise would be incurred.<sup>33</sup>

### 2.3 Disadvantages of Limited Liability

By transferring the risk of liability from shareholders to creditors, limited liability increases the likelihood of excessively risky investments by business enterprises; the calculation has been distorted.<sup>34</sup> This is a particularly serious problem.<sup>35</sup>

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<sup>26</sup> Easterbrook, Frank H. and Fischel, Daniel R -Limited Liability and the Corporationø Vol 52. No.1 *University of Chicago Law Review* Vol 52.No. 1 1985 89-117at 95.

<sup>27</sup> Ibid.

<sup>28</sup> Ibid at 96.

<sup>29</sup> Robert C. Clark -The Regulation of Financial Holding Companiesø(1979) 92 *HARv. L. REv.* 789, 825-36 at 825.

<sup>30</sup> Philip I. Blumberg -Limited liability and Corporate Groupsø(1985-1986) 11 *J.Copr. L.*573 at 615.

<sup>31</sup> Ibid at 615-616.

<sup>32</sup> Blumberg (note 30) at 616.

<sup>33</sup> Meiners, Mofsky & Tollison -Piercing the Veil of Limited Liabilityø(1979) 4 *J. CORP. L.* 351 at 363.

<sup>34</sup> Tony Orhnia -Limited Liability Laws and Corporate Finance in Limited Liability and the Corporationø(1982) 179 *T. Orhnia ed.* at 186.

<sup>35</sup> Blumberg (note 30) at 620.

It is asserted frequently that the corporate group, particularly the multinational group, pursues a policy of group profit maximization in which the interests of the individual constituent companies are subordinated to the welfare of the entire group.<sup>36</sup> This group focus is reflected in intra group allocations of resources for new investment to group activities yielding the highest return for programs of equivalent risk, transfer of funds and personnel, and non market intra group transfer pricing policies.<sup>37</sup>

Professor Arrow has observed that limited liability is a departure from the free market and necessarily impairs its performance.<sup>38</sup> If third parties have been misled about the identity of the entity with which they are dealing, and have been led to believe that they are dealing with the parent corporation or controlling shareholders, rather than with a financially weaker subsidiary or controlled corporation, the case for limited liability disappears.<sup>39</sup>

## 2.4 Piercing the corporate veil in South Africa

The principle of veil piercing seems to go against the notion of incorporation as the courts can still pierce the veil of incorporation and hold members personally liable, though this is generally done when an issues of fairness and fraud or dishonesty is involved. The principle set out in *Salomon* - that a body corporate is a separate entity, separate that is from its members, led to use of the phrase *the veil of incorporation*, which is said to hang between the company and its members and in law at least, act as a screen between them.<sup>40</sup>

Cilliers & Benade<sup>41</sup> examined the instances where the South African courts have disregarded the separate corporate personality of the company, and arranged these into seven categories. This approach will be followed in this work while bearing in mind that the approach taken by the courts appears to be determined on a case by case basis.

The South African Courts have been careful to permit piercing of the veil of incorporation only in egregious cases.<sup>42</sup> According to this area of law it is stated time and time again that courts pierce the veil reluctantly.<sup>43</sup> Nevertheless it has always

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<sup>36</sup> Ibid.

<sup>37</sup> Ibid.

<sup>38</sup> Ibid Blumberg at 621.

<sup>39</sup> Ibid Blumberg.

<sup>40</sup> Denis Keenan and Josephine Bisacre *Smith and Keenan's Company Law* 12ed (2002) at 25.

<sup>41</sup> H S Cilliers and ML Benade *Corpotate Law* 3ed (2000) at 11-12.

<sup>42</sup> Jacqui (note 11) at 20.

<sup>43</sup> Ibid.

been recognised that the legislature can forge a sledge hammer capable of cracking open the corporate shell.<sup>44</sup>

## 2.5 Disregarding by the legislature

The following examples may be identified:

In terms of section 50 (3) of the Companies Act,<sup>45</sup> if a director, officer or agent of a company issues or signs a bill of exchange, a promissory note, a cheque or an order for money or for goods on behalf of the company in which the registered name of the company is not mentioned correctly, he commits an offence and is also personally liable for the holding of that bill of exchange, promissory note, cheque or order for the amount thereof, unless it is duly paid by the company.

Section 66 of the Act provides for the liability of members of a public company for its debts in circumstances where the company's membership is less than seven for a period of more than six months.

Section 172(5) b of the Companies Act provides that until a certificate is issued permitting the company to commence business any debts or liabilities incurred prior to receipt of the certificate is the joint and several liability of the directors and the members of the company. Under section 344(h) of the Act a company may be wound up by the court if it appears to the court that it is just and equitable that the company should be wound up.

Commenting on the above examples it is submitted that the legislature has always made an essential condition for the recognition of corporate personality an essential condition and that this should only be disregarded in instances mentioned.

## 2.5 Disregarding by the Courts

In exceptional circumstances the veil of incorporation has been lifted by the courts. The following are instances where the court has disregarded the separate corporate personality can be categorised.<sup>46</sup>

(a) *Daimler Co Ltd v Continental Tyre and Rubber Co*<sup>47</sup> in this case, the House of Lords held, that in spite of the decision in *Salomon*<sup>48</sup> they were entitled to look beyond the fact that Daimler Co Ltd was incorporated in Great Britain, to the fact that all its members were domiciled in Germany, which was at the time at war with Britain, in order to be categorised as an alien enemy.

<sup>44</sup> L. Nel *Piercing The Veil of Corporate Personality* (1992) Unpublished LLM Dissertation University of Cape Town at 6.

<sup>45</sup> Companies Act 61 of 1973 .

<sup>46</sup> This lay out of the instances had been taken from the book by Benade (note 41) at 13.

<sup>47</sup> *Daimler Co Ltd v Continental Tyre and Rubber Co* [1916].

<sup>48</sup> *Salomon* (note 1).

(b) In *Robinson v Randfontein Estates Gold Mining Co Ltd*,<sup>49</sup> the South African Appellate Division realistically refused to take into consideration the separate existence of a company's subsidiary where the company sought to use the subsidiary as a device in evading a director's fiduciary duties to the holding company.

(c) Where the fraudulent use is made of the rule of separate legal personality for the purposes of improper conduct.<sup>50</sup>

(d) Where the courts seek to use the law of agency to evade the problems which would otherwise arise from a strict application of the principle in *Salomon's* case. Davies argues that there is no presumption of any such agency relationship between the company and shareholders and in the absence of an express agreement between the parties; it will be very difficult to establish one.<sup>51</sup>

(e) Tax liability; as far as the tax liability of a company is concerned, the courts will not permit the true state of affairs to be concealed by the provisions in the company document (e.g. in the objections clause). Regard would be given to the real intention of the board of directors and the members.<sup>52</sup> The courts seem to be more concerned with the intentions of the company, for instance in the *Elandsheuwel* case,<sup>53</sup> a company which had held land with a capital intention to a revenue one (became liable for tax on the proceeds), not because of any actions it took in connection with developing the land etc. but because its shareholding changed, and the new shareholders had a revenue intention with respect to the company's assets, the land.

(f) Underlying Partnership; the courts have recognised the existence of partnerships, in the case of *Ebrahimi v Westbourne Galleries Ltd & Anos*,<sup>54</sup> where the underlying intention was one of partnership, although the partners formed a company to put the partnership into effect.

Embrahimi was removed as director in agreement with the articles of association, Lord Wilberforce held, allowing the winding up of the company on the just and equitable ground that "a limited company is more than a mere legal entity with a personality in law of its own: that there is room in the company law for recognition of the fact that behind it or amongst it, there are individuals, with rights, expectations and obligations which are not necessarily submerged in the company structure."<sup>55</sup>

(g) Groups;

(i) in the absence of fraud, the holding company, as incorporator or otherwise of the subsidiary, is a separate legal persona possessing its own interests, rights, assets and liabilities. (ii) the mere fact that a holding company is able to control the subsidiary does not make the subsidiary its agent. As a consequence of the separate legal

<sup>49</sup> *Robinson v Randfontein Estates Gold Mining Co Ltd* (1921) AD 168.

<sup>50</sup> Benade (note 41); the authors also includes, *Food and Nutritional Products (Pvt) Ltd v Newman* 1986(3) SA 464 in support of his point.

<sup>51</sup> Paul L. Davies *Gower and Davies Principles of Modern Company Law* 8ed (2008) at 203.

<sup>52</sup> Benade (note 41) at 14.

<sup>53</sup> *Elandsheuwel Farming (Edms) Bpk v Sekretaris van Binnrlande Inkomste* 1978 (1) SA 101 (A).

<sup>54</sup> *Ebrahimi v Westbourne Galleries Ltd & Anos* (1937) AC 360 (HL).

<sup>55</sup> *Ibid*( Ebrahimi) at 379 B-C.

personalities of the holding and subsidiary companies the subsidiary itself and not its holding company will have to institute actions and enforce its rights... The traditional common law approach is thus that holding and subsidiary companies possess their own legal personalities, rights, assets and liabilities.<sup>56</sup>

Benade and Cilliers provide that while modern commercial practice has caused modifications (for example the presentation of group accounts) the holding company and its subsidiaries do not thereby lose their separate legal personalities.<sup>57</sup>

## 2.6 Application of General principles through the cases

General principles are important in several legal system as the application thereof ensures steadiness and expectedness in the legislation.<sup>58</sup> Instances when the veil can be pierced seem to alter according to the judicial thinking of the time.<sup>59</sup> It is submitted that there are no distinct instances where the courts have actually sat down to deal with aspects of the piercing the veil of incorporation, and the alike cases seem to used or considered in different instances of veil piercing.

The following discussion considers the different test and factors used by the court when piercing the corporate veil. It considers most of the leading cases in this area of law and also give a picture of how the judges have applied the principle of piercing the veil of incorporation.

Firstly, *In re Yenidje Tobacco Co Ltd*, Warrington LJ stated that:

“I am prepared to say that in a case like the present, where there are only two persons interested ... where there is no means of overruling by the action of a general meeting of shareholders the trouble which is occasioned by the quarrels of the two directors and shareholders the company ought to be wound up if there exists such a ground as would be sufficient for the dissolution of a private partnership at the suit of one of the partners against the other. Such ground exists in the present case. I think it is therefore just and equitable that the company should be wound up.”<sup>60</sup>

The court decided that it was just and equitable that a winding up order should be made. Secondly in *Lategan v Boyes*<sup>61</sup> Loux J stated,

<sup>56</sup> Benade (note 38) at 432

<sup>57</sup> Ibid at 433.

<sup>58</sup> Jaqui (note 11) at 27.

<sup>59</sup> Jennifer Payne “Lifting the Corporate Veil: A Reassessment of the Fraud Exception” *The Cambridge Law Journal* (1997) 284 at 284.

<sup>60</sup> Judge Warrington *In re Yenidje Tobacco Co Ltd* [1916] 2 Ch 426 (CA), JT Pretorius, et el Hahlo’s *South African Company Law through the cases* 6ed (1999) at 25-6.

<sup>61</sup> *Lategan v Boyes* 1980 (4) SA 191 (T).

“I have no doubt that our courts would brush aside the veil of corporate identity time and again where fraudulent use is made of legal personality. In the present case, however, there is no evidence that the second defendant fraudulently failed to mention the position of the sureties. Blackman comments that in *Lategan*, the court did not intend to lay down such a strict fraud requirement, as there was no fraudulent conduct in the *Lategan* case.”<sup>62</sup>

Although the court refused to lift the veil of incorporation, it held the second defendant personally liable on the grounds that he failed to discharge the onus incumbent on him to show that his surety meant he was prejudiced by the amending agreement.<sup>63</sup>

In *Botha v van Niekerk*,<sup>64</sup> Flemming J stated, that the statement in *Lategan* regarding fraud was incorrect. Flemming J formulated a test for veil piercing which was somewhat wider than the *Lategan* rule.<sup>65</sup> The court held that there was no liability attached to the first respondent and only the company be liable to the seller.

The first respondent, he declared, could be held personally liable on the contract only if there was at least a conviction that the applicant had suffered unconscionable injustice as a result of what right-minded persons would perceive to be clearly improper conduct on the part of the first respondent. Applying this criterion to the facts before it, the court found that the applicant had, in terms of the contract, assumed risk that the nominee might be liable, without stipulating that the nominee had to have sufficient independent financial means to meet its obligations.<sup>66</sup>

Furthermore, the possibility still existed at the time of application that the company could raise sufficient funds to enable it to pay the seller. For these reasons the courts refused to pierce the veil of incorporation, and held that it could not arrive at a finding of personal liability of the first respondent for the amount owed to the seller by the company.<sup>67</sup>

In *Securitibank Ltd (No 2)*,<sup>68</sup> Richmond P said:

“It may be that the doctrine laid down in [the] *Salomon* [case] has to be watched very carefully, but that can only be so if a strict application of the principle of corporate entity would lead to a result so unsatisfactory as to warrant some departure from the normal rule. I think that is particularly so in a case such as the present where there is no suggestion that the individual corporate entities . . . were in some way used to create a sham façade.”<sup>69</sup>

<sup>62</sup> Jacqui (note 11) at 28.

<sup>63</sup> JT Pretorius at 26.

<sup>64</sup> *Botha v van Niekerk* 1983 (3) SA 513 (W).

<sup>65</sup> Andrew Domanski ‘Piercing the Corporate Veil- A New Direction’ (1986) *SALJ* 103 at 227.

<sup>66</sup> *Ibid* at 227.

<sup>67</sup> *Ibid*.

<sup>68</sup> *Re Securitibank Ltd (No 2)* 1978 2 NZLR 136 CA (NZ) at 158 -159.

<sup>69</sup> Jacqui (note 11) at 27.

Similarly, in *Cape Pacific v Lubner Controlling Investment (pty) & others*,<sup>70</sup> the appellate Division held that,

“the law is far from settled with regard to the circumstances in which it would be permissible to pierce the corporate veil. Each case involves a process of enquiring about the facts which once determined, may be of decisive importance. Courts should not lightly disregard a company's separate personality, but should strive to effect to and uphold it. But where fraud, dishonesty or other improper conduct (and I confine myself to such situations) are found to be present, other considerations will come into play. The need to preserve the separate corporate identity would in such circumstances have to be balanced against policy considerations which arise in favour of piercing the corporate veil and a court would be entitled to look at the substance rather than form, in order to arrive at the true facts, and if there has been a misuse of corporate personality to disregard it and attribute liability where it should rightly lie.”<sup>71</sup>

In *The shipping Corporation of India Ltd v Eudomon corporation*,<sup>72</sup> Corbett CJ stated that,

“I do not find it necessary to consider, or attempt to define the circumstances under which the Court will pierce the corporate veil. Suffice to say that they would generally have to include an element of fraud or other improper conduct in the establishment or use of the company or the conduct of its affairs.”<sup>73</sup>

In *Hulse-Reutter & Others v Godde*<sup>74</sup> it was contended that the courts should pierce the veil in instances of improper or fraudulent conduct.<sup>75</sup> In this case, [The shareholders] had caused [the company] to enter into the agreement with no intention of [the company] ever honouring its obligations in terms of the agreement. The court held that, “there can be no doubt that the separate legal personality of a company is to be recognised and upheld except in the most unusual circumstances. Much will depend on a close analysis of the facts of each case, consideration of policy and judicial judgment. 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.”<sup>76</sup>

In *Hulse-Reutter*, the court departed from the *Cape Pacific* case without expressly stating so, and seemed to have reintroduced the requirement of unfair advantage into the test in determining whether or not to pierce the veil.<sup>77</sup> *Cape Pacific* expressly avoided holding that there must always be an unfair advantage before the court can pierce the veil, as this requirement was regarded as being too rigid.<sup>78</sup>

<sup>70</sup> *Cape Pacific v Lubner Controlling Investment (Pty) Ltd* 1995 (4) SA 790 (A).

<sup>71</sup> Pretorius (note 63) at 32.

<sup>72</sup> *Shipping Corporation of India Ltd v Eudan Corporation* 1994 (1) SA 550 (A) at 566.

<sup>73</sup> *Ibid* at 556C-F.

<sup>74</sup> *Hulse-Reutter & Others v Godde* 2001 (4) SA 1336 (SCA).

<sup>75</sup> Jacqui (note 11) at 28.

<sup>76</sup> *Ibid* at 29.

<sup>77</sup> Larkin and Cassim, *Company Law The Annual Survey of South African Law* (2001) 506 at 515.

<sup>78</sup> *Ibid*.

*Cape Pacific* was decided on a flexible test and thus did away with the rigidity of *Botha v van Niekerk*. However, the court in *Hulse-Reutter* reverted to a rigid test (without an explanation as to why it did so).<sup>79</sup> It is very difficult to reconcile *Cape Pacific* and *Hulse-Reutter*, because *Hulse-Reutter* required there to be an unfair advantage as well as no other remedy available.<sup>80</sup>

## 2.7 Evaluation

Having considered the cases discussed above, the courts attempt to categorise or rather create some form of guidance when piercing the corporate veil has its faults. For instance, the guideline for piercing the corporate veil in the interest of justice, are vague and gives very little guidance as to when separate legal personality should be disregarded.<sup>81</sup>

The courts also pierce the veil of incorporation on the basis of fraud, in an attempt to achieve justice for the parties involved.<sup>82</sup> The authors<sup>83</sup> state that traditionally the prevention of injustice was merely a category used for determining whether or not the veil should be pierced. This was argued upon, as an exception to the separate personality of the company, with other exceptions being subsets of this general principle, aimed at preventing an injustice to the parties concerned.<sup>84</sup>

As mentioned above it is evident the courts will pierce the corporate veil when there is merely a sham, although it is somewhat problematic to identify what exactly amounts to a sham.

Gallagher and Ziegler<sup>85</sup> put forward a very convincing argument by stating that the different reasons for piercing the corporate veil for instance fraud, unlawful activities, avoidance of obligations, all are as a result the outcome of some sort of injustice. Most of the judges in the cases seem to be reluctant to set down principles, thus piercing the corporate veil is seen as an exceptional remedy and its boundaries are remarkably vague.

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<sup>79</sup> Ibid.

<sup>80</sup> Jacqui (note 11) at 29.

<sup>81</sup> Henry G. Manne 'Our Two corporation Systems: Law and Economics' (1967) 53 *Va. L. Rev.* 259 at 187.

<sup>82</sup> Lynn Gallagher and Peter Ziegler 'Lifting the Corporate Veil in the Pursuit of justice' *The Journal of Business Law* (1990) 292 at 302.

<sup>83</sup> Referring L Gallagher and P Ziegler in note 75.

<sup>84</sup> Ziegler (note 82) at 307.

<sup>85</sup> Supra (note 82).

However, despite the criticisms of Cilliers and Benade's categorisation and the application of this doctrine being vague, it is argued that nonetheless, it does to some extent give some form of guidance to the courts when deciding on cases which involve piercing the corporate veil. Of course not every case will fall in a specific category. It is important that the courts determine whether the veil of incorporation should be pierced by taking into account the facts and circumstances surrounding the case.

J B Cilliers & SM Luiz, submit that the corporate veil should be respected and not be interfered with too readily.<sup>86</sup> A general discretion to disregard the separate personality of a company whenever it seems just, does not exist. However a strict application of the law in a case where exceptional factual circumstances are present, could result in an injustice.<sup>87</sup> It is submitted that exceptional circumstances indeed existed in *Cape Pacific*. Even Van Heerden JA, who delivered the dissenting judgement admitted that, it was with regret he had to conclude that the corporate veil should not be pierced in this case.<sup>88</sup>

Andrew Domanski<sup>89</sup> submits that the grounds upon which the court in *Botha* sought to justify its refusal to pierce the corporate veil are unconvincing. The author opines that the arguments are based on convenience rather than principles of law. Domanski argues in favour of an approach in terms of which the policies behind recognition of a separate corporate existence must be balanced against the policies justifying piercing.<sup>90</sup>

## 2.9 Conclusion

The doctrine of limited liability is one of the most important principles of company law. It is at times referred to as the cornerstone of company law. This principle played a huge role in the formation of companies today. One of its main advantages is the fact that investors and shareholders have limited liability and they only lose what they invested in the business. This encourages investment and economic

<sup>86</sup> J B Cilliers and S M Luiz "The Corporate Veil- An Unnecessarily Confining corset?" (1996) 59 THRHR 523 at 527.

<sup>87</sup> Pretorius (note 53) at 34.

<sup>88</sup> Ibid.

<sup>89</sup> Domanski (note 65) at 227.

<sup>90</sup> Ibid at 234.

growth. It also has its fair share of disadvantages for instance; it increases the likelihood of unnecessarily risky investments. However it is submitted that the advantages seem to prevail over the disadvantages.

The principle of limited liability is recognised and upheld by the legislature and the courts, but is not unqualified. The veil of incorporation can be pierced thus imposing the company's liability to its members in certain circumstances. The theory concerning the doctrine of piercing the veil of incorporation is undoubtedly lacking consistency.

This is due among other reasons to the courts approach in handling each case on its particular facts. Reflecting back on the cases discussed above it is argued that it is virtually impossible for there to be no form of inconsistency in the application of the principles as the courts are taking into account different issues (on a case by case basis) which will at the end of the day have some form of influence on the decision. It follows that the courts seem to be reluctant in setting down existing guidelines as to how and when the veil of incorporation is pierced, and this has resulted in the lack of consistency in its application of the doctrine. The nature and complexity of cases that are brought before the courts are no doubt a factor in this.

However it is submitted that this principle has, been used and developed by the courts for a very long period of time. Given the change in corporate structures and how they are run, this principle has still kept up and is being applied even though it is said to be outdated. As a way of developing some guidance the courts developed the categorisation approach as when the veil of incorporation can be pierced in certain cases. The problem is that in instances where some cases could be placed in a category, it has been left to the courts to find way a of dealing with the situation.

The legislature has recognised the principle of veil piercing and has also drawn up legislation pointing out certain instances when the veil of incorporation has pierced. It is submitted that the legislation in this area of law has not really done much to set up guiding principles for the courts. As a consequence of the aforementioned legislative deficiency and judicial uncertainty, business owners have no

guidance in ascertaining what will or will not result in a loss of limited liability through the piercing of the corporate veil.<sup>91</sup>

Neither the legislature nor the judiciary has gone very far in protecting those dealing with the company from the dangers of incorporation with limited liability.<sup>92</sup> While acknowledging incorporation's right to exist independently, cognisance is taken of the fact that the corporate clock cannot be used to allow members blatantly using it for fraud or improper conduct.<sup>93</sup>

Domanski suggests that the courts should adopt the Glazer principle; he argues that this principle is capable of resolving all problems posed by separate corporate identity.<sup>94</sup> According to this test the policies behind recognition of a separate corporate existence must be balanced against the policies justifying piercing. He contends that this test does provide a coherent principle applicable to any piercing situation, something which cannot be said of its predecessors.<sup>95</sup>

The Glazer decision is not of course the perfect answer to the problem but it does seek to unify and rationalise piercing decisions on the basis of a single underlying principle and may tidy up an untidy part of the law.<sup>96</sup>

It is submitted that Milo is correct by stating that the *Salomon* doctrine is alive and well, subject to largely enigmatic exceptions made in concession to reality. He argues that it must be allowed to live on, for it is still good law in many situations.<sup>97</sup> But, there is still a need for changes to be introduced in the law. There is sufficient material and brilliant suggestions that have been offered from the legal minds in the field and it is up to the legislature to take up some of the recommendations put forward.

### **3. CHAPTER THREE: VEIL PIERCING – LABOUR ILLUSTRATION**

#### **3.1 The Employment Relationship**

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<sup>91</sup> Jacqui (note 11) at 73.

<sup>92</sup> Nel (note 44) at 31.

<sup>93</sup> Ibid.

<sup>94</sup> Domanski (note 65) at 235.

<sup>95</sup> Ibid at 235.

<sup>96</sup> Nel (note 44) at 32.

<sup>97</sup> Dario Milo 'The Liability of a Holding Company for the Debts of its Subsidiary: Is the Salomon Still Alive and Well?' (1998) 115 *S. African L.J.* 318 at 343.

The first question to be asked when on the lookout to resolve any labour law problem is whether the parties are indeed ‘employees’ and ‘employers’ within the meaning of the applicable statute and/ or the common law.<sup>98</sup>

This can be achieved by looking to the contract which has been entered into by the parties.<sup>99</sup> The contract of employment has been defined as a contract between two persons, the master (employer) and the servant (employee), for the letting and hiring of the latter’s services for reward, the master being able to supervise and control the servant’s work.<sup>100</sup>

A number of issues and principles have to be borne in mind when considering the employment contract as a whole.<sup>101</sup> It is for example, always necessary to bear in mind that the employment relationship is not one of equality- the employer, as a rule, will have considerably more economic power than the employee.<sup>102</sup>

The Labour Relations Act (LRA) defines an employee as (a) any person, excluding an independent contractor, who works for another person or for the State, and who receives, or is entitled to receive, any remuneration; and (b) any other person who in any manner assists in carrying on or conducting the business of an employer.<sup>103</sup>

The civil courts have frequently struggled with the difficulty of differentiating between an independent contractor and persons who are ‘entitled to receive payment or someone who assists in conducting the business of an employer’<sup>104</sup>

The legislature has of late attempted to offer guidance to the courts with a new deeming provision, in section 83A of the Basic Conditions of Employment Act (BCEA)<sup>105</sup> and 200A of the LRA.<sup>106</sup> The word employer is not defined in the LRA. An employer, by implication, will be any person who receives services from an employee for payment or is assisted in the conduct of its business by an employee.<sup>107</sup>

Situations may arise where what is presented as an employer is ‘an empty legal shell stripped of its assets while the real power of decision-making and the ability to pay wages rests with another company or person.’<sup>108</sup> Under such

<sup>98</sup> John Grogan *Work Place Law*, 10ed (2009) at 15.

<sup>99</sup> *Ibid.*

<sup>100</sup> *Ibid.*

<sup>101</sup> AC Basson et al, *Essential Labour Law* 5ed (2009) at 21.

<sup>102</sup> *Ibid.*

<sup>103</sup> Section 209 Labour Relations Act 66 of 1995.

<sup>104</sup> Grogan (note 98) at 16.

<sup>105</sup> Section 83A of the BCEA 75 of 1997, the section create a presumption that, a person who earns below a certain amount is an employee if that person is subject to the control or direction of another person or forms part of the employer’s organisation.

<sup>106</sup> Grogan (note 98).

<sup>107</sup> D Du Toit et al, *Labour Relations Law A Comprehensive Guide* 4ed (2003) at 73.

<sup>108</sup> *Ibid.*

circumstances, it has been argued, the company or other person or persons who [have] control of the undertaking in which the worker is employed should be regarded as the employer.<sup>109</sup> This will be dealt in more details in the paragraphs below.

### 3.2 Piercing the Corporate Veil

An employer can take the form of a natural person, a partnership or a variety of corporate entities including a company, or close corporation. The formation and utilization of these corporate structures is implicitly recognized and regulated by corporate law.<sup>110</sup> Shareholders of limited liability companies are protected by virtue of the principle of separate legal personality which affords them protection from personal responsibility for the company's actions or responsibilities,<sup>111</sup> as are members of close corporation sheltered from individual liability for the behaviour of the company. Subsidiaries also possess their own legal personalities, rights, assets and liabilities.<sup>112</sup>

Liability for the unfair dismissal of or discrimination against an employee, or subjecting an employee to unfair labour practice, vicarious liability for an employee's actions or the breach of statutory duties owed to an employee falls squarely on the responsible corporate structure, and controlling shareholders, directors and members are indemnified from personal responsibility.<sup>113</sup>

Thus the courts might pierce the veil of incorporation in order to expose the true employer.

Furthermore the veil of incorporation will be pierced where the dichotomy between a company and natural person behind it (or in control of its activities)<sup>114</sup> is disregarded and liability is attributed to that person where he has misused or abused the principle of corporate personality.<sup>115</sup>

Where the company is used as a façade for the attaining of improper objectives or is used as the alter ego of the controlling shareholders to further their own business or affairs, piercing the corporate veil is appropriate and the protections afforded to the directing minds of the company are waived.<sup>116</sup>

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<sup>109</sup> Ibid.

<sup>110</sup> Cohen (note 5) at 864.

<sup>111</sup> *Dadoo v Krugersdorp Municipal Council* 1920 AD 530 at 550.

<sup>112</sup> *The Albazero* 1975 A 11 ER 21 (CA) 28G-1.

<sup>113</sup> Cohen (note 5) at 864.

<sup>114</sup> Cape (note 70) at 802F.

<sup>115</sup> Ibid.

<sup>116</sup> Cohen (note 5) at 865.

By using the company as a mere instrumentality or business conduit for promoting, not its own business or affairs but those of its controlling shareholders,<sup>117</sup> shareholders are regarded as having abused the company's separate legal identity.<sup>118</sup> While it is not essential to establish an intent to deceive, evidence of the improper misuse of these separate entities resulting in an injustice would have to be established before this exceptional relief will be granted.<sup>119</sup>

Where a close corporation in fact trades on its own account, the employee is deemed the employee of the close corporation, not of the person to whom the close corporation renders service.<sup>120</sup> However, there may be situations in which a court will pierce the veil of incorporation of the close corporation in order to identify the true relationship between its members and the person to whom it renders service.<sup>121</sup>

The following paragraphs will consider the approach taken by the courts in identifying the true employer and the difficulties involved. Contracts between employees and subsidiaries in groups of companies aggravate this problem. In these cases, it must be decided whether an employment relationship exists between the alleged employee and the alleged employer.<sup>122</sup>

In *Board of Executors Ltd v McCafferty*,<sup>123</sup> Mr McCafferty had initially been employed by BOE Ltd but was later transferred to one of its subsidiaries within the BOE stable, BOE Merchant Bank. His appointment was confirmed in a letter under a BOE Ltd letterhead and that company paid his salary. Later he was retrenched a letter under a BOE Ltd letterhead, informed him of his retrenchment. He instituted action for unfair dismissal citing BOE Merchant Bank as the respondent employer. The court substituted BOE Ltd as the respondent. On appeal BOE Ltd denied it was McCafferty's employer, and claimed that all its employees were in fact employed by BOE Merchant Bank. The court found no foundation to pierce the corporate veil of BOE Ltd to institute that BOE was in fact the true employer. It was held that it was possible for an employee to have more than one employer and that while the terms of the employment contract and its object determine the nature of the relationship

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<sup>117</sup> *Die Dros (Pty) Ltd & another v Telefon Beverages CC & others* 2003 (4) SA 207 (C); [2003] 1 All SA 164 (C) at 171.

<sup>118</sup> Cohen (note 5) at 865.

<sup>119</sup> *Ibid.*

<sup>120</sup> Grogan (note 98) at 23.

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

<sup>122</sup> *Ibid.* at 24.

<sup>123</sup> *Board of Executors Ltd v McCafferty* (1997) 18 ILJ 949 (LAC) .

between the parties, the parties' perceptions and the manner in which the contract is carried out are also of assistance.<sup>124</sup>

The current labour courts have indicated a willingness to pierce the corporate veil in order to identify the true employer in circumstances where there is clear evidence of the abuse of juristic personality.<sup>125</sup>

In *Airlink Pilots Association SA v SA Airlines (Pty) Ltd & another*<sup>126</sup> the court was required to consider an urgent application contesting the alleged unilateral variation of the applicant pilots' terms and conditions of employment, that required them to forego the seniority system that had been recognized as a promotion criteria in terms of a collective agreement concluded with the first respondent. The dispute arose after the applicants were required to resign from their employment with the first respondent and take up employment with the second respondent which being a separate legal entity, was not bound by the seniority system.<sup>127</sup>

The court noted that, for the applicant to succeed, the veil of incorporation would have to be pierced. The court considered case law on the prerequisites for lifting the corporate veil, particularly the factor of fraud or improper conduct in relation to a particular transaction.

In this matter the question to be determined was not who the real employer was, but who the real decision maker was with regard to the abandoning of the seniority system and the amendment of other terms and conditions of employment. The facts established that the first respondent controlled the second respondent to the extent that it was the sole decision maker, particularly with regard to the employment of pilots. The court held that the re-employment requirement and the resultant avoidance of the pilots' seniority system, was not a decision which emanated from the second respondent but from the first respondent and appeared to be a device to change the terms and conditions of the employment relationship between the first respondent and the applicant. Based on this the court was prepared to grant the application.<sup>128</sup>

In *Buffalo Signs Co Ltd & others v De Castro & another*,<sup>129</sup> the court concluded that the retrenchment process was flawed and substantively and procedurally unfair and that the second appellant was liable to compensate the respondents.<sup>130</sup>

The respondents then obtained an order in the Industrial Court (IC) against all the appellants jointly and severally. The LAC considered the correctness of such an

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<sup>124</sup> Ibid at 954 para 25.

<sup>125</sup> Cohen (note 5) at 866.

<sup>126</sup> *Airlink Pilots Association SA v SA Airlines (Pty) Ltd & another* (2001) 22 ILJ 1359 (LC).

<sup>127</sup> Cohen (note 5) at 866.

<sup>128</sup> Ibid at 866-7.

<sup>129</sup> *In Buffalo Signs Co Ltd & others v De Castro & another* (1999) 20ILJ 1501(LAC).

<sup>130</sup> Cohen (note 5) at 867.

order and concluded that the IC was limited to ordering compensation against the employer. The fact that the third appellant was in all likelihood an accomplice to the second appellant's deceit did not render such party an employer. The court pointed out that there was no fictional employer and the true employer is the party that fits the definition of employer. The true employer, the court noted, 'may be plucked from his hiding place behind the corporate veil'.<sup>131</sup>

The facts established that the second appellant paid the respondents and were the perpetrators of the fraud upon the respondents. That the third appellant was the controlling company of the second appellant did not, on this basis alone, transform it into the employer of the respondents.

The LAC's willingness to disregard corporate personality was evidenced in the recent decision of <sup>132</sup> *Footwear Trading CC v Mdlalose*.<sup>133</sup> Nicholson JA noted that: 'The abuse of juristic personality occurs too frequently for comfort and many epithets have been used to describe the abuse against which the courts have tried to protect third parties, namely puppets, shams, masks and alter ego. However, the general principle underlying this aspect of the law of lifting the veil is that, when the corporation is the mere alter ego or business conduit of a person, it may be disregarded. The lifting of the veil is normally reserved for instances where the shareholders or individuals hiding behind the corporate veil are sought to be responsible. I do not see why it should not also apply where companies and close corporations are juggled around like puppets to do the bidding of the puppet master.'<sup>134</sup>

The court concluded that Fila and Footwear were separate legal personalities but the effect of the machinations of Mr K, director and shareholder of Fila and managing member of Footwear, and his staff was such that they were in effect joint or co-employers. To the extent that Footwear wanted it otherwise, it was prevented from denying that fact by virtue of the numerous representations that were made that either Footwear was the employer or Footwear and Fila were joint employers.

Furthermore in *Camdons Realty (Pty) Ltd v Hart*<sup>135</sup> the appellant had engaged the employee to work for a company to be formed, B. An employment contract was eventually signed between the employee and B. In subsequent proceedings brought by the employee against the appellant, the appellant took the point that B, and not it,

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<sup>131</sup> Ibid at 1506.

<sup>132</sup> Cohen (note 5) at 868.

<sup>133</sup> *Footwear Trading CC v Mdlalose* (2005) 26 ILJ 443 (LAC).

<sup>134</sup> Ibid at 444.

<sup>135</sup> *Camdons Realty (Pty) Ltd v Hart* (1993) 14 ILJ 1008 (LAC).

was the employer. The Labour Appeal Court found that B was merely a legal shell and that it was the appellant who provided work for the employee.<sup>136</sup>

In *PPWAWU v Lane NO*<sup>137</sup> the court established that the liquidation of a close corporation and the simultaneous creation of a second one to take its place was a deceptive device used, among other things, to get rid of part of the work-force without having to retrench them. The court was accordingly prepared to hold the reconstituted close corporation liable for the dismissal of employees.<sup>138</sup>

Likewise, in *Viljoen v Wynberg Travel (Pty) Ltd*<sup>139</sup> it was supposed that the business of the close corporation was so entangled with that of the respondent company, that the respondent may well be regarded the real employer of the applicant.<sup>140</sup>

In *Gaymans v Ben Ngomeni*<sup>141</sup> the court was equipped to lift the veil of incorporation to establish the true identity of the employer in circumstances where his conduct was at best, disingenuous, and at worst, dishonest; and there is ample evidence of improper conduct.<sup>142</sup>

### 3.3 Foreign Owned Companies

With the increasing incursion into the South African economy of Multinational companies, the problem of identifying the true employer may become more complex.<sup>143</sup> Through the growth in trade between nations, some companies will cross borders and establish subsidiaries on foreign soil.

The courts have had to consider whether a person, employed by a foreign holding company to manage a South African subsidiary is employed by the holding company, thereby falling outside of the jurisdiction of South African labour law or is employed by the local subsidiary.<sup>144</sup>

In *Pearson v Sheerbonnet South Africa (Pty) Ltd*<sup>145</sup> the court held that the managing director was not an employee of the subsidiary but the foreign

<sup>136</sup> Toit (note 107) at 74.

<sup>137</sup> *PPWAWU v Lane NO* (1993) 14 ILJ 1366 (IC).

<sup>138</sup> Toite (note 107).

<sup>139</sup> *Viljoen v Wynberg Travel (Pty) Ltd* NH 11/2/93800 (unreported); cited in Current Labour Law (1993) at 8.

<sup>140</sup> Toit (note 138).

<sup>141</sup> *Gaymans v Ben Ngomeni* [2000] 9 BLLR 1042 (LC).

<sup>142</sup> *Ibid* at para 8.1.

<sup>143</sup> Grogan (note 98) at 25.

<sup>144</sup> Cohen (note 5) at 870.

<sup>145</sup> *Pearson v Sheerbonnet South Africa (Pty) Ltd* (1999) 20 ILJ 1580 (LC).

holding company, and consequently falls outside the jurisdiction of the South African Courts.

In *August Läßle (South Africa) v Jarrett & others*<sup>146</sup> the court declined to follow this interpretation and held that even though the applicant was employed by the parent company, he was considered also an employee of the subsidiary as the director, and was paid by and accountable to the board of the subsidiary.

The court noted that a managing director, like an ordinary employee, was unrestricted to the protection of South African law and that the true nature of the relationship should be established by reference to the terms of the contract and the ordinary tests used to determine the presence of an employment relationship, most notably the dominant impression test.<sup>147</sup>

The court stated that: 'If externally based companies, like LAG, were led to believe by the courts that they were free to avoid the reach or ambit of the LRA by merely resorting to the simple stratagem of contractually providing that persons (who are clearly employees within the meaning of the very widely defined word 'employee' in the LRA) are not employees of internally based subsidiaries, there would be complete and total disadvantage to South African citizens working for these foreign companies.' The court held that the dominant impression indicated that the applicant was an employee of both the subsidiary and the holding company.<sup>148</sup>

### 3.4 Conclusion

The traditional view in terms of limited liability is that it must be respected, and only in certain exceptional circumstances should the veil of incorporation be pierced. It is submitted that the labour courts are more willing to disregard or pierce the veil of incorporation to expose the true employer. There seems to be consistency in the cases mentioned at above when dealing with issues concerning unfair dismissals and where corporations try and hide behind the empty shell corporations. Most of the decisions seem to be policy driven, as the courts strive to come to decisions which are in line with the constitution. Unlike the commercial courts, the labour courts do not go on to try and establish or design new tests when it comes to dealing with cases involving veil piercing.

In *Airlink*,<sup>149</sup> the employers attempt to change the employees working terms and conditions by trying to use the second respondent and claiming to be a separate entity, could only be resolved by piercing of the corporate veil to identify the true

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<sup>146</sup> *August Läßle (South Africa) v Jarrett & others* [2003] 12 BLLR 1194 (LC).

<sup>147</sup> Cohen (note 144).

<sup>148</sup> *ibid.*

<sup>149</sup> *Supra* (note 126).

identity of the person who was actually responsible for decision making with regard to the two corporations. It is submitted that the courts were correct in coming to this decision and hence the piercing of the veil was justified in this case.

This notion of piercing the veil in the labour perspective has been criticised.

Deakin argues that the idea is so vague that there is inevitably an air of arbitrariness about its application, whatever the outcome. He states that there is a need for a more functional conception of the legal personality of an enterprise, one which looks beyond the form in which the owners or controllers of a business choose to constitute it to take into account the role and interests of the other stakeholders, employees included.<sup>150</sup>

Despite the criticism, it is submitted that the doctrine of veil piercing has proved to be workable and efficient. Employers had attempted to deceive their employees by forming an empty legal shell. However the courts have been able to look behind the veil to see what is actually going on.

As mentioned above the establishment of foreign subsidiaries in South Africa has led to difficulties in identifying the true employer when the employee has been employed by the foreign parent company. In *Pearson* the court was incorrect by leaving the employee without a remedy because they could not claim jurisdiction. It is argued that the decision was unconstitutional, because under section 23 of the constitution,<sup>151</sup> everyone has the right to fair labour practice which includes being given a remedy failure of which goes against the constitution.

Hence the court in *August Läßle*,<sup>152</sup> declined to follow the earlier decision, as they rightfully concluded that, this will mean South African citizens working for overseas corporations would be disadvantaged. Persons employed outside the territorial boundaries of the Republic are not bound by South African Legislation, unless perhaps, the contract is finished in South Africa, the parties expressly or implicitly accepted the jurisdiction of the South African courts, or their employer is based in South Africa. Conversely, foreign companies operating inside the Republic are bound by the South African labour Acts.<sup>153</sup>

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<sup>150</sup> Simon Deakin -Lifting the Veil. Illustration form Labour Law(1995) 54 *The Cambridge Law Journal* 3.510-512 at 512.

<sup>151</sup> Section 23 Constitution of the Republic of South Africa No.108 of 1996.

<sup>152</sup> Supra (note 146).

<sup>153</sup> Grogan (note 98) at 27.

To this end the paternalistic nature of South African labour legislation, permitted by constitutional safeguards, casts a wide net around the identification of employers and employees. This, together with a willingness on the part of the judiciary to adopt a purposive interpretation of statutory and contractual provisions in order to uncover the substance and not the form of the working relationship, has diffused many of the difficulties posed by disguised employment relationships.<sup>154</sup>

#### 4. CHAPTER FOUR: THE ASSOCIATED SHIP IN MARITIME LAW

##### 4.1 Background to the associated ship arrests

A person seeking to claim in maritime law can find that it proves difficult.

Situations arise where the debtor is in all likelihood a shell company registered in an obscure jurisdiction with its sole asset a ship that tramps the jurisdiction of the maritime world.<sup>155</sup> Failing satisfaction of its claim, creditors would take action against the owner of the ship by attaching any one of the ships to the ships of the line to found jurisdiction of the court.<sup>156</sup>

This was known as the ‘sister ship’ procedure, which allowed a claimant to arrest the particular ship in respect of which the maritime claim arose, or any other ship which is owned by the person who was, at the time when the maritime claim arose, the owner of the particular ship in respect of which the claim arose.<sup>157</sup>

In fact it was this same self-legitimizing of the sister ship procedure in the eyes of the international community which contributed to its downfall as an effective means of recovering debts of one ship from another: ship owning companies were quick to limit the exposure of their fleets by re-financing their ship into one-ship companies.<sup>158</sup>

Because of the separate legal personalities of such companies, the claimant could proceed only against the ‘guilty ship’.<sup>159</sup> But because ships are notoriously elusive, and even when one is arrested, it usually happens that the amount of the claim exceeds the value of the ship.<sup>160</sup>

When drafting of the South African Act, the ‘brass-plate’ ship owning company was the norm, South Africa adopted an innovative approach to sister ship

<sup>154</sup> Cohen at 880.

<sup>155</sup> John Hare *Shipping Law and Admiralty Jurisdiction in South Africa* 2ed (2009) at 104.

<sup>156</sup> *Ibid.*

<sup>157</sup> The International Convention for the Unification of Certain Rules relating to the Arrest of Sea-Going Ships, Brussels, 1952, Article 3.1.

<sup>158</sup> Hare (note 155).

<sup>159</sup> Hilton Staniland and J S McLennan ‘The Arrest of an Associated Ship’ (1985) 102 *S. African L.J.* 151 at 148.

<sup>160</sup> *Ibid.*

arrest and as a result extended the concept of lifting the corporate veil to a maritime application.<sup>161</sup>

The concept of an associated ship ( The Admiralty Jurisdiction Regulation Act 1983) goes considerably further than the sister ship provision in going behind the separate corporate personality of ship-owning companies to their controlling interests and on the basis of common control, providing that ships are associated.<sup>162</sup>

The effect of the associated ship provisions of the Act is therefore to provide a remedy additional to those contemplated by the sections enabling proceedings in *personam* and in *rem*.<sup>163</sup> Having laid out a brief history of an associated ship concept the following paragraphs consider the justifications for the introduction or fusion of the company law concept of piercing the corporate veil into maritime law. This will be mostly based on Judge Willis's<sup>164</sup> analysis of the justifications for the associated ship arrest.

#### **4.2 Piercing the Corporate Veil**

The principles of company law related to, the doctrine of piercing the corporate veil will not be considered on this occasion as it has already been dealt with in Chapter two. This having been said the following undertaking has been aligned with the background of the general principles of company law, and the general development of maritime law. It is apparent that as a point of departure there is a need to examine the basis upon which the company law doctrine of piercing the corporate veil was extended to apply in maritime law.

#### **4.3 Reasons for the introduction of associated ship provisions**

It all began with the changing pattern of ship ownership that had seen an ever-growing proportion of ship owners moving away from national registries and

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<sup>161</sup>Hare (note 155).

<sup>162</sup> Wallis (note 6) at 1.

<sup>163</sup> Hare (note 154).

<sup>164</sup> Supra (note 6) Chapter 4 of the thesis by Judge Willis considers the concept of piercing the corporate veil in maritime law, why it was recommended and its various justifications.

registering their vessels under flags of convenience, usually in one-ship companies.<sup>165</sup>

The associated ship provisions were introduced, in accordance with the South African Law Commission, in an attempt to defeat the proliferation of single-ship companies variously described as *õ*asset-poor*õ* or *õ*brass-plate*õ* concerns.<sup>166</sup>

Hence a shipowner with having more than one ship could assign his ships to be owned separately by different individual companies, thus ensuring that one ship would not be arrested in respect of a claim against another ship, this occurs because of the legal personalities of such companies, the claimant could proceed against only the guilty ship.<sup>167</sup>

Shaw states that, although often referred to in such pejorative terms as a scheme or device, this was and is a perfectly legitimate utilization of the advantages which the limitation of liability under the company laws is designed to give.<sup>168</sup> The South African courts recognize that in some cases it is proper to disregard the apparent existence of the company because the company is, as it is frequently put, a mere sham or has been set as a step in a fraud. Shaw also states that, cases of this nature may still be relevant despite the associated ship provisions. Reference should be made, to these cases if for instance, it is desired to show that the ship to be arrested although ostensibly owned by company A, is in fact owned by another natural person, whether natural or corporate.<sup>169</sup>

õAccording to the Minister of Justice,<sup>170</sup> the associated ship provision extends a principle of South African law, which can be summarized thus: Although the principle of the sanctity of a separate corporate personality of a company distinct from its members was enshrined in *Salomon v Salmon*, our courts should brush aside the veil of corporate identity time and again where fraudulent use is made if the fiction of legal personality.õ<sup>171</sup>

Wallis argues that close examination suggests that the foundation is lacking for this resort to company law for a justification of the associated ship arrest provisions in their broadest significance.<sup>172</sup> It is submitted that there is a firm foundation already set in terms of the company law doctrine of piercing the veil, the principle is not alien at all, it is a widely recognised principle of law. Hence it should not really pose much of a problem as the courts still have the authority and power to pierce the veil under certain circumstances.

<sup>165</sup> Wallis (note 6 ) at 92.

<sup>166</sup> Hilton Staniland, *The Arrest of Associated Ships in South Africa: Lifting the Corporate Veil Too High?* (1996-1997) 9 *U.S.F. Mar. L.J.* 450 at 410.

<sup>167</sup> *Ibid.*

<sup>168</sup> D J Shaw *Admiralty Jurisdiction and Practice in South Africa* (1987) Juta and Co Ltd at 36.

<sup>169</sup> *Ibid.*

<sup>170</sup> House of Assembly Debates (Hansard) 11 August 1983 col 11172.

<sup>171</sup> Wallis at 96-7.

<sup>172</sup> Wallis (note 6 ) at 97.

It follows that another justification for the introduction of this jurisdiction in maritime law, is that from a business perspective, the registration of vessels in this form is a completely justifiable business decision and has its own advantages.

Wallis states that the nature of the industry is such that from an operational viewpoint shipowners are highly mobile and in a position to take advantage of fiscal benefits and cost savings that arise if they move their base of operations from one jurisdiction to another.<sup>173</sup> Also that there is no reason why their vessels should remain registered in a high-cost, high-tax jurisdiction when they can with equal ease and no disadvantage be registered in a low-cost, low-tax jurisdiction, particularly if their base of operations for the purposes of management can remain the same.<sup>174</sup>

From an economic point of view, Wallis says;

that by creating an entity separate from the natural persons engaged in the business and limiting the liability of those persons a number of purposes can be achieved which are in general conducive to the promotion of investment and entrepreneurial activity.<sup>175</sup>

Professor Manne<sup>176</sup> maintained that limited liability in many enterprises, means they can operate with-out risking a disastrous loss if any corporation under which they have invested becomes insolvent.<sup>177</sup> In other words, the rule facilitated diversification of risk.<sup>178</sup> Furthermore he argued, the rule promotes efficiency because it is less costly for the creditors of a corporation to assess the risks of investment than it is for many small shareholders.<sup>179</sup> Posner asserts that limited liability facilitates a form of transaction advantageous to both investors and creditors; in its absence the supply of investment and the demand for credit might be much smaller than they are.<sup>180</sup>

The underlying argument was originally and remains that by enabling investors to divide their other assets from those of the business and from attack by the creditors of the business or, to a lesser extent, by enabling the business to divide its assets from the assets and liabilities of its investors, the raising of capital is facilitated as the risks involved in the venture are clearly defined at the outset.<sup>181</sup> This in turn promotes entrepreneurial activity for the general benefit of the economy and creates investment markets in which investors can participate secure in the knowledge that

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<sup>173</sup> Ibid at 102.

<sup>174</sup> Ibid.

<sup>175</sup> Ibid at 106.

<sup>176</sup> Manne (note 81).

<sup>177</sup> Ibid at 262.

<sup>178</sup> Roger Meiners, et al "Piercing The Veil of Limited Liability"(1978-19) 4 *Del. J. Corp. L.* 351at 358.

<sup>179</sup> Ibid.

<sup>180</sup> Richard Posner "The Rights of Creditors if Affiliated Corporations"(1976) 43 *U. CHI. L. Rev.* 499 at 503.

<sup>181</sup> Wallis (note 6) at 106-7.

the financial soundness of their fellow investors is in large measure irrelevant to their investment decisions.<sup>182</sup>

Furthermore in justifying the reasons for the introduction of this jurisprudence it is worth discussing the reasons for the formation of groups by companies as this goes in line with the drastic change that took place in the shipping industry (companies establishing subsidiaries to run their ships). The following discussion looks at only five reasons.

(a) Centralised Control and Decentralised Administration

Centralised control in the holding company with decentralised management in its subsidiary makes possible the implementation of a group policy which combines the advantages of large scale production and the efficiency of small- scale production.<sup>183</sup> Separate boards of directors and staffs or administrative officers for each subsidiary may have the effect of enabling those businesses to be operated more efficiently and economically than if from a central point, this way cumbersome management structures can also be avoided.<sup>184</sup>

(b) Unified Financing

The holding company may act as the financial superstructure of the whole group and a subsidiary may find it easier to obtain credit because of its identification with the holding company, the holding company could also finance the whole group which through its size would have easier access to the investing public.<sup>185</sup>

(c) Pyramiding of Companies

This enables the control of subsidiaries by a holding company through the investment of a relatively small amount of capital, this will involve a holding company holding of the minimum amount of shares in a subsidiary to make the latter a subsidiary in terms of section 1(3) of the Act<sup>186</sup> this process will can be repeated many times by subsidiary upon subsidiary.<sup>187</sup> This arrangement in effect makes the control of the whole group possible through control of the ultimate holding company.<sup>188</sup>

(d) The Separation of a Company's Business Activities

The separation of a company's business activities into separate departments by the use of subsidiaries becomes possible in a holding company/ subsidiary relationship, this may be called for where one of the subsidiaries is engaged in a new or risky undertaking and the holding company seeks to limit its potential liability to the

<sup>182</sup> Ibid; also see, Paul Davies, *Gower and Davies Principles of Company Law*, 7ed (2003) 176-180.

<sup>183</sup> David H. Botha "Groups In South African Company Law"(1981) Phd Dissertation University of Pretoria.

<sup>184</sup> Ibid.

<sup>185</sup> Ibid at 101.

<sup>186</sup> Section 1(3) South African Companies Act 61 of 1973.

<sup>187</sup> Supra (note 183) at 101-02.

<sup>188</sup> Ibid.

capital subscribed by it.<sup>189</sup> In this manner the insulation of companies from the creditors of other companies within the group can be achieved.<sup>190</sup>

Having considered the justifications for the introduction of this company law jurisprudence it is important to also examine its application in terms of cases involving associated ship arrest.

#### 4.4 The associated ship provisions

The amended Admiralty Jurisdiction Regulation Act No. 87 of 1992, brought changes to the provisions dealing with associated ship. The definition of an associated ship was altered to incorporate the notion of common law control of the companies owning the vessels.<sup>191</sup> Like the old Act, the new provisions are not retrospective, provision was dealt with in *National Iranian Tanker Co. v The Pericles GC*.<sup>192</sup>

Mr. Justice Shearer held that the test was whether the amendment had brought within its net a company or vessel which was not there before. And if the amendment has so brought a company or vessel which was not there before into the net, the amendment is not retrospective.<sup>193</sup> In the Appellate Division it was held that the amended provisions did not have retrospective effect because it would operate in a manner which prejudiced shipowners by creating burdens or obligations that did not exist before,<sup>194</sup> it would interfere with existing rights and create new burdens.<sup>195</sup> Furthermore, the rights of innocent third parties could be adversely affected by giving the amending Act retrospective operation.<sup>196</sup>

Other relevant amendments dealing with the right to arrest an associated ship include sections 3(6) and 3(7).

Section 3(6) states that subject to the provisions of subsection (9), an action in rem, other than such an action in respect of a maritime claim contemplated in paragraph

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<sup>189</sup> Ibid.

<sup>190</sup> Ibid.

<sup>191</sup> Duncan Butcher "Judging a Ship by the Company it Keeps" (1995) *J.B.L Vol 3*, Issue 3 at 120.

<sup>192</sup> *National Iranian Tanker Co. v MV Pericles GC* 1995 (1) SA 475 (A).

<sup>193</sup> *The PERICLES GC*, No. A238/92, at 3.

<sup>194</sup> Tanker (note 192) at 484G(A).

<sup>195</sup> Ibid Tanker at 485H.

<sup>196</sup> Ibid at 485G.

(d) of the definition of 'maritime claim', may be brought by the arrest of an associated ship instead of the ship in respect of which the maritime claim arose.<sup>197</sup>

This section appears to restrict the use of the associated ship provisions to action *in rem*, so where a claimant would ordinarily proceed *in rem*, they are given the option of proceeding against the vessel concerned or against an associated ship.<sup>198</sup>

As provided for in section 3(4), actions *in rem* may be enforced where; (a) the claimant has a maritime lien over the property to be arrested; or (b) if the owner of the property to be arrested would be liable to the claimant in an action *in personam* in respect of the cause of action concerned. Whist section 3(4) read with section 3(5) provides that property, other than just the ship may be arrested to enforce an action *in rem*, section 3(6) limits the associated provisions to only one type of maritime property, namely the associated ship.

If the claimant therefore has a maritime claim which gives rise to a maritime lien or, in respect of which the owner of the associated ship is liable to the claimant *in personam* the associated ship may be arrested instead of the ship in respect of which the claim arose.<sup>199</sup>

In *The Fayrouz IV*<sup>200</sup>, the Court held however that: 'it is important that the associated ship provisions are intended to provide an alternative method of enforcing the claim *in personam* by an arrest if another ship instead of the guilty ship. The claim *in personam* remains even when an arrest is affected and an action *in rem* has been thus brought or instituted.'<sup>201</sup> The court concluded that sections 3(6) and (7) provide an extension of the remedy provided by section 3(5) and an alternative action *in rem*.<sup>202</sup>

Furthermore section (3) (7) (a) of the Act defines an associated ship;

as a ship, other than the ship in respect of which the maritime claim arose owned, at the time when the action is commenced, by the person who was the owner of the ship concerned at the time when the maritime claim arose;<sup>203</sup> or owned, at the time when the action is commenced, by a person who controlled the company which owned the ship concerned when the maritime claim arose;<sup>204</sup> or owned, at the time when the action is commenced, by a company which is controlled by a person who

<sup>197</sup> Section 3(6) Admiralty Jurisdiction Regulation Act 105 of 1983, (as amended in 1992).

<sup>198</sup> Craig Cunningham -The Arrest of An Associated Ship In Terms of section 5(3) of the Admiralty Jurisdiction Regulation Act No 105 of 1983( as amended) Unpublished LLM thesis The Burden of Proof (1999) University of Cape Town at 7.

<sup>199</sup> Ibid at 8.

<sup>200</sup> *October International Navigation Inc. v MV Fayrouz IV* 1988(4) SA 675 (N).

<sup>201</sup> Ibid October at 678.

<sup>202</sup> Ibid at 679.

<sup>203</sup> Section 3(7)(a)(i) of the Admiralty Jurisdiction Regulation Act 105 of 1983, (as amended in 1992).

<sup>204</sup> Section 3(7)(a)(ii).

owned the ship concerned, or controlled the company which owned the ship concerned, when the maritime claim arose.<sup>205</sup>

It is the provisions that institute an association through common control that have no parallel in other maritime jurisdiction and that distinguish the South African associated ship arrest provision from sister ship or surrogate ship arrest provisions elsewhere.<sup>206</sup> It is these provisions that contribute to South Africa's reputation as an arrest friendly jurisdiction.<sup>207</sup>

The section is supplemented by section 3(7)(b), this section provides support in establishing an associated ship during common ownership or control in the form of a deeming provision.<sup>208</sup>

Under the unamended provisions of section 3(7) of the 1983 Act, the guilty ship and the other ship are associated if the associated ship was owned by a company in which the shares, when the maritime claim arose, were controlled or owned by a person who then controlled or owned the shares in the company which owned the guilty ship.<sup>209</sup>

Several judgments have pointed out that control of the shares of a company is a different matter from control of the company itself.<sup>210</sup> The question of what constitutes control was first dealt with by the court in *EE Sharp & Sons Ltd v MV Nefeli*,<sup>211</sup> the case involved an admiralty action *in rem* for the attachment of the ship Nefeli. The ship was registered in Panama and owned by a Greek Company. The applicant's maritime claims were in respect of goods supplied to the vessels alleged to be associated with the ship or sister ships. The question was whether similar orders could be granted to enforce the claims against the associated ship in terms of section 3(6). All the ships concerned were owned by separate companies.

King AJ observed;

“this is precisely the situation which the section is intended to create for, namely a series of ‘one ship’ companies, all controlled by the same interests, but previously because of their separate legal personalities immune from attachment in respect of debts incurred in respect of the sister ship.”<sup>212</sup>

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<sup>205</sup> Section 3(7)(a)(iii).

<sup>206</sup> Graham Bradfield ‘Guilt by Association in South African Admiralty Law’ [2005] *L.M.C.L.Q.* 234 at 236.

<sup>207</sup> *Ibid* Graham.

<sup>208</sup> *Ibid*.

<sup>209</sup> Hilton (1996-97) (note 166) at 413.

<sup>210</sup> Wallis (note 6) at 201.

<sup>211</sup> *EE Sharp & Sons Ltd v MV Nefeli* 1984(3) SA 325 (C).

<sup>212</sup> *Ibid* at 326 H.

King AJ granted the application, basing his decision on the deeming provision contained in paragraph (b) (ii):<sup>213</sup> stating, 'in my view this relates to overall control, such as is exercisable for instance by a majority shareholder or his nominee, of the assets and destiny of the company; it does not refer to its day to day management and administration.'<sup>214</sup>

In *Zygos Corporation v. Salen Rederierna AB*,<sup>215</sup> Mr Justice Friedman observed that for the purposes of section 3(7), in its original form, it is possible for a person to control a company without necessarily controlling the shares in that company.<sup>216</sup> Similarly, Mr. Justice Majid has pointed out that 'there is a vast conceptual and factual difference between control of the management of a company's affairs and control of the shares in that company.'<sup>217</sup> These views have been confirmed by the Appellate Division.<sup>218</sup>

Control over a company can be exercised, for instance, without a majority shareholding where voting rights are not commensurate with shareholding, or where 'pyramiding' takes place.<sup>219</sup> That consideration, together with the appreciation that actual control or ownership of shares may be extremely difficult to prove (especially since such matters are not made public in some jurisdictions), resulted in the 1992 amendment so that control of a company is no longer linked to control of ownership of shares.<sup>220</sup> In other words, under the amended section 3(7), control of the company relevant in determining real power, in contrast to control or ownership of the shares under the original provision.<sup>221</sup>

Another difficulty, has been the explanation of the expression 'power, directly or indirectly, to control in section 3(7)(b)(ii) which provides that a person shall be deemed to control a company if he has power, directly or indirectly, to control the company.'

In *MV Heavy Metal Belfry Marine Ltd v Palm Base Maritime SDN BHD*,<sup>222</sup> the vessel arrested as an 'associated' ship was owned by a corporation whose common shareholder and only director was one Lemonaris, a Cypriot advocate.

<sup>213</sup> Section 7(b)(ii) of the Admiralty Jurisdiction Regulation Act 105 of 1983.

<sup>214</sup> Sharp (note 211) at 326-7.

<sup>215</sup> *Zygos Corporation v. Salen Rederierna AB* 1985(2) SA 486 (C).

<sup>216</sup> *Ibid* at 489B.

<sup>217</sup> *Hilton* (1996-97) (note 166) at 414.

<sup>218</sup> *Ibid*; *The Pericles GC*, 1995(1) SA 475, 485B(A); *Dole Fresh Fruit Int'l Ltd. v. The KAPETAN LEONIDAS* (1995) (3) SA 112, 119F-G(A).

<sup>219</sup> *Hilton* (1996-97) at 414.

<sup>220</sup> *Ibid*

<sup>221</sup> *Ibid*.

<sup>222</sup> *MV Heavy Metal Belfry Marine Ltd v Palm Base Maritime SDN BHD* 1999 (3) SALR 1083 (SCA).

That in itself would have been sufficient to establish common control had the facts not been complicated by his assertion that he was a merely the nominee shareholder for different beneficial or actual holders of the shares in each of the shipowning companies.<sup>223</sup> It had, in fact, been conceded on the arresting creditor's paper that Mr Lemonaris was probably a nominee and merely a post-box.<sup>224</sup>

The matter was further complicated by the fact that Mr Lemonaris contended initially that the laws of Cyprus precluded him from divulging the identity of the actual or beneficial owners of the shares in the respective shipowning companies.<sup>225</sup> The court *a quo* dismissed an application to set the arrest of the Heavy Metal aside.<sup>226</sup>

Having gone on appeal to the Supreme Court of Appeal the issue of the interpretation of the phrase "the power, directly or indirectly, to control," was considered;

the majority of the court which was split three to two on this issue held that the section identified two sources of possible control: direct and indirect control.<sup>227</sup> It equated "direct control" in the Act with *de jure* control of the company, namely the control exercised by the registered majority shareholder as the person who, according to the register of the company controls its destiny.<sup>228</sup>

Indirect control, it held, meant *de facto* control of the company, namely the power to control a company that would be wielded through someone who had direct control of the company, as would be the case with the beneficial or actual owner holding shares in a company through a nominee.<sup>229</sup>

If the same person, so the reasoning continued, exercised *de jure* power to control both the company owning the "guilty" ship and the company owning the targeted ship, the statutory nexus between the ships would be established, if the *de jure* control resided in different hands, it would be open to the arresting creditor establish that the same person, or entity was in *de facto* control.<sup>230</sup>

On this interpretation of the wording of the section and the facts then, Mr Lemonaris as registered majority shareholder was the person in direct control of both companies at the relevant time, as to the identities of the indirect controllers of the shares in the respective companies. The court was confronted with the refusal to identify both those persons and the uncorroborated assertion that they were not one and the same.<sup>231</sup>

To the majority the word "or" in "directly or indirectly, to control," meant the arresting party could rely on either form of control, since common arrest has been

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<sup>223</sup> Ibid at 1090B-D, [13].

<sup>224</sup> Ibid, at 10891, [11].

<sup>225</sup> Graham, (note 206) at 245.

<sup>226</sup> Ibid.

<sup>227</sup> MV (note 222) at 1106C, [9] and 1107D[14].

<sup>228</sup> Ibid at 1106E-F, [10].

<sup>229</sup> Ibid at 1106D, [9].

<sup>230</sup> Graham (note 206) at 245.

<sup>231</sup> Ibid.

established, the arresting creditor had an association between the vessel and the arrest had to stand.<sup>232</sup>

For an associated ship to be liable for arrest, it is sufficient if it is owned at the time when the action is commenced by a natural person or company, or any other juristic person and body of person, irrespective of whether or not any interest therein consists of shares<sup>233</sup> this provision applies to all forms of corporate ownership of ships by virtue of section 3(7)(a)(iii) which provides that a company includes any other juristic person and any body of persons irrespective of whether any interest therein consists of shares. It does however ensure that whatever form of corporate ownership may be adopted in relation to a ship it will be possible to apply the associated ship provision in relation thereto.<sup>234</sup>

So where a natural person owns the guilty ship directly and also owns the associated ship indirectly through a company, that ship may be subject to arrest.<sup>235</sup> It follows that the new amendment to section 3(7) now casts the net of liability much wider: it equates the owner of the ship with any charterer (whether it be demise, time or voyage charterer) with the owner of the ship.<sup>236</sup>

#### **4.5 The Provisions as an Extension of Existing Rights and Remedies**

Diverse views have been articulated on the associated ship provisions. These provisions have been viewed as an extension of the existing rights and remedies, firstly by the South African Law Commission, who when motivating for the introduction of the associated ship provisions described them as a logical extension of the notion of the arrest of a sister ship under the Convention.<sup>237</sup>

Secondly according to the Minister of Justice, the associated ship provisions merely extended a fundamental principle of South African company law.<sup>238</sup> A third reason for viewing the provisions merely as extension of existing rights and remedies is, of course, the civil law tradition in South Africa of the attachment of any property of the defendant within the jurisdiction.<sup>239</sup> The tradition meant that arrest of a ship

<sup>232</sup> Ibid at 245-6.

<sup>233</sup> Hilton (1996-97) (note 166) at 412.

<sup>234</sup> Wallis (note 6) at 207.

<sup>235</sup> Hilton (1966-97) (note 151) at 413.

<sup>236</sup> Ibid 415.

<sup>237</sup> Ibid at 417.

<sup>238</sup> Hansard (note 170).

<sup>239</sup> Hilton (1996-97) (note 151) at 418.

other than the guilty ship would not, as a concept, be entirely new; albeit that the purpose of an arrest *in rem* of an associated ship is different from the attachment of any property of a foreign defendant within the jurisdiction of the court.<sup>240</sup>

When the Colonial Court of Admiralty had jurisdiction over the maritime claims there was no need to arrest the ship *in rem* to find jurisdiction, the action *in rem*, the foundation of which was a maritime lien or claim upon the *res*, commenced with the issues of the writ of summons and was thus dependent upon a common law arrest to found jurisdiction of the court.<sup>241</sup>

Finally, the notion of the arrest or attachment of property, apart from the guilty ship, is back dated to the early history of the English and hence South African Admiralty Court, so for these reasons, the associated ship provisions were not entirely new, at least in concept.<sup>242</sup>

#### 4.6 The Unique Character of the Provisions

The associated ship provisions are strange, even heretical, from the prospective of an English lawyer; but they are not unknown by such lawyers who frequently have their provisions invoked in South Africa in order to provide security for litigation or arbitration contemplated, pending, or proceeding in London.<sup>243</sup>

The associated provisions are unorthodox because they clearly abscond from the fundamental principle of company law, the provisions allow a ship which is owned by a corporation to be arrested for a maritime claim against another ship, provided the two companies are subject to the same control, under English company law the position is different. As Lord Justice Templeman puts it: "A parent company may spawn a number of subsidiary companies, all controlled directly or indirectly by the shareholders of the parent company. If one of the subsidiary companies, to change the metaphor, turns out to be the runt of the litter and declines into insolvency to the dismay of the creditors, the parent company and the other subsidiary companies may prosper to the joy of the shareholders without any liability for the debts of the

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<sup>240</sup> Ibid.

<sup>241</sup> Ibid.

<sup>242</sup> Ibid.

<sup>243</sup> Ibid at 417.

insolvent subsidiary.<sup>244</sup> The departure from these principles, so long established and unchallengeable, constitute the novelty of the associated ship provisions.<sup>245</sup>

The adoption of the associated ship concept in South African admiralty law has not been followed by other jurisdictions that introduced or reformed their admiralty practices after the enactment of the South African Act.<sup>246</sup> The Australian Law Commission recognised that some form of corporate veil provision would be advantageous for local interests but ultimately rejected the idea.<sup>247</sup> They are of the view that enacting statutory veil piercing provisions might lead to inconsistencies in the approach to corporate veil piercing.<sup>248</sup>

Hilton says, under the South African statutory veil piercing regime in relation to ship arrests, there is a fundamental difference in approach to the remedy of veil piercing between the context of shipping companies and other contexts. He also asserts that under the associated ship arrest provisions, veil piercing is available as a matter of course and not as an exceptional remedy.<sup>249</sup> It follows also that the tests for veil piercing, namely what the corporation is either a mere facade or that there has been a failure to maintain the separate existence of the corporation, are irrelevant, it is presumed that this is so in every instance and there is no question of the exercise of any given instance.<sup>250</sup>

The associated ship provision are not content merely to lift and let fall the veil in special circumstances, once the association is established in one claim, all the ships of the associated company may stand exposed to arrests for other claims as well.<sup>251</sup>

#### 4.7 Conclusion

The new provisions seem to have resolved the problems that were being experienced by creditors by providing them with an option to arrest an associated ship, even though they are owned different companies. They disregard the principle that because companies have separate legal personalities, a ship owned by one company cannot, as the traditional rule, be arrested in respect of a claim brought against the guilty ship.

<sup>244</sup> *Re Southard & Co.* [1979] 3 All E.R. 556, 565.

<sup>245</sup> Hilton (note 151 ) at 419.

<sup>246</sup> Graham (note 190) at 248.

<sup>247</sup> *Ibid.*

<sup>248</sup> *Ibid.*

<sup>249</sup> *Ibid.*

<sup>250</sup> *Ibid.*

<sup>251</sup> Hilton (1996-7) (note 151) at 423.

This allows a maritime creditor to arrest an associated ship instead of the guilty ship if at the time the claim is sought to be enforced the ship to be arrested is owned by a person, or by a company controlled by a person, who at the time the claim arose, owned the ship, or controlled the company that owned the ship in respect of which the claim arose is to permit the maritime creditor, as a matter of course, to look past the separate corporate entity that owns the vessel to the entity's controller.<sup>252</sup>

The provisions may be described as a statutory mode of the of piercing the corporate veil. Shipowning companies are treated, as a matter of course, as mere facades concealing the identity of the true debtor, once the identity of the debtor is established, any ship, other than the guilty vessel, owned or controlled by the true debtor may be arrested as an associated ship to enforce the maritime claim in question.<sup>253</sup>

One argument against the introduction of this jurisdiction is it that may require more severe attention in the case of a shipping line that has fallen upon difficult times and is seeking to restructure its operations by disposing of vessels that cannot be operated profitably.<sup>254</sup>

The Australian Law Commission had at first recognised the introduced of some sort of corporate veil provision ended up rejecting it. The commission laid down some very strong arguments against the introduction of this jurisdiction, that the issue has no particular or peculiar maritime aspect, but is a general issue raised by the ability to set up corporate bodies. It was suggested that this issue is much better dealt with as a subject of general law, instead of admiralty jurisdiction. Arguably, the general law at present strikes the appropriate balance in leaving the corporate veil intact, cases of fraud apart.<sup>255</sup>

Secondly, allowing the veil to be lifted in admiralty has the potential to complicate further what is already a highly complicated matter. Even further complications would occur if there is insolvency in admiralty involving some or all of the same assets as a corporate insolvency under general law.<sup>256</sup>

The application of the associated ship arrest provision to shipowning companies has generated inconsistencies in the approach to piercing the corporate veil beyond those envisaged at the time of the introduction of the provisions. Such inconsistencies may

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<sup>252</sup> Hilton (note 159) at 236.

<sup>253</sup> Ibid.

<sup>254</sup> Wallis (note 6) at 122-3.

<sup>255</sup> Civil Admiralty Jurisdiction (ALRC Report 33) at 139. Available at <http://www.austlii.edu.au/au/other/alrc/publications/reports/33/8.html#fnB154> [Accessed on 18/01/11].

<sup>256</sup> Ibid.

be still tolerable on the grounds that justified the introduction of the differential treatment of shipowning companies under the associated ship arrest provisions.<sup>257</sup>

It is unfortunately in the absence of a reasoned alternative the language that our courts continue to use, whether as a result of habit, a failure of analysis or as fig leaf to cover the otherwise inexplicable is difficult to tell. One would have thought that more than twenty-five years of the associated ship jurisdiction being invoked against perfectly respectable groups of companies that are plainly not constituted through one-ship companies for any dishonest or dishonourable purpose would have caused the courts to pause for reflection before repeating this tired old mantra, but there is no sign in their judgments that they have done so.<sup>258</sup>

It is submitted that besides the Australian commission's arguments the South African courts appear to not to have difficulties, of course previously the issues of retrospective effect was, a problem as Parliament did not state whether the amending Act was retrospective, as mentioned above this problem was dealt with and clarified in *MV Pericles* as discussed above.

Besides the difficulties and complications that revolve or surround the company law doctrine of veil piercing, the Australian Law commission refer to the general law not of admiralty jurisdiction to deal with the issue. It is argued that there is still a need for something more concrete than just general law, and not the doctrine of piercing the veil is the way forward as it is the only principle in this case which seems to fit in with the issues that come to light when dealing with associated ship provisions. At the end of it all results are being seen as this principle insures that the right people are held liable and cannot hide behind their companies.

Clearly the justifications for the introduction of this jurisdiction (company law) into Admiralty jurisdiction show that this is the right path to take in dealing with associated ship arrests, despite some of the criticism note above. One could argue that there is no reason why a guilty party should go scotch free because he claims that the one ship is owned by a different company which he in turn controls. This also encourages companies to be more conscious about their day to day operations as they can now be liable for by arrest of the associated ship rather than the guilty ship.

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<sup>257</sup> Graham (note 206) at 252.

<sup>258</sup> Wallis (note 6) at 103-4.

## 5. CHAPTER FIVE: CORPORATIONS

### 5.1 Criminal Liability of Corporations

The increase in corporate crime, including breaches of health and safety regulations and environmental degradation perpetrated by companies, as well as the failure of public authorities to protect persons in danger, have led countries to the realisation that comprehensive criminalisation, based on a coherent theory of corporate liability is required.<sup>259</sup>

There are a number of theories of corporate liability; (i) the principle of identification which attributes the conduct and state of mind of certain high-ranking officers in the corporation (representing the directing mind and will of the corporation) to the corporate body thus rendering the corporate body directly liable. (ii) the principle of aggregation where a conviction is based on a derivative, but collective, responsibility determined by the aggregation of conduct and states of mind within the corporation; and (iii) an organisational model of liability that determines fault by examining the institutional practices and corporate policies of the institution.<sup>260</sup>

The traditional approach to the criminal law is that only a natural person is capable of performing an unlawful act with a blameworthy state of mind.<sup>261</sup> The current approach to criminal liability of corporations in South Africa is in, fact based on derivative liability (in which the conduct and fault of the agent or servant of the corporation is imputed to the corporation).<sup>262</sup>

This derivative approach of corporate criminal liability has been questioned by legal writers in a number of common law jurisdictions. Various proposals for reform have emerged, the most innovative of which is a rejection of derivative liability in favour of a model envisaging direct corporate liability, and others concerning the creation of specific corporate offences involving negligence.<sup>263</sup>

### 5.2 Derivative Models of Corporate Criminal Liability

#### (a) Vicarious liability

In criminal law no such general principles of vicarious liability is recognised, indeed the general rule of the common law is that a person is not liable for the crime of another unless he authorised or procured its commission or took part in it.<sup>264</sup>

Even so various forms of liability have played an important role in the history of corporate criminal liability. As early as 1939, the South African legislature created a

<sup>259</sup>Burchell (note 9) at 562.

<sup>260</sup>Ibid.

<sup>261</sup>Jordaan (note 10) at 48.

<sup>262</sup>Burchell (note 9) at 563.

<sup>263</sup>Jordaan (note 10) at 49.

<sup>264</sup>Burchell at 555.

very wide form of corporate criminal liability based essentially on the principle of vicarious liability. Its essential provisions but are found today in section 332(1) of the Criminal Procedure Act, the theoretical basis of the legislation is clearly that a corporate body per se is incapable of performing an *actus reus* and also incapable of blameworthy state of mind.<sup>265</sup>

Section 332(1) provides as follows:

(1) For the purpose of

imposing upon a corporate body criminal liability for any offence, whether under any law or at common law— (a) any act performed, with or without a particular intent, by or on instructions or with permission, express or implied, given by a director or servant of that corporate body; and (b) the omission, with or without a particular intent, of any act which ought to have been but was not performed by or on instructions given by a director or servant of that corporate body, in the exercise of his powers or in the performance of his duties as such director or servant or in furthering or endeavouring to further the interests of that corporate body, shall be deemed to have been performed (and with the same intent, if any) by that corporate body or, as the case may be, to have been an omission (and with the same intent, if any) on the part of that corporate body.<sup>266</sup>

Section 332(1) removes the obstacle to impose criminal liability upon an artificial person that cannot be found guilty of a crime requiring fault since it has no mind. In terms of the subsection, where a corporation is charged with such a crime the fault of the director or servant who committed the crime will be imputed to the corporation, thus in *R v Bennett & Co (pty) Ltd*<sup>267</sup> the negligence of an employee was imputed to the company, resulting in a conviction of the of latter culpable homicide.<sup>268</sup>

This section also covers or includes negligence and strict liability, which was confirmed by the Supreme Court of Appeal in *Ex parte Minister van justice: In re S v Suid-Afrikaans Untisaai-korporaie*.<sup>269</sup> Section 332(1) expressly renders the corporate body liable where, in committing the crime, the director or servant acted beyond his powers or duties, but was nevertheless -furthering or endeavouring to further the interests of the corporation.

Liability under the section, therefore, extends beyond the normal limits of vicarious responsibility where the principle or master is liable only if the agent or servant acted within the scope of his authority or employment.<sup>270</sup> A distinction should be drawn between a director or servant of a corporation who is acting solely for his own

<sup>265</sup> Jordaan (note 10) at 50.

<sup>266</sup> Section 332(1) Criminal Procedure Act 51 of 1977.

<sup>267</sup> *Rv Bennett & Co (pty) Ltd* 1941 TPD 194.

<sup>268</sup> Burchell (note 9 ) at 566.

<sup>269</sup> *Ex parte Minister van justice: In re S v Suid-Afrikaans Untisaai-korporaie* (1992) (4) SA 804 (A) at 807.

<sup>270</sup> Burchell (note 10) at 566.

personal interests and one who is acting in furtherance, or attempted furtherance, of the corporation's interest. The former individual should not render the corporation liable for any crimes committed in furtherance of his own interests, while the latter should render the corporation liable under section 332(1).<sup>271</sup>

The objection to vicarious liability, that it creates liability without an enquiry into fault, applies also to corporate bodies; the distinguishing features of corporate bodies do not shield them from any penal costs of a criminal conviction.<sup>272</sup>

Although section 332(1) has not as yet been scrutinised from a constitutional perspective, a number of South African legal writers have questioned its wide ambit, for instance, Du Plessis suggests that criminal liability of corporate bodies should not extend beyond crimes committed by the organs that represent the directing mind and will of the corporate body. She finds support for this point of view in the doctrine of identification, applied in Anglo-American law to establish corporate liability for crime requiring culpability.<sup>273</sup>

### **(b) The doctrine of identification**

The idea that corporations can be criminally liable like humans can seem strange, since a corporation cannot perform any acts except through human individuals or have a state of mind independently of one or more individuals within the organisation.<sup>274</sup> The courts have invented the fiction that acts and state of mind of certain senior managers or officials are the acts and state of mind of the corporation, what the senior executive does is identified, and becomes the acts of the company itself.<sup>275</sup>

In some versions of the doctrine, these personnel are said to represent the 'directing mind' of the corporation.<sup>276</sup> Lord Denning's metaphor in the civil case of *H.L. Bolton (Engineering) Co. v. T.J. Graham & Sons, Ltd*,<sup>277</sup> explains the notion:

'A company may in many ways be likened to a human body. It has a brain and nerve centre which controls what it does. It also has hands which hold the tools and act in accordance with directions from the centre. Some of the people in the company are mere servants and agents who are nothing more than hands to do the work and cannot be said to represent the mind or will. Others are directors and managers who represent the directing mind and will of the company, and control what it does. The

<sup>271</sup> Ibid.

<sup>272</sup> Jordann (note 9) at 53.

<sup>273</sup> Ibid.

<sup>274</sup> Russell Heaton *Black Stones Learning Texts Criminal law* 2 ed (1998) at 414.

<sup>275</sup> Ibid Heaton.

<sup>276</sup> Eric Colvin, 'Corporate Personality and Criminal Liability' (1995) 6 *Crim.L.F.* 1 at 8.

<sup>277</sup> *H.L. Bolton (Engineering) Co. v. T.J. Graham & Sons, Ltd* [1957] 11 QB 159.

state of mind of these managers is the state of mind of the company and is treated by the law as such.<sup>278</sup>

There is judicial power which insists that corporate liability on the foundation of identification is theoretically quite separate from vicarious liability.<sup>279</sup> In light of the identification doctrine, the company's guilt is demonstrated rather than attributed to it, yet a scrutiny of those terms reveals identification to be cognate to vicarious liability.<sup>280</sup>

Over time, the doctrine became well embedded in both civil and criminal law and, with familiarity, an increasingly liberal approach was taken to the question of which corporate officials could be identified with the company, this liberality was checked by the House of Lords decision in *Tesco Supermarkets Ltd v Natrass*<sup>281</sup> where it was ruled that only individuals at the apex of the corporate hierarchy could be identified with the company.<sup>282</sup>

Lord Diplock took a rigid and formal approach to this question: only officials granted plenary authority in the articles of association over a company's affairs could be so identified. For him, that would include the board of directors making decisions on behalf of the company, together with the chief executive and possibly, any other executive possessing plenary authority for the activity at issue in a particular case.<sup>283</sup> Lord Reid too, required a plenary authority as opposed to a delegated responsibility but was prepared to look at substance as well as form; he did not make a grant of authority in the articles of association a precondition for identification.<sup>284</sup>

The narrowness of the doctrine has been a major obstacle in obtaining corporate convictions in the United Kingdom. In *R v P & O European ferries (Dover) Ltd*,<sup>285</sup> for instance, where the defendant company was charged with manslaughter following the Zeebrugge sinking, the ship's master was found not to be a person who could be identified with the company. This was dealt with similarly in *R v Redfen and Dunlop Ltd*<sup>286</sup> (aircraft division), where Dunlop Aviation (Europe) was charged with knowingly exporting combat equipment to Iran in contravention of agreed sanctions. The facts of the matter were known to the European sales manager but he was considered insufficiently important in Dunlop's scheme of things to be

<sup>278</sup> Ibid at 172.

<sup>279</sup> G.R Sullivan 'The Attribution of Culpability to Limited Companies' (1996) 55 *Cambridge L.J.* 515 at 518.

<sup>280</sup> Ibid.

<sup>281</sup> *Tesco Supermarkets Ltd v Natrass* [1972] AC 153.

<sup>282</sup> AP Simester et al *Simester and Sullivan's Criminal Law Theory and Doctrine*, 4 (2010) at 275.

<sup>283</sup> Ibid.

<sup>284</sup> Ibid.

<sup>285</sup> *R v P & O European ferries (Dover) Ltd* (1991) 93 Cr App R 73.

<sup>286</sup> *R v Redfen and Dunlop Ltd* (1996) Crim LR 43.

identified with his company. Such outcomes have led to criticisms of the identification principle.

Jordaan states that the main objections to this approach is that, the doctrine as applied in English law does not reflect modern corporate practice, particularly in larger companies where decision making is the product of corporate policies and procedures on various levels in the organisation, rather than that of a single individual at the top level.<sup>287</sup>

Fisse and Braithwaite explain:

-Offences committed on behalf of large concerns are often visible only at the level of middle management whereas the principle [of identification] requires proof of fault on the part of a top-level manager. By contrast, fault on the part of a top-level manager is much easier to prove in the context of small companies. Yet that is the context where there is usually little need to impose corporate criminal liability in addition to individual criminal liability.<sup>288</sup>

An objection to the doctrine of identification is that it distorts the allocation of liability between large and small corporations, while in fact many significant decisions in large corporations are taken at the level of branch or at the level of middle management.<sup>289</sup> A corporation will be insulated from liability for these decisions unless the identification doctrine is given very broad scope.<sup>290</sup> Furthermore the identification liability is the same as the vicarious liability in any of its forms, a corporation's liability turns on the conduct of corporate personnel rather than on the presence of corporate fault.<sup>291</sup>

A company may have taken all reasonable precautions to prevent an offence and nevertheless be liable.<sup>292</sup> However, the Supreme Court of Appeal's decision in the *SABC* case,<sup>293</sup> demonstrates that this objection can also be raised in respect of a broad version of vicarious corporate criminal liability as applied in South Africa.<sup>294</sup>

In the United Kingdom, the Law Commission for England and Wales has proposed a statutory version that identifies "controlling officers" as the persons from whom liability may be derived and gives the following definition of this class: "Controlling officer" of a corporation means a person participating in the control of the corporation in the capacity of a director, manager, secretary or other similar officer (whether or not he was, or was validly, appointed to any such office).<sup>295</sup> The Supreme Court of Canada, in *Canadian Dredge & Dock*,<sup>296</sup> endorsed the basic principle of *Tesco Supermarkets* but qualified its

<sup>287</sup> Jordaan (note 10 ) at 55.

<sup>288</sup> Brent Fisse and John Braithwaite -The Allocation of Responsibility for Corporate Crime: Individualism, Collectivism and Accountability(1988) 11 *Sydney L.Rev.* 468 at 504.

<sup>289</sup> Colvin (note 276) at 15.

<sup>290</sup> Ibid.

<sup>291</sup> Ibid .

<sup>292</sup> Jordaan (note 10) at 56.

<sup>293</sup> *Ex parte* (note 269).

<sup>294</sup> Jordaan at 56.

<sup>295</sup> Colvin (note 276) at 10.

<sup>296</sup> *Canadian Dredge & Dock Co.v.R.*[1985] 1 S.C.R.662 (Can.).

application in a way that could extend the scope of corporate liability under the identification theory.<sup>297</sup>

The Supreme Court agreed with the House of Lords that the key idea is that of a "directing mind" with whom the corporation can be identified. The Court rejected, however, any notion that a corporation necessarily has a single directing mind, wielding centralized authority; Justice Estey argued that the organizational structures of many modern corporations divide authority in a way that creates more than one directing mind<sup>298</sup>: "[A] corporation may . . . have more than one directing mind. This must be particularly so in a country such as Canada where corporate operations are frequently geographically widespread. The transportation companies, for example, must of necessity operate by the delegation and sub-delegation of authority from the corporate centre; by the division and subdivision of the corporate brain; and by decentralizing by delegation the guiding forces in the corporate undertaking. The application of the identification rule in Tesco may not accord with the realities of life in our country, however appropriate we may find to be the enunciation of the abstract principles of the law made."<sup>299</sup>

In the United States, the position in relation to State criminal laws is more complex, some states have adopted more sophisticated statutory provisions concerning corporate liability, based, in some cases, on the Model Penal Code.<sup>300</sup> Although no mention is made of a 'directing mind,' the Code, inter alia, makes a corporation liable for the conduct of its board of directors or any 'high managerial agent' acting on behalf of the corporation.<sup>301</sup>

The U.S. formulations appear to place more stress than do the Commonwealth ones on the idea that the conduct should, in some sense, reflect corporate policy, moreover, some formulations have required that corporate management "tolerate" the activity.<sup>302</sup> This requirement, however, is interpreted loosely, so that tolerance may be diagnosed even in the face of an express prohibition.<sup>303</sup>

Some recent Australian and Canadian proposals for the codification or recodification of criminal law have recommended an expansion of corporate liability beyond the scope of the Tesco Supermarkets principle. More radical proposals for organizational liability are contained in the Australian Model Criminal Code.<sup>304</sup>

Nevertheless, the Model Criminal Code does include a version of the identification doctrine as one of the ways of establishing corporate liability for offenses involving subjective fault. The formulation, like that of the U.S. Model Penal Code, allows the

<sup>297</sup> Supra Colvin (note 295).

<sup>298</sup> Ibid.

<sup>299</sup> Canadian (note 296) at 693.

<sup>300</sup> Allens A. Robinson -Corporate culture as a basis for the criminal liability of corporations prepared for the United Nations Special Representative of the Secretary- General on Human Rights and Business February 2008.[ Accessed at <http://198.170.85.29/Allens-Arthur-Robinson-Corporate-Culture-paper-for-Ruggie-Feb-2008.pdf>] on 24/01/2011.

<sup>301</sup> Jordaan (note 10) at 56.

<sup>302</sup> Colvin (note 276) at 11.

<sup>303</sup> Ibid.

<sup>304</sup> Ibid at 11-12.

culpability of the board of directors or of a "high managerial agent" to be transferred to the corporation, "high managerial agent" is defined as "a servant, agent or employee or officer of the body corporate with duties of such responsibility that his or her conduct may fairly be assumed to represent the policy of the body corporate."<sup>305</sup>

There has been some disagreement about the nature of identification liability and its relationship to vicarious liability. The simplest and most sensible explanation is that identification liability is a modified form of vicarious liability, under which the liability of a restricted range of personnel is imputed to a corporation. Instead of all employees and agents having the capacity to make the corporation liable, only some category of persons with directorial or managerial responsibilities has this capacity.<sup>306</sup>

### (c) The principle of aggregation

The third basis of corporate liability is the aggregation theory which allows the aggregate or combined fault of a number of individuals, each of whom in himself lacks the required means to be imputed to the company thus fixing it with liability.<sup>307</sup> The aggregation theory is based on the view that frequently no one individual within a company was sufficiently at fault but that cumulatively the organisation might be considered to possess the requisite of fault.<sup>308</sup>

The principle of aggregation has been applied in American federal law to establish corporate criminal liability.<sup>309</sup> In the leading case, *United States v Bank of New England*<sup>310</sup>, the court concluded that the bank would be liable if some of its personnel knew about the reporting requirement and disregarded it, even if this requirement were not known to those personnel who knew of the transactions in issue. The court endorsed the concept of "collective knowledge" in the context of complex organizations:<sup>311</sup>

“A collective knowledge instruction is entirely appropriate in the context of corporate criminal liability. . . . Corporations compartmentalize knowledge, subdividing the elements of specific duties and operations into smaller components. The aggregate of those components constitutes the corporation's knowledge of a particular operation.”<sup>312</sup>

The concept of collective knowledge, in its all-encompassing meaning, deals with situations that previous models had left unattended. It seeks to expand the liability of legal bodies to include additional events, beyond the scope of previous doctrines. In this sense, collective knowledge relates to previous doctrines of liability

<sup>305</sup> Ibid.

<sup>306</sup> Ibid. Colvin at 13.

<sup>307</sup> Finbarr Mc Auley and J.Paul McCutcheon *Criminal Liability* (2000) at 390.

<sup>308</sup> Ibid.

<sup>309</sup> Jordann (note 10) at 58.

<sup>310</sup> *United States v Bank of New England* 821 F2d 844(1<sup>st</sup> Cir), cert denied, 484 US 943 (1987).

<sup>311</sup> Colvin (note 276) at 19.

<sup>312</sup> *Bank of New England* 821 F2d (note 310) at 856.

as the theory of direct liability relates to the vicarious liability doctrine.<sup>313</sup> The aggregation model allows for the conviction of legal bodies within the broad-scoped vicarious doctrine of respondent superior, which is dominant in American law, by linking the thoughts of different agents of the legal body and thus creating the required mental element. The body of knowledge in possession of each of the various agents is attributed to the corporation separately, relying on the known rules of the vicarious liability doctrine.<sup>314</sup>

Some jurisdictions like the United Kingdom, did not adopt this particular concept of criminal liability. The scheme came about in events associated to the *Zeebrugge ferry*<sup>315</sup> catastrophe, occurred when the ferry set sail with its bow doors still open. The company owning the ferry was ultimately prosecuted for manslaughter but the case was stopped by the trial judge on the basis that no one person sufficiently senior to be identified with the company displayed the necessary fault for manslaughter. The courts were not convinced by the virtues of aggregation as this can be seen from Bingham J's opinion in *R v HM Coroner for East Kent, ex parte Spooner*.<sup>316</sup> Bingham J stated:

Whether the defendant is a corporation or a personal defendant, the ingredients of manslaughter must be established by proving the necessary mens rea and actus reus of manslaughter against it or him by evidence properly to be relied on against it or him. A case against a personal defendant cannot be fortified by evidence against another defendant. The case against a corporation can only be made by evidence properly addressed to showing guilt on the part of the corporation as such.<sup>317</sup>

Gobert states that; Bingham J's premise that the case against a personal defendant cannot be fortified by evidence against another defendant is correct, but his conclusion that a case against a corporation can only be made by evidence properly addressed to showing guilt on the part of the corporation does not follow. Guilt against an individual is by definition personal. The defendant on trial will suffer the stigma and sanctions of a criminal conviction. The defendant obviously should not be convicted on the basis of another person's acts or state of mind. But the purpose of the prosecution of company is not to blame any particular individual but to determine whether there was corporate fault. The responsibility sought to be affixed is not individual but collective, and any punishment will be sought to be affixed is not individual but collective, and any punishment will be borne by the company as a whole.<sup>318</sup>

The High Court of Australia also rejected the aggregation principle in *R v Australia Films Ltd*,<sup>319</sup> the case involved; Charges connected to claims by a

<sup>313</sup> Eli Lederman, 'Models for Imposing Corporate Criminal Liability: From Adaptation and Imitation Toward Aggregation and the Search for Self-Identity' (2000) 4 *Buff. Crim. L. R.* at 662.

<sup>314</sup> *Ibid.*

<sup>315</sup> *R v P & O European ferries* (note 285).

<sup>316</sup> *R v HM Coroner for East Kent, ex parte Spooner* (1989) 88 Cr App R 10.

<sup>317</sup> *Ibid* at 16-17.

<sup>318</sup> James Gobert 'Corporate criminality: four models of fault' (1994) 14 *Legal Stud.* 393 at 404.

<sup>319</sup> *R v Australia Films Ltd* 29 C.L.R. 195 (1921) (Austl.).

company for refund of duties it had paid on imported films, the required proof of intent to defraud, the usage of the films was unknown to the employee who had made the claims, in the trial judge's view, this gap was because of poor book keeping practices of the company.<sup>320</sup> However, the High Court held that the only state of mind that can be imputed to a corporation is that of the individual who performs the prohibited act.<sup>321</sup>

Proposals to introduce some form of aggregation have been made recently in Australia and Canada. In Australia, the focus has been on the aggregation of negligence.<sup>322</sup> The Model Criminal Code prepared by the Criminal Law Officers Committee states that a corporation is negligent if the conduct of the body corporate when viewed as a whole (that is, by aggregating the conduct of any number of its servants, employees or officers) is negligent.<sup>323</sup> In general, the idea of aggregation has found the greatest favour where negligence is at stake and a decision has to be made about whether a collective failure to exercise reasonable care was culpable or about how great the measure of culpability was.<sup>324</sup>

Smith and Hogan are prepared to accept the usefulness of the idea in relation to offenses of negligence, although they dismiss out of hand its application to problems of subjective fault:

It is submitted that it is not possible to artificially create a *mens rea* in this way. Two innocent states of mind cannot be added together to produce a guilty state of mind. Any such doctrine could have no application in offenses requiring knowledge, intention or recklessness; but, arguably, there is a place for it in offenses of negligence. The company owes a duty of care and if its operation falls far below the standard required it is guilty of gross negligence. A series of minor failures by officers of the company might add up to a gross breach by the company of its duty of care.<sup>325</sup>

Colvin states that the major objection to aggregation is not that it does violence to ordinary language. It is, rather, that it distorts the nature of corporate criminal liability, as long as aggregation is presented within a framework of vicarious or identification liability it carries an air of artificiality. The qualification to the model of derivative liability is so great that the usefulness of the basic model is called into question. Moreover, once the derivative model is abandoned in favour of a model of true organizational responsibility, aggregation becomes a weak conceptual tool. At best, aggregation can be viewed as only one part of a broader conceptual framework for tackling issues of organizational responsibility.<sup>326</sup>

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<sup>320</sup> Ibid at 199.

<sup>321</sup> Ibid at 217.

<sup>322</sup> Colvin (note 276) at 20.

<sup>323</sup> Ibid

<sup>324</sup> Ibid at 21.

<sup>325</sup> J.C. Smith & Brian Hogan, *Criminal Law* 7ed (1992) at 178.

<sup>326</sup> Colvin (note 276) at 23.

### 5.3 Organisational Models of Corporate Criminal Liability

Recently, there has been increased focus on an alternative model of liability, focused on the acts or omissions of the corporation itself. Under this model, rather than the corporation being liable for the acts of individual offenders, a corporation is liable because its 'culture', policies, practices, management or other characteristics encouraged or permitted the commission of the offence. Australia is a prime example of this 'organisational' liability model.<sup>327</sup>

The argument is that the behaviour of individuals is often shaped by their relationship to groups and collectives.<sup>328</sup> Because a collective entity, such as a company, provides the structural context for individual conduct of company officers, the company per se may incur civil and criminal liability, hence corporate criminal liability need not be derivative of the culpability of individuals associated with the company.<sup>329</sup> Jordaan states that, the challenge has been to locate the actus reus and fault required for criminal liability in organisations.<sup>330</sup>

Field and Jorg argue that the policies, standing orders, regulations and institutional practices of corporations are evidence of corporate aims, intentions and knowledge that are not reducible to the aims, intentions and knowledge of individuals within the corporation. Such regulations and standing orders are authoritative, not because any particular individual devised them, but because they have emerged from a decision-making process recognised as authoritative within the corporation. These regulations and standing orders are also evidence of corporate capacity to differentiate right from wrong and act accordingly, to think ethically in terms of the consequences of corporate actions for others and to give reasoned explanations to the outside world.<sup>331</sup>

### 5.4 The United Kingdom

An organisational model of criminal liability was introduced by the Law Commission in England and Wales in respect of one particular offence, namely corporate manslaughter.<sup>332</sup> Following the failure of the prosecution of the company in the Zeebrugger disaster<sup>333</sup> the Law commission suggested the introduction of an organisation model of criminal liability.

They recommended (1) that there should be a special offence of corporate killing, broadly corresponding to the individual offence of killing by gross carelessness;(2) the corporate offence should be committed only where the defendant's conduct in causing the death falls far below what could reasonably be expected;(3) that the corporate offence should not require that the risk be obvious; (4)that for the purposes of the corporate offence, a death should be regarded as having been caused by the

<sup>327</sup> Allen (note 300) at 4.

<sup>328</sup> Jordaan (note 10) at 61.

<sup>329</sup> Ibid Jordaan.

<sup>330</sup> Ibid at 61.

<sup>331</sup> Stewart Fieldand and Nico Jorg, 'Corporate Liability and Manslaughter: Should we be going Dutch?'(1991) *Crim.L.R.* at 159.

<sup>332</sup> Jordaan (10) at 62.

<sup>333</sup> European Ferries (Dover) (note 285).

conduct of a corporation if it is caused by a failure, in the way in which the corporation's activities are managed or organised.<sup>334</sup>

These recommendations were taken on into "The Corporate Manslaughter and Corporate Homicide Act 2007," which received its Royal Assent on 26 July 2007 and most of the Act was brought into force on 6 April 2008. The main section that deals with the provisions that concern corporate manslaughter are found in section 1 of the Act.<sup>335</sup> Although the Act appears to create a broader-reaching offence in terms of bodies to which it will apply and the duties of care which will trigger liability, these are severely curtailed by the technical qualification integral to that all important duty questions and by the numerous far reaching exclusions designed to protect public bodies. The layers of technicality serve to restrict the scope of liability far more than would at first appear, and are also likely to lead to substantial practical difficulties in prosecution.<sup>336</sup>

In order to establish liability, the prosecution will have to prove that, (i) a qualified organisation (ii) which owed a relevant duty of care to the victim and (iii) caused the death of the victim; and (iv) and that the death was attributed to a gross breach of a relevant duty (gross breach being defined as conduct falling far below what could reasonably have been expected of the organisation in the circumstances); and (v) that the way in which the organisation's activities were managed or organised by its senior management constituted a substantial element in the gross breach.<sup>337</sup>

The offence follows many of the core aspects of gross negligence manslaughter. The crucial difference is that rather than being contingent on the guilt of one or more individuals, liability for the organisation are run.<sup>338</sup>

Section 20 of the Act abolishes the common law offence of manslaughter by gross negligence in its application to corporations, and in any application it has to other organisations which the Act applies. The Act also provides that an individual cannot be guilty of aiding, abetting or procuring the commission of an offence of corporate manslaughter.<sup>339</sup> Individuals within the companies can of course still be prosecuted for gross negligence manslaughter as principal offenders subject to what

<sup>334</sup> Law Commission Report 237 Legislating the Criminal Code: Involuntary Manslaughter (1996) at 128.

<sup>335</sup> Section 1 of the Corporate Manslaughter and Homicide Act 2007.

<sup>336</sup> David Ormerod *Smith and Hogan Criminal law* 12ed (2008) at 535.

<sup>337</sup> James Gobert "The Corporate Manslaughter and Corporate Homicide Act 2007- Thirteen years in the making but was it worth it?" (2008) *Modern Law Review* 71(3) 413-463 at 415. Thereafter referred to as James.

<sup>338</sup> Ormerod (note 336) at 537.

<sup>339</sup> Section 18(1) Corporate Manslaughter and Corporate Homicide Act 2007.

has been said above.<sup>340</sup> Under section 19 an organisation can be liable for corporate manslaughter or homicide for an offence under any health and safety legislation. Section 1(5) provides that the offence under this section is called- (a) corporate manslaughter, in so far as it is an offence under the law of England and Wales or Northern Ireland. Ormerod argues that, this is misleading because it can be committed by certain organisations other than corporations.<sup>341</sup> Section 1(2) applies the offence to a corporation, a department or other body listed in Schedule 1; a police force; and a partnership, or trade union or employers' association, that is an employer. Relevant duty of care is defined in section 2 of the Act as:

A relevant duty of care, in relation to an organisation, means any of the following duties owed by it under the law of negligence

(a) a duty owed to its employees or to other persons working for the organisation or performing services for it; (b) a duty owed as occupier of premises; (c) a duty owed in connection with— (i) the supply by the organisation of goods or services (whether for consideration or not), (ii) the carrying on by the organisation of any construction or maintenance operations, (iii) the carrying on by the organisation of any other activity on a commercial basis, or (iv) the use or keeping by the organisation of any plant, vehicle or other thing; (d) a duty owed to a person who, by reason of being a person within subsection (2), is someone for whose safety the organisation is responsible.<sup>342</sup>

The duties reflect the duties of care at common law, the duty is owed in the common law of negligence or where applicable the statutory duty which has superseded the common law duty, for example, the Occupiers' Liability Act 1957. It is made clear by s 2(4) that a duty owed under the law of negligence will apply if the common law duty of negligence has been superseded by statutory provision imposing strict liability.<sup>343</sup> It is easy to see how the categories might give rise to duties of care which, if breached, could lead to fatalities, duties as employer would include duties to provide safe place of work.<sup>344</sup>

Section 2(2) lists the various forms of custody or detention which will prompt a duty. Deaths in custody give rise to problems because of the particular status of the victim; that by definition the activities will be occurring within premises

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<sup>340</sup> Ormerod (note 336) at 538.

<sup>341</sup> Ibid.

<sup>342</sup> Section 2 Corporate Manslaughter and Corporate Homicide Act 2007.

<sup>343</sup> Ibid at 540.

<sup>344</sup> Ibid.

and the fact that the organisation providing the detention service is one which have to make public policy decisions at to allocation of resources.<sup>345</sup>

Another element required for the offence is that the breach must be as a result of the way the activities are managed or organised. This test is not linked to a particular level of management but considers how an activity was managed within the organisation as a whole, the language is designed to reflect the concentration things done consistently with the organisation's culture and policies more generally.<sup>346</sup>

Under section 1(3): an organisation is guilty of an offence under this section only if the way in which its activities are managed or organised by its senior management is a substantial element in the breach referred to in subsection (1). Senior management is defined in section 1(4) (c) as the persons who plays significant roles in (i) the making of decisions about how the whole or a substantial part of its activities are to be managed or organised, or (ii) the actual managing or organising of the whole or a substantial part of those activities.

It is stated that this goes further than the constricted category of senior individuals (directing minds) who are referred to in the identification doctrine. The senior managers' management and organisation must be a significant aspect in the breach of duty that causes the death.

The consequences being that the senior managers' involvement, and conduct of others -non senior managers' who are involved in the management and organisation of activities is also relevant. Secondly when assessing the management failure the contribution of those individuals who are not senior management can be taken into account even if their involvement is substantial provided it is not so great as to render the senior management involvement something less than substantial.<sup>347</sup>

Ormerod states that the requirement of a gross breach of duty is clearly designed to echo the gross negligence manslaughter offence at common law and that section 2(4) provides a more detailed explanation, of the concept a breach of a duty of care by an organisation is a gross breach of the conduct alleged to amount to a breach of that duty falls far below what can reasonably be expected of the organisation in the circumstances.<sup>348</sup> The jury's duty in relation to determining the breach of duty is provided in section 8, the section also notes that the jury is obliged to consider whether the organisation complied, not just whether its senior management complied, this further supports the argument that the activities of non senior managers are relevant in determining whether there has been a management failure.<sup>349</sup>

Of course some academics have described the Act as a disappointment for instance Gobert argues that; the Act is restricted to one statistically minor (in terms of its incidence although clearly not in terms of the seriousness of the harm caused) dimension of a much more complex problem injuries and deaths caused by an organisation's blatant disregard for the safety and

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<sup>345</sup> Ibid.

<sup>346</sup> Ibid.

<sup>347</sup> Ibid at 543.

<sup>348</sup> Ibid at 544.

<sup>349</sup> Ibid.

welfare of employees, consumers and members of the public.<sup>350</sup> Further, through its requirement that persons who play a significant role in the formulation and/or implementation of organisation policy be shown to have made a substantial contribution to the corporate offence, the Act threatens to perpetuate the same evidentiary stumbling blocks that frustrated prosecutions under the identification doctrine.<sup>351</sup>

The Acts categories of what qualifies as an organisation is criticised for being too broad, it should have been restricted to for-profit organisations as a measure of deterring companies from putting profit ahead of safety.<sup>352</sup> The duties listed in section 3 of the Act are an importation from the civil law of negligence, and where given the status of an element of gross negligence manslaughter by the House of Lords in *Adomako*,<sup>353</sup> a prosecution involving a natural person.<sup>354</sup> The court of Appeal in *Wacker*<sup>355</sup> questioned the authenticity of these duties in criminal context.<sup>356</sup>

The author argues that the definition of gross negligence<sup>357</sup> begs several important questions: (1) how to determine what is to be reasonably expected of organisations under different circumstances (if judged by what similarly situated organisations do, the test may turn out to be a recipe for an across-the-board lowering of industry standards); (2) exactly how far below reasonable expectations must an organisation's breach fall before it can be characterised as 'gross' (Lord Mackay's response in *Adomako* that the deviation had to be 'so bad in all the circumstances . . . that it should be judged criminal' is obviously circular) and against what benchmarks can this be measured; and (3) what 'circumstances' are relevant when considering liability (presumably a company's lack of profitability would not justify its ignoring basic safety requirements, but the lack of clarity in the term 'circumstances' leaves open the possibility).<sup>358</sup>

Furthermore this Act has been criticised for being too narrowly conceived from the outset, instead of addressing the generic problem of corporate wrong doing and how to hold organisations accountable for illegality whatever form it might take, the Act is restricted to cases of homicide.<sup>359</sup>

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<sup>350</sup> James (note 337) at 414.

<sup>351</sup> *Ibid.*

<sup>352</sup> *Ibid* at 415.

<sup>353</sup> *R v. Adomako* [1995] 1AC 171.

<sup>354</sup> Gobert (2008) (note 337).

<sup>355</sup> *R v. Wacker* [2003] 1 Cr App R 329.

<sup>356</sup> *Ibid* at 338, the court of Appeal observed that, it may well step in at the moment when civil remedy has nothing to do with whether as a matter of public policy the criminal law applies.

<sup>357</sup> Section 1(4) (b) a breach of a duty of care by an organisation is a 'gross' breach if the conduct alleged to amount to a breach of that duty falls far below what can reasonably be expected of the organisation in the circumstances.

<sup>358</sup> James (note 337) at 417.

<sup>359</sup> *Ibid* at 420.

## 5.5 Australia

There has been an increasing tendency in Australian statutes to impose individual liability on company directors and managers, on the premise that targeting such individuals for liability will promote greater monitoring by them.<sup>360</sup> A number of policy reasons have been advanced for the development of corporate criminal liability.

These policy justifications relate to matters such as the opacity of the corporation, which makes it sometimes difficult to identify or gather evidence against the wrongdoer within the enterprise; the potential for scapegoating within the organization; the existence of devices such as indemnification, which may insulate top management from the effects of personal liability; and the existence of some inherently "organizational" wrongs such as failure to have adequate systems in place to provide a check on human error.<sup>361</sup>

The Australian Criminal Code Act 91<sup>362</sup> recognises true corporate fault as the basis for criminal liability for offences requiring negligence as well as offences requiring subjective fault.<sup>363</sup> The Criminal Code is based upon the findings of a sub-committee of the Standing Committee of Attorneys-General from Federal, State and Territory Governments, which was formed to consider the development of a uniform criminal code for Australian jurisdictions, the Committee's Report concluded that the Tesco principle was "no longer appropriate" as the touchstone for corporate criminal liability, in view of more diffuse governance structures and delegation to junior officers of corporations. The Report instead favoured adoption of a species of corporate criminal liability which recognised independent corporate fault and would cast a substantially broader and "much more realistic net of responsibility over corporations" than the narrow liability under Tesco.<sup>364</sup>

The Committee's alternative model of corporate criminal liability is now found in Part 2.5 of the Criminal Code.<sup>365</sup> Section 12.1 provides that the Code applies, with necessary modifications, equally to bodies corporate as to natural persons, specifying that a "body corporate may be found guilty of any offence, including one punishable by imprisonment". Section 12.2 imposes vicarious liability upon the corporation for the physical elements (though not the mental element) of the offence when committed by any employee, agent or officer within the actual or apparent scope of employment. This departs from the Tesco principle, where the

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<sup>360</sup> Jennifer Gill "Corporate Criminal Liability in Australia: An Evolving Corporate Governance Technique?" [2003] *Journal of Business Law* 1 at 8.

<sup>361</sup> *Ibid* Gill.

<sup>362</sup> Commonwealth of Australia, Criminal Code Act No. 12 of 1995.

<sup>363</sup> Jordann (note 10) at 63.

<sup>364</sup> Gill (note 360) at 15.

<sup>365</sup> Commonwealth of Australia (note 362).

physical elements of the offence must be attributable to a high-level officer.<sup>366</sup> Under s 12.3(1) of the Criminal Code, the requisite element of fault in an offence, characterised by, for example, intention, knowledge or recklessness, is established on the part of the body corporate itself, where the body corporate has "expressly, tacitly or impliedly authorised or permitted the commission of the offence." The means by which such an authorisation or permission may be established in two ways; firstly proof that the board of directors or a high managerial agent intentionally, knowingly or recklessly carried out the relevant conduct, or expressly, tacitly or impliedly authorised or permitted the commission of the offence.<sup>367</sup>

Secondly proving that a high managerial agent of the body corporate intentionally, knowingly or recklessly engaged in the relevant conduct or permitted the commission of the offence.<sup>368</sup> However the company may have a defence in the case if offences committed by high managerial agent of the company proves, on a balance of probabilities that it exercised due diligence to prevent the conduct.<sup>369</sup>

It is, however, the last two means by which authorisation or permission by the corporation may be established which truly break new ground under Australian corporate criminal law.<sup>370</sup> Thus under s 12.3(2)(c) and (d), the corporation will be taken to have authorised or permitted the commission of an offence if it is proved that a corporate culture" existed, which either actively encouraged non-compliance<sup>371</sup> or failed to promote compliance.<sup>372</sup> Corporate culture is defined as 'an attitude, policy, rule course of conduct or practice existing within the body corporate generally or in the part of the body corporate in which the relevant activities take place'.<sup>373</sup>

The concept of "corporate culture" focuses on blameworthiness at an organizational level, in the sense that the corporation's practices and procedures have contributed in some way to the commission of the offence.<sup>374</sup> Gill states that, for liability to be attributed to the corporation by these means, there is no level in the corporate hierarchy beneath which attribution of liability to the corporation is impossible. Rather the key issue will be whether the organizational structure of the

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<sup>366</sup> Gill (note 360) at 16.

<sup>367</sup> Para 12.3(2)(a) Commonwealth of Australia, Criminal Code Act No.12 of 1995.

<sup>368</sup> Ibid para 12.3.(2) (b).

<sup>369</sup> Ibid para 12.3.(3).

<sup>370</sup> Gill (note 360).

<sup>371</sup> Para 12.(3) (2) (c).

<sup>372</sup> Para 12.(3) (2) (d).

<sup>373</sup> Para 12(6).

<sup>374</sup> Gill (note 360) at 17.

corporation was such that the relevant act of non-compliance could occur at any level.<sup>375</sup>

Indeed in the Explanatory Memorandum to the Criminal Code Bill 1994, it is expressly stated that the new provisions would now catch managerial techniques against which Tesco was powerless such as when employees, under implied threat of dismissal, are given production deadlines which cannot be met without, for example, breaches of safety legislation.<sup>376</sup> The concept of corporate culture is also perceived to extend Tesco by allowing the prosecution to examine a company's "unwritten rules", if these are inconsistent with formal compliance documentation. The unwritten rules of an organisation may, admittedly, be difficult to prove.<sup>377</sup>

The Criminal Code sets out some factors that may be relevant in determining whether corporate culture exists.

Section 12.3(4) states that the relevant factors include: (a) whether authority to commit an offence of the same or a similar character had been given by a high managerial agent of the body corporate; and (b) whether the employee, agent or officer of the body corporate who committed the offence believed on reasonable grounds, or entertained a reasonable expectation, that a high managerial agent of the body corporate would have authorised or permitted the commission of the offence.<sup>378</sup>

Although the fault element can be located in the culture of the corporation, even though it is not present in any individual, it is still required that the actus reus of an offence be performed by an employee, agent or officer of a body corporate acting within the actual or apparent scope of his or her employment.<sup>379</sup>

The physical element of the offence (the actus reus) is attributed to the body corporate.<sup>380</sup> The Act also introduced the principle of aggregation in establishing corporate negligence.<sup>381</sup>

The provisions have also been criticised for blurring the fault element of offences, under the provisions, a corporation will be liable if it merely 'authorised or permitted' the offence.' Authorising or permitting' an offence is different to the fault element of the offence itself as it would apply to an individual (for example, intention or recklessness).<sup>382</sup> This is particularly problematic because s12 deals uniformly with different fault elements (intention, knowledge and recklessness), reducing them all to the same 'authorised or permitted' threshold for corporations. However, this is an almost inevitable corollary of the fact that corporations do not have the mental capacities of natural persons, and the "corporate" state of mind is not amenable to the same distinctions.<sup>383</sup>

Areas of uncertainty include how 'corporate culture' is to be ascertained, and the scale on which 'corporate culture' will be assessed, particularly in circumstances in which the 'corporate culture' of a particular corporate group or entity was acceptable,

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<sup>375</sup> Ibid.

<sup>376</sup> Ibid.

<sup>377</sup> Ibid.

<sup>378</sup> Section 12.3(4) Criminal Code Act.

<sup>379</sup> Jordann (note 10 ) at 64.

<sup>380</sup> Para 12.2.

<sup>381</sup> Para 12.4 (b).

<sup>382</sup> Allens (note 318) at 17.

<sup>383</sup> Ibid.

but the culture in particular business divisions or office sites was deficient. It may be very difficult to obtain evidence of a corporation's 'culture', and particularly to pinpoint the corporation's 'culture' at a particular moment in time.<sup>384</sup>

## 5.6 Conclusion

The problem with the criminal law is that its concepts were developed for individual acts or omissions committed by human individuals. Large companies are not simply the sum of the individuals employed; they are organisations which have their own systems and because of the vast organisational edifice of larger companies, it may be impossible for an outsider to identify any controlling officer whose actions or inactions and whose blameworthiness have led to the commission of the offence.<sup>385</sup> Hence there is a need for an organisational model that takes into account various factors in determining corporate liability especially with large companies.

In light of the developments discussed above, dealing with the different models of corporate liability it is submitted that there a need for South Africa to consider some form of reform to a more organisational model of corporate liability, the reasons being that, derivate models of corporate liability have proved to be problematic for example; the objection to the principle of vicarious liability that it creates liability without an investigation into fault.

The principle of identification has its own flaws, on significant one, is its narrowness which is caused problems as shown in the case of *ferries* discussed above. It is also outdated in that it proves difficult to identify one particular individual especially in today's large corporations, as most decision making is dealt with via policies and procedures on different levels in the organisation than on identifiable individual. Another issue is that this principle seems to target to management this brings about problems when the actually decision was made by middle management of rather the particular individual can not be identified. On the other hand the aggregation principle at first instance seems promising to deal with some aspects of the issues surrounding the identification theory. The idea of finding fault within a selected group (officers having the knowledge) could be aggregated and imputed to the corporation seems has in some jurisdictions been accepted.

It is submitted that this seems to be a form of vicarious liability, this methods seems to border the lines of which persons can be found liable. Even if the mental

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<sup>384</sup> Ibid.

<sup>385</sup> Heaton ( note 274).

states of various employees were to be aggregated, there is still the question of whose knowledge may be said to represent the company for the purposes of aggregation.<sup>386</sup> Presumably it could only be knowledge of those who represent the directing mind and will whose mental states may be aggregated, as only they may be said to embody the company, if this is so aggregation is unlikely to be of much assistance as the same difficulties in identifying the directing mind and will would have to be addressed, but this time in respect of a range of people.<sup>387</sup>

Furthermore, having addressed the traditional concepts and principles of corporate liability, it is submitted that there is a need for the South African legislature to consider a more broad approach and adopt an organisational model of criminal liability. The examples given above bring to light how countries like the United Kingdom and Australia have adapted this principle. It is suggested that there is a need to introduce a broad model of corporate criminal liability based on the concept of organisational fault. This will of course entail bringing the focus of criminal liability on policies, corporate culture and institutional practices. There is a need to narrow down section 332(1) as it holds the corporate body liable in circumstances where the director or servant acted beyond his powers or duties in committing the crime but while endeavouring to further the interests of the company. It is suggested that the corporation should only be held liable to a director or servant that was acting to furthering the interests of the company, the individual acting to further his own interests should not hold the corporation liable.

The traditional principles of criminal law namely *actus reus* and *mens rea* need to be adapted to apply also in the corporate context. Such adaptation may involve the following innovations: Recognition of compliance with the conduct element required for a crime if the culture or institutionalised practises of a corporation encouraged or caused its occurrence by means of a positive act or omission.<sup>388</sup> The corporation should be able of being found liable of homicide if corporate negligence can be evidenced. Also in terms of omissions for example if the corporation fails to create safe environments or fails to comply with some protection

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<sup>386</sup> Jonathan Clough and Carmel Mulhern *The Prosecution of Corporations* (2002) at 107.

<sup>387</sup> *Ibid.*

<sup>388</sup> Jordaan (note 10) at 71.

legislation. The notion of corporate culture should be considered as this looks to more of the rules and practices of the corporations which are not set in stone writing.

There is also a need for some use of criminal sanctions to punish corporations for negligence. The fine has been the most common sanctioning penalty attributed to corporations because of the notion that corporations cannot be imprisoned like human beings.

As Clough and Mulhern demonstrate, there is a range of more creative penalties available to those who are prepared to look further than monetary penalties and or sanctions. Publicity as a court-ordered sanction is designed to have a punitive impact upon the corporation, "corporate problem" and ultimately, in severe cases, the corporate equivalent of imprisonment could apply restraint, immobilization and an order that the corporation ceases trading in a limited sphere or be deregistered.<sup>389</sup>

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<sup>389</sup> Burchell (note 9) at 569.

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