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PERSONAL LIABILITY OF COMPANY DIRECTORS TOWARDS COMPANY CREDITORS UNDER THE COMPANIES ACT 71 OF 2008 : MUCH ADO ABOUT NOTHING?

BY

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SUMMARY

The legal fiction known as separate legal personality is the foundation of company law and attracts natural persons to incorporate companies, appoint a board of directors and raise capital. In terms of s 66 of the Companies Act, 71 of 2008 ("the 2008 Act"), directors can now be regarded as the heart of a company and represent the body through which the company takes all actions within the economic sphere. As a default position, directors owe fiduciary duties and a duty of care and skill to the company itself and not its creditors. However, on its face, this default position is placed under threat by s 218(2) of the 2008 Act. This section potentially constitutes a general remedy for any interested person, including company creditors, to hold liable any person, including company directors, for any loss or damage suffered as a result of a contravention of any provision in the 2008 Act. The potential threat posed by s 218(2) becomes heightened if one considers the prohibition on reckless trading as codified in s 22(1) of the 2008 Act. This statutory prohibition against reckless trading, considered in light of a stringent solvency and liquidity test prescribed by s 4 of the 2008 Act, places a microscope on the conduct of a debtor company *vis-à-vis* its creditors. The question then arises, whether or not s 218(2) read with s 22(1), and any other interrelated provisions of the 2008 Act, represent a novel and effective remedy for creditors to pursue company directors personally as a result of reckless trading? Or is s 218(2) rather, in the words of the renowned playwright Shakespeare, much ado about nothing? In order to interpret the potential operation of s 218(2), it is important to consider existing remedies available to creditors for the purpose of holding directors personally liable under South African common law and in terms of s 424 of the Companies Act, 61 of 1973 ("the 1973 Act"). This study primarily focuses on s 218(2) and its interplay with s 22(1) and other interrelated provisions of the 2008 Act and whether it creates a legal remedy for creditors to hold company directors personally liable for the reckless trading of a debtor company. It is concluded that whilst s 218(2) is a novel general remedy, the ability of creditors to enforce s 218(2) for the purpose of holding directors personally liable is hamstrung by interpretive difficulties and adverse policy considerations. In the circumstances, the existing and recognised remedies available to creditors, appear to be better calibrated for the purpose of holding directors personally liable for the reckless trading of a debtor company.

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Chapter 1: Introduction

I INTRODUCTION

The legal remedies available to creditors to hold company directors personally liable for any debts owed by a debtor company or damages and/or loss caused to creditors encroaches on the fundamental concept that is separate legal personality.[1] For the purpose of this study, the word 'debt' is attributed its widest meaning as interpreted within the context of the Prescription Act, 68 of 1969.[2] Therefore, the words 'debt', 'loss' and 'damage' will be used interchangeably and represent any right of action which a creditor may have against a debtor company in contract, delict, unjustified enrichment or statute, for any special, general or liquidated damages, as well as pure economic loss.

The supreme court of appeal faced with a creditor`s claim in terms of a so-called statutory 'reckless trading' provision, has rationalised holding company directors personally liable towards creditors, as exacting 'a quid pro quo' where those managing the affairs of the company abuse the 'figment of law' that separate legal personality represents and 'incur obligations on behalf of the corporation recklessly, grossly negligently or fraudulently'.[3] For the purpose of this study, the phrase 'reckless trading' denotes the unlawful conduct of directors, as postulated in *Ebrahim*, by allowing the company they manage to incur obligations towards creditors either recklessly, grossly negligently or fraudulently.[4]

If the fact that creditors are regarded as stakeholders with a specific interest in the company is recognised alongside the adoption by the 2008 Act of the so called 'enlightened shareholder value model', the conduct of directors appear to be increasingly placed under a microscope when a debtor company is suspected of having trading recklessly.[5] In a fluctuating

[1] Rehana Cassim 'The Legal Concept of a Company' in Farouk HI Cassim (ed), Maleka Femida Cassim, Rehana Cassim, Richard Jooste, Joanne Shev and Jacqueline Yeats *Contemporary Company Law* 2 ed (2012) 29-33 comment that the foundation of company law rests on the concept that a company has separate legal personality and refer to *Salomon v Salomon and Co Ltd* [1897] AC 22 (HL) as the leading case in this regard.
[2] *Duet and Magnum Financial Services CC (in liquidation) v Koster* 2010 (4) SA 499 (SCA) para 24 and *Desai NO v Desai* 1996 (1) SA 141 (A) at 146I-147A. In the latter case, the court held that the word 'debt' had a wide meaning and included an obligation to do something or refrain from doing something.
[3] *Ebrahim and Another v Airport Cold Storage Pty Ltd* 2008 (6) SA 585 (SCA) para 15 ('Ebrahim'), which related to s 64(1) of the now repealed Close Corporation Act, 69 of 1984 comprising a 'reckless trading' provision regarded as the equivalent of s 424 of the 1973 Act, the latter which remains in operation. See also *Fundstrust v Van Deventer* 1997 (1) SA 710 (A) at 735F-H for the proposition that, in the context of a personal liability company, a statutory provision seeking to hold directors personally liable should be construed 'strictly' by 'giving preference to the least onerous construction of the provision'.
[4] Ibid. See also Richard Stevens & Philip De Beer 'The duty of care and skill, and reckless trading: Remedies in Flux? (2016) 28 *SAMLJ* 250 at 266. The authors opine that 'most cases' dealing with reckless trading do so 'in the context of insolvency'.
[5] Carl Stein & Geoff Everingham *The New Companies Act Unlocked A Practical Guide* (2011) 8-10 comment that stakeholders under the 2008 Act have 'significantly greater rights' and that the 2008 Act encourages

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South African economy, a great number of companies are unable to meet their obligations towards creditors, which exposes unsecured creditors to the financial risk and prejudice that is inherent in a debtor company trading recklessly.[6]

Within the context of South African company law, there are essentially three existing legal remedies available to creditors seeking to hold directors personally liable for the reckless trading of a debtor company and they comprise the following:

(a) Two of the three remedies are found in the common law of delict, which appears to involve the disregarding of separate legal personality and thereby fixing liability on the particular director of the debtor company who either committed a fraud on creditors or acted with such negligence, as to cause patrimonial loss to the creditor.[7]

(b) The third remedy is found in statute under section 424 of the 1973 Act in circumstances when a debtor company is being wound up.[8]

Legislature has taken the initiative to incorporate a general liability remedy in the 2008 Act which takes the form of s 218(2) (hereinafter interchangeably 'the civil liability remedy').[9] The civil liability remedy provides as follows:

'Section 218 Civil actions □

'stakeholder activism'. See also Irene-Marie Esser & Piet Delport 'The protection of stakeholders: The South African Social and Ethics Committee and the United Kingdom's enlightened shareholder value approach: part 1' (2017) 50 (1) *De Jure* 97 at 98-99.

[6] According to Stats SA Statistical Release P0043 Statistics of Liquidations and Insolvencies (Preliminary) December 2019 available at http://www.statssa.gov.za/publications/P0043/P0043November2019.pdf a preliminary statistical release by Statistics South Africa in December 2019, the voluntary and compulsory liquidation of companies and close corporations increased by 10.7% from 2018. In *Ozinsky NO v Lloyd and Others* 1992 (3) SA 396 (C) at 414G the court articulated the test for reckless trading as follows: 'If a company continues to carry on business and to incur debts when, in the opinion of reasonable businessman, standing in the shoes of directors, there would be no reasonable prospect of creditors receiving payment when due, it will in general be a proper inference that the business is being carried on recklessly'.

[7] *Ex-Parte Lebowa Development Corporation Ltd* 1989 (3) SA 71 (T) at 106-109 ('Lebowa'). The common law principles derived from English law and recognised in *Cape Pacific Ltd v Lubner Controlling Investments Pty Ltd* 1995 (4) SA 790 (A) regarding a *sui generis* action for 'piercing the corporate veil' fall outside the scope of this study. As to the development of 'piercing the corporate veil' within a South African context see also *Botha v Van Niekerk* 1983 (3) SA 513 (W) at 815H-821C.

[8] Under chapter fourteen of the 1973 Act, s 424 applies exclusively to companies in winding up as a result of the transitional arrangements contained in item 9 to schedule 5 of the 2008 Act. The concept of 'commercial insolvency' is discussed in *Boschpoort Ondernemings (Pty) Ltd v Absa Bank Ltd* 2014 SA 518 (SCA) para 17 and is closely linked with the test for reckless trading described in *Ozinsky* supra note 8.

[9] Piet Delport (ed), Quintus Vorster, Contributors: David Burdette, Irene-Marie Esser, Sulette Lombard *Henochsberg on the Companies Act 71 of 2008* (2011) (Service Issue 21) 639 comments that s 218(2) 'provides a general remedy to any person which obviously include the company, shareholder, creditor, etc, to hold any person who contravenes any provision of the Act liable for any loss or damage suffered as a result of the contravention'.

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(2) Any person who contravenes any provision of this Act is liable to any other person for any loss or damage suffered by that person as a result of that contravention.

(3) The provisions of this section do not affect the right to any remedy that a person may otherwise have.'[10]

The civil liability remedy, considered in light of a partial codification of directors` duties in terms of the 2008 Act, could potentially have the effect that 'liability for the breach of fiduciary duties, as well as the duty of care and skill', could be extended to creditors'.[11] It is also 'drafted in very wide terms' which may deter experienced people from 'serving as directors, notwithstanding that it may be difficult for third parties to succeed with a claim based on s 218(2)'.[12] From the perspective of creditors, it is the potential interaction of sections 4, 22(1), 66(1), 77(3)*(b)* and 214(1)*(c)*, as introduced by the 2008 Act, which may have changed the playing field on which creditors consider holding directors personally liable for the reckless trading of a debtor company.[13]

First, direct authority over a company is now vested with its board of directors in terms of s 66(1) of the 2008 Act.[14] Secondly, the 2008 Act has completely abolished the former capital maintenance rule and substituted it with a new age solvency and liquidity test under s 4, which prescribes strict solvency and liquidity thresholds.[15] Thirdly, the potential reckless trading of a debtor company has been expressly prohibited through incorporation of s 22(1), which provides as follows:

'22 Reckless trading prohibited □

(1) A company must not carry on its business recklessly, with gross negligence, with intent to defraud any person or for any fraudulent purpose.'

[10] The civil liability remedy was introduced under Part B to Chapter 9 of the 2008 Act, which is headed 'Miscellaneous matters' and the word 'person' is defined in s 1 of the 2008 Act as including a 'juristic person'.
[11] Esser & Delport op cit note 5 at 106-107.
[12] Ibid.
[13] Farouk HI Cassim 'The Duties and the Liability of Directors' in FHI Cassim et al. op cit note 1 at 587 with reference to the potential interplay between various statutory provisions and the civil liability remedy, the author emphasises that all these provisions 'heavily underscore the gravity of a contravention of s 22(1)' and also warns that 'No director or prescribed officer should treat s 22 lightly'.
[14] FHI Cassim in FHI Cassim et al. op cit note 1 at 507. It is opined that the direct power vested in directors by s 66(1) results in making fiduciary duties 'of even greater importance…'.
[15] The former capital maintenance rule, also known as the rule in *Trevor v Whitworth* (1887) 12 App Cas 409, formed part of South African company law since its inception. However, it was to a large extent already abolished and had limited application under the Companies Amendment Act 37 of 1999. See also PA Delport 'Capital' in JT Pretorius (ed), PA Delport, Michele Havenga, Maria Vermaas *Hahlo`s South African Company Law Through the Cases: A Source Book* 6 ed (1999) 121-122.

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Fourthly, under Part A to Chapter 9 titled 'Offences and penalties', the 2008 Act has incorporated s 214(1)*(c)* which could assist creditors seeking to invoke the civil liability remedy pursuant to a contravention of section 22(1), considering that s 214(1)*(c)* provides as follows:

'214 False statements, reckless conduct and non-compliance

(1) A person is guilty of an offence if the person —

(c) was knowingly a party to an act or omission by a company calculated to defraud a creditor or employee of the company, or a holder of the company's securities, or with another fraudulent purpose;'

Finally, as part of codifying the specific liability of directors within the context of reckless trading, s 77(3)*(b)* of the 2008 Act provides as follows:

'77. Liability of directors and prescribed officers

(3) A director of a company is liable for any loss, damages or costs sustained by the company as a direct or indirect consequence of the director having —

(b) acquiesced in the carrying on of the company's business despite knowing that it was being conducted in a manner prohibited by s 22(1).'

It is the potential interplay between s 66(1), read with the solvency and liquidity requirement in s 4, subsequently viewed in the context created by s 214(1)*(c)* as read with s 77(3)*(b)* of the 2008 Act, which raises the question whether or not directors are capable of personally contravening s 22(1) and being held liable by creditors under the civil liability remedy.[16] Should creditors be able, as matter of law, to successfully invoke the civil liability remedy alongside interrelated provisions of the 2008 Act for the purpose of holding company directors personally liable it would constitute an exceptional encroachment on separate legal personality and possibly entail the development of South African common law on directors duties.[17]

[16] The postulated interplay of these interrelated provisions has been the subject matter of judicial consideration, in amongst others, *Rabinowitz v Van Graan and Others* 2013 (5) SA 315 (GSJ) ('Rabinowitz').
[17] Delport et al. op cit note 9 at 641 comments that 'third parties' could hold directors liable for breach of their fiduciary duties and other duties owed to the company as codified in terms of the 2008 Act.

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II RESEARCH QUESTIONS

The primary research question is whether creditors can hold directors personally liable as a result of a debtor company having traded 'recklessly' as envisaged in s 22(1) by way of invoking the civil liability remedy in s 218(2)?[18]

For the purpose of this study and proceeding from the assumption that the primary research question can be answered in favour of creditors, the subsidiary research questions concern an analysis of the potential nature and scope of s 218(2) and how it has been interpreted by South African courts and commentators, with specific reference to:

(a) What are the existing personal liability remedies available to creditors?
(b) Whether s 218(2) is a novel remedy?
(c) Whether s 218(2) allows creditors to hold directors personally liable for the contravention of duties traditionally owed to the company itself?
(d) Whether s 218(2) requires the interplay of various other statutory provisions to sustain its operation?
(e) In what context and for what purpose was s 218(2) incorporated by legislature?
(f) How do similar provisions in the Australian Corporations Act (Cth) 2001 ('the Corporations Act') influence an interpretation of s 218(2)?

III RESEARCH METHODOLOGY

This study is highly topical in view of the fact that South African courts are increasingly being asked to consider and adjudicate claims against directors involving the civil liability remedy.[19] This study is predominantly a review of the relevant textbooks, law journals, legislation, case law and internet sources concerning the personal liability of directors towards company creditors within the specific ambit of section 218(2) of the 2008 Act. This study undertakes an interpretational approach, in order to consider on what basis, if any, the 2008 Act has changed the landscape available to creditors for pursuing delinquent directors personally for the reckless trading of a debtor company.[20] An interpretational approach is necessary in order to answer the relevant research questions and delineate the state of South African law as to the potential

[18] FHI Cassim in FHI Cassim et al. op cit note 1 at 587. Creditors in particular will be entitled to redress from the company or its directors for fraudulent or reckless trading.
[19] *Rabinowitz* supra note 16 and *Hlumisa Investment Holdings (RF) Limited and Another v Kirkinis and Others* 2019 (4) SA 569 ('Hlumisa').
[20] The concept of a 'delinquent director' has gained significant traction in South African company parlance as a result of s 162 of the 2008 Act which provides a remedy aimed at disqualifying a person from serving as a director by way of a delinquency order.

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operation of the civil liability remedy in favour of creditors. For the purpose of interpreting the civil liability remedy, similar provisions incorporated under the Corporations Act will be identified and discussed.[21] In particular, s 1324(10) read with s 182(1) and viewed in the context of the prevailing Australian case law will be discussed, considering that these particular provisions have in certain instances enabled creditors to hold company directors personally liable for their breach of statutory duties owed to the corporation itself.[22]

IV CHAPTER OUTLINE

In the body of this study the author will analyse and interpret the civil liability remedy from the perspective of creditors seeking to hold directors personally liable for the reckless trading of a debtor company, with reference to certain interrelated statutory provisions under the 2008 Act. In chapter 2, the mechanics and policy considerations behind the operation of the existing personal liability remedies are highlighted and discussed in order to create a baseline from which to interpret and measure the civil liability remedy. Chapter 3 is concerned with the subsidiary research questions and proceeds from the premise that the primary research question can be answered in favour of creditors. It involves an analysis of the potential operation of the civil liability remedy and focusses on each of the respective subsidiary research questions with due regard to the views of current commentators and South African case law. In chapter 4, the author introduces and discusses similar provisions in the Corporations Act in order to gauge whether there is any commonality which could give guidance to the interpretation of the civil liability remedy. Chapter 5 concerns the primary research question and draws on various views detailed in chapters 2 and 3, for the purpose of providing a proper interpretation of the civil liability remedy. Chapter 6 serves as remarks in conclusion and provides the author`s view and recommendations in so far the primary and secondary research questions are concerned.

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[21] Section 5(2) of the 2008 Act allows the consideration of foreign law ‘to the extent appropriate’ for the purpose of interpreting the 2008 Act.
[22] Delport et al. op cit note 9 at 641.

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Chapter 2: The three existing personal liability remedies

I INTRODUCTION

In order to interpret the civil liability remedy and its interplay with the reckless trading prohibition comprising s 22(1), it would be relevant to briefly consider the origin and nature of the existing common law and statutory remedies available to creditors.[23] In doing so, this study first, provides a contextual background to the civil liability remedy and secondly, creates a baseline from which creditors can measure the potential operation in law and practical effectiveness, if any, of the civil liability remedy.[24]

II THE COMMON LAW LIABILITY OF DIRECTORS TOWARDS CREDITORS

The foundational concept that a company has separate legal personality gives rise to the default position that both the fiduciary duties of directors and their independent duty to exercise reasonable care and skill, are owed to the company itself and not individual shareholders or creditors whilst the company is a going concern.[25] This foundational concept gives rise to rules of corporate law such as the proper plaintiff rule.[26]

On the one hand and within a corporate law context, the general basis for not recognising a direct duty of directors towards creditors, is due to the fact that separate legal personality allows a company itself to commit unlawful acts towards its creditors, whilst those same affected creditors are then able to enforce their contractual rights against the non-performing debtor company and additionally retain a statutory remedy in winding up such as s 424 of the 1973 Act.[27] On the other hand and within the context of the common law of delict, it is trite that a claim in delict is primarily directed at compensation for the infringement of a

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[23] This study is exclusively limited to a brief overview of the relevant principles found in both the common law of delict and the statutory remedy comprising s 424 of the 1973 Act and by no means constitutes a detailed exposition of the legal mechanics or policy considerations akin to the respective remedies.

[24] *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 (4) SA 593 (SCA) para 18. Where a 'unitary approach' towards the interpretation process is proposed which involves ascertaining the 'context and purpose' of the statute being interpreted.

[25] *Percival v Wright* [1902] 2 Ch 421 and *Multinational Gas and Petrochemical Co v Multinational Gas and Petrochemical Services Ltd* [1983] 2 All ER 653 (CA) at 288E-F. In the latter case, the duty on directors was at best only 'expanded' to 'consider the interests of creditors' where the solvency of the company is at risk despite this duty not being owed directly to creditors themselves. See also Michele Havenga 'Creditors, Directors and Personal Liability under Section 424 of the Companies Act' (1992) 4 (1) *SAMJL* 63 where the author with reference to multiple authorities, confirms that 'there is some controversy as to whether the fiduciary duties owed by directors to the company can be extended to creditors'.

[26] Also known as the rule in *Foss v Harbottle* (1843) 2 Hare 461; 67 ER 189. The rule is aimed at ensuring that when the company is wronged, the company itself initiates proceedings to recover from its miscreant directors rather than individual stakeholders such as shareholders or creditors. See also FHI Cassim in FHI Cassim et al. op cit note 1 at 516.

[27] Louis de Koker 'Die Aanspreeklikheid van Direkteure vir Delikte Gepleeg in Ampsverband' (2002) 1 *TSAR* 18 at 24 and JJ du Plessis 'Directors` duties towards Groups other than the Company` 1992 *De Jure* 378 at 387-388.

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legally recognised interest, which interest should exist independently from any contractual obligation and leads to the principle that everyone should answer for his or her wrongful acts.[28] There is a tension between separate legal personality and certain trite principles pertaining to the law of delict which has rendered the legal basis for holding directors personally liable in respect of their unlawful acts committed either in their official capacity *qua* director or as an agent of the company quite evasive and altogether unclear.[29]

Furthermore, there is a scarcity of reported cases which have directly considered and applied the law of delict for the purpose of holding a director personally liable towards creditors for the reckless trading of a debtor company.[30] One of the earliest cases is *Orkin Bros Ltd v Bell and Others*[31], which was subsequently relied upon in a controversial judgment of Stegmann J in *Lebowa*, where the latter court distinguished between an instance where the company itself commits a delict against its creditors and an instance when those who manage the company commit a delict against creditors independently of the company.[32]

For this differentiation, Stegmann J accepted that ‘anyone who injures another by fraud (dolus) or negligence (culpa) is of course personally liable to the victim in terms of the common law remedies respectively deriving from the *actio doli* and the *actio legis aquiliae* for

[28] Michele Havenga ‘Directors’ Co-Liability for Delicts’ (2006) 18 *SAMLJ* 229 and JC Van Der Walt & JR Midgley *Principles of Delict* 4 ed (2016) para 5, where the latter authors distinguish a delict from a breach of contract.
[29] JS McLennan ‘The Liability of Agents for Debts Contracted on Behalf of Insolvent Companies’ 1998 *SALJ* 68 and De Koker op cit note 27 at 35.
[30] The scarcity of reported cases may be attributable to how JJ Du Plessis & JJ Henning ‘The delictual liability of persons acting as company organs’ (1989) 52 *THRHR* 540 describe the development of liability in delict as ‘slumbery’. This observation should be considered in conjunction with creditors having had a statutory reckless trading remedy comprising s 185bis of the Companies Act, 46 of 1926 and subsequently s 424 of the 1973 Act at their disposal concurrently to the common law.
[31] 1921 TPD 92 at 106 (‘Orkin’). Whilst the exact basis for the court having fixed personal liability on the directors is not entirely clear, the court reasoned that when a company orders goods from a merchant there is an ‘implied representation’ that the directors ‘believe the company will probably be able to pay’ and if they know there is no such likelihood they commit a ‘fraud’. McLennan op cit note 29 at 68 argues that *Orkin* could only have been decided on the basis of a delict considering the court made a finding of ‘fraud’ and that the measure of ‘damages’ for purposes of the law of delict would be equal to the non-payment of the ‘purchase price’. See also *Ruto Flour Mills Pty Ltd v Moriates & Another* 1957 (3) SA 113 (T) at 115A-F.
[32] *Lebowa* supra note 7 at 79, 106, 108 & 109 where the court was faced with an application to authorise a statutory meeting for purposes of approving a compromise or arrangement in terms of s 311 of the 1973 Act and not an action to declare directors personally liable. Other than *Orkin*, Stegmann J relied on the judgment in *Fisheries Development Corporation of SA Ltd v Jorgensen and Others* 1980 (4) SA 156 (W) at 165-166. Noteworthy is that the *ratio* of *Lebowa* was criticised in *Lordan N.O. v Dusky Dawn Investments (Pty) Ltd (in liquidation) (Pearmain and Another intervening)* 1998 (4) SA 519 (SE) at 527-528 and partially overruled in *Ex-Parte De Villiers and Another N.N.O.: In re: Carbon Developments (Pty) Ltd (in liquidation)* 1993 (1) SA 493 (A) at 504 to the extent that ‘a company trading under insolvent circumstances is not *per se* reckless and that recklessness would depend on the particular facts and circumstances of each case’.

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patrimonial loss resulting from the said fraud or negligence'.[33] This finding in *Lebowa* that directors, whilst acting in their official capacity, are capable of committing a delict *vis a vis* creditors independently of the company they manage, has also been considered by the commentators De Koker and Havenga respectively.[34] The respective commentaries appear to agree that a director is capable of committing a delict independent of the company and opine that the question of whether or not personal liability should ultimately be attributed to a director should be determined with regard to the essential requirement of wrongfulness, whilst appropriately balancing various competing policy considerations.[35] In turn, the inquiry towards ascertaining wrongfulness, is whether or not it is reasonable to impose liability under the prevailing facts and circumstances, with due regard to the legal convictions of the community.[36]

For the purpose of fixing the personal liability of directors towards creditors, the test of wrongfulness can be used to determine whether a particular director in fact owed a legal duty to a plaintiff creditor under the particular set of facts and circumstances. Notwithstanding, the existence of such an independent legal duty and a director`s concomitant breach thereof, personal liability will not follow 'automatically', unless the court is satisfied that a plaintiff creditor has satisfied all other elements for fixing liability in delict.[37] To a large extent, the exact nature of a creditor`s ability to hold directors personally liable for their unlawful acts committed either negligently or intentionally by relying on the common law of delict has remained undeveloped.[38]

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[33] Ibid. The court in *Lebowa* considered a 'known risk such as trading under insolvent circumstances' and directors 'obtaining credit for a company without disclosing such a known risk' to be a 'fraud on the creditor' and that the contemplated fraud comprised the 'exposure of a creditor`s economic interests to unauthorised risk'. See also Van der Walt & Midgley op cit note 28 para 28 where the authors opine, contrary to *Lebowa*, that the 'better view' appears to be that 'an Aquilian action for patrimonial loss based on *dolus* has superseded the historical *actio doli*'.
[34] De Koker op cit note 27 at 37 and Havenga (2006) op cit note 28 at 236.
[35] Ibid and De Koker op cit note 27 at 40.
[36] Van der Walt & Midgley op cit note 28 at 99-100.
[37] Ibid para 26. Where the general basis for liability is recorded as a plaintiff`s claim for 'patrimonial loss' due to having sustained 'harm', which was 'wrongfully and culpably caused by the defendant'. See also De Koker op cit note 27 at 40-41, where the author cites individual considerations within a corporate law context.
[38] The position of creditors should be distinguished from the debtor company itself which is owed a recognised duty of care and skill arising from the concept of 'negligence' within the law of delict as discussed in *Fisheries Development* supra note 32.

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III SECTION 424 OF THE 1973 COMPANIES ACT

The statutory remedy incorporated under s 424(1) of the 1973 Act is *sui generis* in nature and supplemental to the common law remedies.[39] This statutory remedy subjects miscreant directors to personal liability for the debts of the company they manage if any particular director was 'knowingly a party to the carrying on of the business' of the debtor company either recklessly or fraudulently.[40] It specifically permits 'any creditor' to apply to court for a declaration that any defendant director 'shall be personally responsible, without any limitation of liability, for all or any of the debts or other liabilities of the company as the court may direct'.[41] The historic policy basis for this statutory remedy, which has been described as 'one of the most powerful instruments in the hands of creditors', is creditor protection.[42] It acts as a counter-balance to separate legal personality through which individual creditors are able to recoup their losses in instances, where as a result of legal personality, they would be unable to do so.[43]

The court considering personal liability is conferred a wide discretion in terms of s 424(2) to 'make whatever direction it thinks proper for the purpose of giving effect to its declaration', which allows a particular plaintiff creditor to seek payment of a particular debt of the debtor company, directly from the directors, without any regard to the general body of creditors.[44] Whilst the philosophy driving s 424 is regarded as 'compensatory' and 'punitive' in nature, it does not entail rendering a director and the debtor company co-principal debtors, rather, the fixing of personal liability appears to function as an indemnification of the debtor company to the extent that it is unable to satisfy the claim of a creditor.[45]

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[39] *Lebowa* supra note 7 at 109. MS Blackman (ed), RD Jooste, GK Everingham, JL Yeats, FHI Cassim & R De la Harpe *Commentary on the Companies Act* (2002) (Service issue 9) at 522 where the origin of the statutory reckless trading remedy and its recognition in s 185bis of the Companies Act, 46 of 1926, succeeded by a broader reckless reading provision taking the form of s 424 of the 1973 Act is documented.
[40] Stein & Everingham op cit note 5 at 451 where it is noted that s 424 has not been repealed insofar it relates to the winding-up of both solvent and insolvent companies.
[41] Ibid.
[42] Jean Jacques du Plessis *Maatskappyregtelike Grondslae van die Regsposisie van Direkteure en Besturende Direkteure* (Unpublished LLD thesis, University of the Orange Free State, 1990) 126 and Stevens & De Beer op cit note 4 at 272.
[43] Ibid.
[44] Havenga (1992) op cit note 25 at 68 and Delport et al. op cit note 9 at APPI-304, where the latter author comments that 'when a particular creditor obtains a declaration of personal liability for the company`s particular debt owed to that particular creditor, the court can only direct payment to that particular creditor'. See also Blackman et al op cit note 39 at 550-551 where the author opines, in disagreement with Delport, that irrespective of the particular circumstances 'a declaration always renders the delinquent liable to the company to pay it a sum equal to the amount of the debts for which he is declared responsible' and where the company is being wound up 'that money forms part of the general assets of the company, to be applied for the benefit of all its creditors'.
[45] *L & P Plant Hire BK and Others v Bosch and Others* 2002 SA (2) 662 (SCA) para 39 and *Ebrahim* supra note 3 para 21.

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Therefore, at least from an evidential perspective, a creditor is required to showcase an 'inability to pay' by the debtor company.[46] Various other individual aspects increase the attractiveness for creditors to utilise s 424 for the purpose of holding company directors personally liable and can briefly be summarised as follows:

(a) Personal liability can be fixed if a director acts 'recklessly', which recklessness does not pre-suppose either intent or fraud.[47] Alternatively, personal liability can be fixed when a director acts with 'an intent to defraud'.[48]

(b) Personal liability can be fixed to any person, even if such a person is neither a member, nor a director, or an officer of the company, and may be a juristic person.[49]

(c) A court is empowered to declare a director personally responsible, without any limitation of liability, for all debts or liabilities of the company, including those incurred prior to the alleged reckless or fraudulent conduct of the company or for any specific debt or liability.[50]

(d) Proof of a causal link between the offending conduct and the debts or liabilities in respect of which a declaration of personal liability is sought is not required.[51]

(e) Within the context of the 1973 Act, effective inquiries in terms of either s 415 or 417 and 418 can be held in order for creditors and/or the liquidator to obtain the necessary information and documentation towards formulating a claim in terms of s 424.[52]

(f) In an instance where the plaintiff creditor has no means to adduce evidence regarding the operations of the debtor company, because the facts lie exclusively within the knowledge of the defendant director, less evidence will suffice, particularly where the defendant director elects not to reveal the facts or furnish any explanation of the evidence placed before the court.[53]

(g) The ambit of the section includes a single reckless or fraudulent transaction.[54]

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[46] Ibid para 40.
[47] *Fourie v Newton* 2011 (2) All SA 265 (SCA) para 29. The court equated recklessness to 'an entire failure to consider the consequence of one's actions, in other words, an attitude of reckless disregard of such consequence'.
[48] Delport et al. op cit note 9 at APPI-300(3). The concept 'with the intent to defraud or fraudulent purpose' appears to entail a 'certain degree of subjective belief i.e. a state of mind insofar a misrepresentation of a fact is concerned'.
[49] *Cooper N.N.O. v SA Mutual Life Assurance Society* 2001 (1) SA 967 (SCA) para 16.
[50] *Terblanche NO v Damji* 2003 (5) SA 489 (W) at 515A-516E.
[51] *Fourie v First Rand Bank Ltd and Another N.O.* 2013 (1) SA 204 (SCA) para 30 albeit that a causal link may be a factor taken into account when considering whether or not to fix personal liability in terms of s 424.
[52] Sections 415, 417 & 418 of the 1973 Act.
[53] *Strut Ahead Natal Pty Ltd v Burns* 2007 (4) SA 600 (D) at 608A-F.
[54] *Gordon and Rennie NNO v Standard Merchant Bank Ltd* 1984 (2) SA 519 (C) at 528A-H.

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(h) The meaning of 'business carried on' need not involve active trading and includes the realisation of assets and dealing with their proceeds or the falsifying of financial statements, inflating income, or winding up a debtor company.[55]

It appears that the statutory remedy that s 424 presents, facilitates the ability of creditors to hold directors personally liable for the purpose of recovering debts owed by the debtor company, where at common law, such personal liability might not exist or such a claim may be difficult to prove.[56]

[55] *Re Sarflax Ltd* [1979] 1 All ER 529 (Ch) at 534. *Nel NNO v McArthur* 2003 (4) SA 142 (T) at 158F-G. *McLuckie v Sullivan* 2011 (1) SA 365 (GSJ) para 11.
[56] *Mafikeng Mail Pty Ltd v Centner (No1)* 1995 (4) SA 603 (W) at 605F-H and *Howard v Herrigel NO* 1991 (2) SA 660 (A) at 672C-F.

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Chapter 3: The Potential Nature and Scope of the Civil Liability Remedy

I INTRODUCTION

From the perspective of creditors, the potential nature and scope of the civil liability remedy will indicate first, a creditor`s ability to pursue a sustainable cause of action by invoking the civil liability remedy and secondly, its potential operation with due regard to other interrelated statutory provisions. Considering the focus of this chapter, both the common law and statutory defences available to directors in order to avoid personal liability *vis a vis* 'any person' invoking the civil liability remedy, falls outside the scope does of this study.[57]

II NOVEL REMEDY

Compared to former South African company law legislation, the civil liability remedy does not have an equivalent.[58] Considering that the civil liability remedy has been incorporated in conjunction with a partial codification of directors` common law duties, its novelty is underscored by its 'very wide terms' and its potential effect of 'extending liability for the breach of duties' to 'outside stakeholders' including third party creditors.[59] Furthermore, the civil liability remedy has been interpreted to entail an innocent contravention of the 2008 Act which in turn has given rise to contrasting views on whether or not the contemplated 'loss or damage' as a result of 'that contravention', prescribe elements such as fault or wrongfulness.[60] If the civil liability remedy is interpreted to constitute a primary remedy for creditors, which imposes strict personal liability on directors for having breached their codified statutory duties traditionally owed to the company itself, the remedy could not only be considered novel, but highly controversial.[61]

[57] It is recognised that from a common law perspective a director`s conduct still needs to meet the partly objective and partly subjective threshold test as described in *Fourie* supra note 51 para 28. It is noteworthy that the 2008 Act has incorporated the so-called 'business judgment rule' under s 76(4) and an 'exclusion of liability' provision under s 77(9).
[58] Stein & Everingham op cit note 5 at 402 comment that s 218(2) is a 'civil penalty' which forms part of a 'fundamental policy change by government' where the majority of criminal sanctions in terms of the 1973 Act have been replaced with a system of 'administrative fines and/or civil liability'.
[59] Esser & Delport op cit note 5 at 106-107. FHI Cassim in FHI Cassim et al. op cit note 1 at 587.
[60] Delport et al. op cit note 9 at 641. See also Maleka Femida Cassim 'Shareholder Remedies and Minority Protection' in FHI Cassim et al. op cit note 1 at 821. Both Delport and MF Cassim interpret s 218(2) as potentially imposing 'strict liability, however, recently in *Hlumisa* supra note 19 paras 43-49, Melopa-Setshosa J expressly found an argument that the civil liability remedy operates as a form of strict liability unsustainable on the basis that the words 'as a result of' import a causative requirement.
[61] Esser & Delport op cit note 5 at 106-107. The authors state that s 218(2) is drafted in very wide terms and this type of provision may 'prevent experienced people from serving as directors…'.

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III PERSONAL LIABILITY AND DUTIES OWED TO THE COMPANY

On an ordinary grammatical reading of the civil liability remedy, it regulates the contravention of 'any provision' of the 2008 Act which could entail either a positive contravention or a passive contravention, in the form of non-compliance, whilst the words 'as a result of' connotes some form of causation.[62] Should the uniform view expressed by various commentaries be correct that the civil liability remedy is capable of allowing creditors to hold directors personally liable for the breach of duties owed to the debtor company itself then it certainly increases the scope of the civil liability remedy compared to the three existing personal liability remedies.[63]

In support of the view that 'third parties have a claim against the directors for breach of fiduciary duties and other duties owed to the company itself', reliance has been placed on *Grancy Property Limited,* where the court held that 'a director who does not comply with the standards of conduct as set out in section 76 of the 2008 Act, would be liable to any person suffering a loss as a consequence thereof'.[64] Within the context of s 76 of the 2008 Act, a director`s codified duty in terms of s 76(3)*(b)* to 'act in the best interest of the company' is regarded as a potential gateway for 'third parties' to hold directors personally liable.[65] Such an interpretation would require 'third parties to argue that directors breached s 76(3)*(b)* by not having considered that particular third party`s specific interest', which may be 'difficult to prove as the third party will have to show that by not acting in his or her interest the director did not act in the best interest of the company`.[66]

To add judicial weight to the potential of directors being held personally liable under the 2008 Act for the breach of duties owed traditionally to the company itself, the South African

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[62] *Endumeni* supra note 24 para 18 is considered the positive law in respect of the interpretation of any written document, including statutes. The SCA emphasised the reading of a statute in 'light of the ordinary rules of grammar and syntax'. See also Delport et al. op cit note 9 at 641 where it is opined that the concept of 'contravene' within the context of the civil liability remedy, would mean 'any offence in terms of the Act and also include any non-compliance with a provision of the Act that may not be an offence'.

[63] Delport et al. op cit note 9 at 641-642. FHI Cassim in FHI Cassim et al. op cit note 1 at 587. Esser & Delport op cit note 5 at 106-107. See also Simphiwe Phungula 'Lessons to be learned from reckless and fraudulent trading by a company: Section 424(1) of the Companies Act 61 of 1973 and sections 22 and 77(3)(b) of the Companies Act 71 of 2008' (2016) 28 *SAMLJ* 238 at 249 where the author postulates that 'section 77(3)*(b)* allows creditors to claim for damages from the directors of the company'.

[64] Delport et al. op cit note 9 at 640 relies on the judgment in *Grancy Property Limited and Another v Gihwala and Others* (1961/10;12193/11) [2014] ZAWCHC 97 (26 June 2014) para 104.

[65] Esser & Delport op cite note 5 at 107.

[66] Ibid. See also Stevens & De Beer op cit note 4 at 281 where after comparing the statutory duty of care and skill codified in s 76(3)*(b)* to the reckless trading prohibitions in both s 22(1) and s 424, it is concluded that 'from a remedial perspective' the remedies appear to have 'reversed roles' and that whilst 'a company will in all likelihood use the less burdensome requirements of s 77(3)*(b)* to recover its losses from errant directors…', company creditors will find the least amount of resistance by having 'recourse to the duty of care and skill via s 218(2).'

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courts have made the following relevant findings pursuant to having interpreted the civil liability remedy:

(a) A creditor can hold a director personally liable in terms of s 218(2) for acquiescing in or knowing about a company`s conduct that falls within the reckless trading prohibition comprising s 22(1).[67]

(b) A director`s codified duty in s 77(3)*(b)* not to 'acquiesce in the carrying on of the business of the company whilst knowing that the business was being conducted reckless for purposes of s 22(1)' in fact places a statutory duty on directors in favour of both the wronged company and its creditors.[68]

(c) Section 76(3)*(a)* and *(b)* requiring a director to 'act in the best interest of the company, in good faith and for a proper purpose' can found a cause of action on behalf of a third party in terms of s 218(2).[69]

(d) Directors could personally contravene s 22(1) and be held liable by a creditor in terms of s 218(2).[70]

The body of commentary and judicial authority discussed in this chaper give rise to the view that creditors are indeed capable of holding directors personally liable in terms of the 2008 Act for the contravention of codified duties traditionally owed to the company itself.

IV AN INTERPLAY WITH INTERRELATED PROVISIONS OF THE 2008 ACT

The civil liability remedy serves as an empowering provision in order for creditors to potentially claim damages or loss suffered as a result of either a director and/or the debtor company itself having contravened another interrelated provision of the 2008 Act.[71] Therefore, the operation of the civil liability remedy is dependent on its interplay with other provisions of the 2008 Act in order to first, establish the necessary contravention as envisaged in s 218(2) and secondly, create a nexus between the loss or damage suffered by the creditor and the

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[67] *Rabinowitz* supra note 16 at para 22.
[68] *Blue Farm Fashion Limited v Rapitrade 6 (Pty) Ltd and Others* (22288/2014) [2016] ZAWCHC 35 (1 April 2016) para 31 ('Blue Farm').
[69] *Sanlam Capital Markets (Pty) Ltd v Metal Manco (Pty) Ltd and Others* 2014 (3) All SA 454 (GJ) para 42. This finding appears to be *obiter* considering the court undertook no recognisable judicial investigation.
[70] *Chemfit Fine Chemicals (Pty) Ltd t/a SA Premix v Maake and Others* (5772/2016) [2017] ZALMPPHC 27 (1 September 2017) paras 24-25 ('Chemfit'). Despite the court a quo`s interpretation that s 22(1) is capable of personal contravention by a director having been recognised on appeal to a full court, its factual finding of reckless trading was overturned in *Maake and Others v Chemfit Finechemical (Proprietary) Limited* (5772/2016, HCAA04/2018) [2018] ZALMPPHC 71 (22 November 2018) para 28 & 32.
[71] Stevens & De Beer op cit note 4 at 274 where a hermeneutical approach to the interpretation of s 218(2) is proffered.

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conduct of the offending director or debtor company.[72] In terms of s 66(1) of the 2008 Act, the board of directors now have an 'original' statutory power to manage the business of a company as opposed to a 'delegated' power formerly held under the 1973 Act, which results in the view that the 'ultimate power' of the company no longer vests with the shareholders.[73] The significance of a director`s direct authority was relied on by the court in *Rabinowitz* with a view towards concluding that a director could personally contravene the reckless trading provision incorporated under s 22(1).[74]

From the perspective of creditors, it is important to recognise that the 2008 Act has abolished the capital maintenance rule in favour of a new age 'solvency and liquidity' test.[75] The driving purpose of the solvency and liquidity test is based on the principle that as long as the test is satisfied, creditors will not be prejudiced if the 'capital' of the company is used other than for the ordinary business purposes of the company.[76] Therefore, considering that creditors have a material and direct interest in the solvency and liquidity of a debtor company, any potential non-compliance with s 4 of the 2008 Act could be regarded as reckless trading for purposes of s 22(1).[77] The potential interplay between sections 66(1), 4 and 22(1) of the 2008 Act strengthens the view that directors indeed owe creditors, at the very least, an implied or tacit statutory duty not to manage the company in contravention of s 22(1).[78] Such potential interplay is strikingly similar to the criticised reasoning in *Lebowa* and could represent a

[72] Delport et al. op cit note 9 at 642 for an exposition of the tension between the authors view on causation as opposed to the findings in *Rabinowitz* supra at note 16. See also *Burco Civils CC v Stolz and Another* [2016] ZAGPPHC 350 unreported (GP 26201/15) paras 47-48.
[73] Delport et al. op cit note 9 at 250(4) and Rehana Cassim 'Governance and the Board of Directors' in FHI Cassim et al. op cit note 1 at 403.
[74] R Cassim in FHI Cassim et al. op cit note 1 at 403 and *Rabinowitz* supra note 16 para 21.
[75] On a plain reading of the solvency and liquidity test, its strictness is fortified considering that first, the words 'for any purpose of this Act' is wide enough to include for the purpose of a debtor company not trading recklessly as prohibited by s 22(1) and secondly, it requires prospective solvent trading for the ensuing 12 months from the date the test is considered and applied, whilst thirdly, it requires directors to consider the 'fair valuation of the company`s assets and liabilities, including reasonably foreseeable contingent assets and liabilities' and finally, appears to require a purely objective bystander test, rather than allowing some form of subjective judgment of individual directors. See also Richard Jooste 'Corporate Finance' in FHI Cassim et al. op cit note 1 at 272-273.
[76] Delport et al. op cit note 9 at 33.
[77] K van der Linde (2009) 'The Solvency and Liquidity Approach in the Companies Act 2008' 2 *SALJ* 224 at 239 where the author comments that the 'solvency element' recognises a creditor`s priority over shareholders 'upon dissolution of the company' and that the 'liquidity element' prevents the company from 'favouring its shareholders through partial liquidation'. See also FHI Cassim in FHI Cassim et al. op cit note 1 at 593 for the proposition that directors 'can no longer remain ignorant of the financial affairs of the company' and it is recommended that directors are 'best advised to monitor regularly the company's financial status to determine its solvency and liquidity.'
[78] Stevens & De Beer op cit note 4 at 274. In *Rabinowitz* supra note 16 para 22, the court appears to have implied a duty on directors personally into s 22(1).

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statutory regulation of the potential 'prejudicial exposure of a creditor`s economic interest to unauthorised risk'.[79]

South African courts are developing a body of judicial authority regarding the civil liability remedy and its interplay with certain interrelated provisions of the 2008 Act. In *Rabinowitz*, the plaintiff creditor sought the amendment of her pleadings for the purpose of introducing the alleged liability of the defendant directors on the basis that 'they were knowingly parties to reckless trading in contravention of s 22(1)' which gave rise to their personal liability under s 218(2) in respect of certain alleged 'losses' the plaintiff creditor sustained.[80] The court was called upon to decide, at an interlocutory stage, whether or not the proposed personal liability premised on s 22(1), as read with s 218(2) of the 2008 Act, disclosed a sustainable cause of action.[81] The court`s limited analysis of sections 22(1), 77(3)*(b),* 162(5)*(c)(iv)(bb)*, 214(1)*(c)* and 218(2) lead to it making an express finding that 'a third party can hold a director personally liable in terms of the Act for acquiescing in or knowing about conduct that falls within the ambit of s 22(1)'.[82]

First, the court in *Rabinowitz* accepted that s 214(1)*(c)* made it an offence for a director to 'knowingly acquiesce in a company`s reckless trading as prohibited by s 22(1)' which appears to have served as the baseline from which the court conducted its subsequent interpretation.[83] Secondly, the court relied on the views of both Cassim and Delport respectively, who have commented on the 'wide ambit' of the civil liability remedy and that the word 'contravene' within the context of s 218(2), would obviously include either an offence under the 2008 Act or non-compliance with a provision of the 2008 Act.[84] Thirdly, the court found support for its interpretation by referencing s 162(5*)(c)(iv)(bb)*, which contemplates that a director 'must' be declared delinquent for conduct falling within the ambit of s 77(3)(b).[85] Finally, the court considered the combination of criminal liability *qua* s 214(1) *(c)*, delinquency *qua* s 162(5)*(c)(iv)(bb)*, the express wording of s 77(3)*(b)* and the fact that directors are

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[79] *Lebowa* supra note 7 at 106-107.
[80] *Rabinowitz* supra note 16 para 2 and 23. However, see *Meatworld Factory CC v ET Trading House (Pty) Ltd and Another* [2019] JOL 45224 (GJ) para 36 where despite doubting the 'soundness' of *Rabinowitz*, the court regarded itself bound by the decision unless it could be regarded 'clearly wrong'.
[81] Ibid para 3.
[82] Ibid para 22.
[83] Ibid at para 17.
[84] Ibid para 18. FHI Cassim in FHI Cassim et al. op cit note 1 at 587. Delport et al. op cit note 9 at 640.
[85] Ibid para 20.

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responsible for the management of the company under s 66(1), as decisive in concluding that the 2008 Act prohibits directors from 'engaging' in conduct as described in s 22(1).[86]

The findings in *Rabinowitz* appear to show that the court came to disregard the legal personality of the debtor company premised on its interpretation that a director acting in terms of s 66(1) can personally 'contravene' s 22(1) and that legislature also 'prohibits' directors from 'engaging' in conduct envisaged in s 22(1).[87] In line with the *Rabinowitz* interpretation, it appears that a creditor is required to first, establish that a debtor company has 'contravened' s 22(1) and secondly, that the defendant directors had knowingly participated or acquiesced in the company`s reckless trading. Once these to findings of law are made, according to *Rabinowitz*, the contemplated statutory offence in terms of s 241(1)*(c)* triggers the 'contravention' mechanism provided for in s 218(2) and vests a complete cause of action in respect of personal liability.[88]

In *Blue Farm,* the plaintiff creditor instituted action against the debtor company and the defendant directors jointly, alleging that the debtor company`s inability to make payment of a contractual debt due and owing to the plaintiff creditor, under circumstances where the debtor company was trading on an insolvent basis, at the behest of the defendant directors, justified personal liability.[89] The plaintiff creditor argued that a 'purposive interpretation' of s 77(3)*(b)* of the 2008 Act, in fact places a statutory duty on directors in favour of both the wronged company and its creditors not to 'acquiesce in reckless trading despite knowing of such conduct'.[90] The court in *Blue Farm*, also at an interlocutory stage, proceeded to interpret s 77(3)*(b)* and relied on general principles of interpretation to reach the conclusion that in its view, s 77(3)*(b)* was ambiguous and had to be interpreted to avoid an absurdity.[91] To this end, the court reasoned that, if only the company had a statutory right to claim under s 77(3)*(b)*, it would mean that whilst the company was not in winding up in terms of s 424 of the 1973 Act, it would be precluded from enforcing its own claim against the delinquent directors because those same directors would control the debtor company.[92] Such an absurdity, in the court`s

[86] Ibid paras 21-22.
[87] Ibid.
[88] Ibid paras 13-22.
[89] *Blue Farm* supra note 68 para 5.
[90] Ibid para 15.
[91] Ibid para 31.
[92] Ibid.

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view, needed to be avoided by way of interpreting s 77(3)*(b)* as also placing a duty on directors in favour of company creditors.[93]

In *Chemfit*, the plaintiff creditor pursued application proceedings and the court was asked to focus exclusively on an order for damages under the auspices of the civil liability remedy.[94] Unlike the former cases of *Rabinowitz* and *Blue Farm*, the court considered the merits of the matter and whether or not the plaintiff creditor was entitled to damages under the civil liability remedy. On the facts of *Chemfit*, the court agreed and accepted that the debtor company traded under commercially insolvent circumstances when it sought an increase of its credit facilities with the plaintiff creditor.[95] The court appears to have accepted, without qualification, that the debtor company could only do so acting through its board of directors and therefore the individual directors contravened s 22(1) of the 2008 Act and incurred personal liability.[96] For this finding, the court found comfort in the *ratio* of both *Rabinowitz* and *Blue Farm*.[97]

If regard is had to the prevailing case law on the civil liability remedy and its interplay with interrelated provisions of the 2008 Act, it appears that the most persuasive and cogent statutory 'recipe' available to creditors for the purpose of formulating a sustainable cause of action against directors, would be the interpretation followed in *Rabinowitz* which can be summarised as follows:

(a) Establishing conduct of the debtor company which 'contravenes' the prohibition on reckless trading contained in s 22(1).

(b) To this end, a debtor company`s contravention of s 22(1) is potentially aided by reference to s 4 of the 2008 Act.

(c) Once a contravention of s 22(1) by the debtor company is established, s 66(1) read with s 214(1)*(c)* serve as a mechanism directly implicating the directors of the debtor company in the contravention of s 22(1).

(d) On the rationale of *Rabinowitz*, once it is accepted that a director has committed an offence for the purpose of s 214(1)*(c)*, it can then be argued that a director has

[93] Ibid.
[94] *Chemfit* supra note 70 para 1.3. Overturned on appeal on a point other than its interpretation of the civil liability remedy.
[95] Ibid para 24.
[96] Ibid paras 24-25.
[97] Ibid paras 30, 35 & 39.

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personally contravened s 22(1) which has caused the creditor loss or damage as envisaged in s 218 (2).

V THE CONTEXT AND PURPOSE BEHIND THE CIVIL LIABILITY REMEDY

The 2008 Act 'must be interpreted and applied in a manner that gives effect to the individual purposes set out in s 7', and to the extent appropriate, a court interpreting the 2008 Act 'may consider foreign company law'.[98] On 23 June 2004, prior to the promulgation of the 2008 Act, the Department of Trade and Industries ('DTI') published a policy document ('2004 policy document') which is considered to be in line with the individual purposes of s 7 of the 2008 Act.[99]

Whilst the DTI does not directly address the rationale for having introduced the civil liability remedy, it does cryptically state, under the subheading 'Corporate Governance', that the 'need for statute to allow directors to have regard to the interest of stakeholders other than shareholders, should be evaluated against the constraints it will place on the development of the common law'.[100] In turn, and according to Delport, s 7*(d)* of the 2008 Act provides that directors have to 'manage a company in such manner that promotes both economic and social benefits'.[101] Considered against the background of the 2004 policy document, it appears that s 7*(d)* does not serve the purpose of creating a *sui generis* duty on directors towards outside stakeholders such as creditors, rather, the preferred interpretation appears to be that in line with the enlightened shareholder value model adopted by the 2008 Act, directors under the 2008 Act are to pay attention to the interests of creditors without providing said creditors with any direct rights.[102]

In 2007, following the 2004 policy document, the DTI published an 'explanatory memorandum' comprising a draft bill for discussion ('2007 draft bill').[103] In its introductory paragraphs and under the headings 'Company governance' and 'Enforcement', the DTI contemplated that 'compliance orders' may be issued against a company or individual, if the 2008 Act was 'contravened' by either one, or if the 2008 Act holds the company and another individual jointly liable.[104] Whilst said compliance orders and their conditions could be

[98] Sections 5 and 7 of the 2008 Act.
[99] The 'South African Company Law for the 21st Century Guidelines for Corporate Law Reform' published in GG 26493 of 23 June 2004. See also Delport et al. op cit note 9 at 54.
[100] Ibid.
[101] Delport et al. op cit note 9 at 54.
[102] Ibid.
[103] http://www.uct.ac.za/usr/companylaw/downloads/legislation/Companies_Bill_2007.pdf.
[104] Ibid at 12-16.

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challenged in court, should such challenges be unsuccessful, the Companies and Intellectual Property Commission ('CIPC') *qua* statutory regulator, could apply for an administrative fine or refer the matter to the National Prosecuting Authority.[105] The 2007 draft bill also proposed for the purpose of 'improving corporate accountability' that it would be 'an offence, punishable by a fine or up to ten years imprisonment' for a director to be 'reckless in the conduct of a company`s business'.[106]

If regard is had to the 2004 policy document considered alongside the 2007 draft bill and the adoption of the enlightened shareholder value model, it appears that the reckless trading prohibition in s 22(1) was deliberately framed within a compliance context. To this end, legislature appears to have incorporated it as a check and balance to decriminalising company law. This check and balance would provide the CIPC with a remedy to demand compliance by a company or individual director contravening the Act. Failing compliance, the CIPC could demand that the non-compliant company 'cease to trade' and initiate administrative sanctions in terms of s 214(1) read with sections 216 and 217 of the 2008 Act.[107]

[105] Ibid.
[106] Ibid.
[107] Stein & Everingham op cit note 5 at 452-453. The authors opine that s 22(2) read with regulation 19(2) of the 2008 Act 'gives the Commission a powerful new enforcement tool' which allows for the 'lodgement of a complaint with the Commission' regarding a company`s contravention of s 22(1) and may lead to the CIPC ordering the non-compliant company to 'cease trading'.

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Chapter 4: Similar Provisions in the Australian Corporations Act 2001 (Cth)

I INTRODUCTION

The relevance of considering s 182 read with s 1324 of the Corporations Act lies therein that on a plain reading of the particular provisions, they contemplate a scenario where directors who owe statutory duties towards the company they manage, potentially attract personal liability towards company creditors if, by contravening their statutory duties, the interests of those creditors were 'effected' as a result of the 'insolvency of the company' having been an element of their statutory contravention.[108]

II SIMILAR PROVISIONS

Section 182(1) of the Corporations Act prohibits directors from improperly using their position to cause 'detriment to the corporation', whilst s 182(2) expressly provides that a director 'contravenes' s 182(1), if involved in the prohibited conduct prescribed by s 182(1). In turn, s 1324(1) of the Corporations Act provides a remedy for either the Australian companies regulator ('ASIC'), or 'a person' whose interests have been, are currently, or would in future be 'affected', to claim an injunction, alternatively damages in terms of s 1324(10), arising from 'conduct that constituted, constitutes or would constitute' a multifaceted contravention of the Act.[109] Importantly, s 1324(1A) expressly prescribes that a 'contravention of the Act affects the interests of a creditor or member of the company if the insolvency of the company is an element of the contravention'.[110]

To varying degrees, creditors have been successful in establishing their *locus standi* under s 1324 of the Corporations Act for the purpose of seeking relief against directors for having allegedly breached their statutory duties.[111]

The first case to have considered the merits of a creditor`s claim formulated within the parameters set by s 182 read with s 1324 of the Corporations Act was the supreme court of Queensland *qua* court of first instance, in *Phoenix Constructions Queensland Pty Ltd v*

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[108] RP Austin & IM Ramsay *Ford's Principles of Corporations Law* 14 ed (2013) 754 and Victoria Schnure Baumfield 'Injunctions and damages under s 1324 of the Corporations Act: Will McCracken v Phoenix Constructions revive the narrow approach?' (2014) 32 *Companies and Securities Law Journal* 453 ('Baumfield'). See also Abe Herzberg and Helen Anderson 'Stepping Stones – From Corporate Fault to Directors Personal Civil Liability' (2012) 40 *Federal Law Review* 181.

[109] Delport et al. op cit note 9 at 643, where s 1324 of the Corporations Act is considered within the context of a general right to claim damages against directors of a wronged company.

[110] Section 1324(1A) of the Corporations Act.

[111] *Allen v Atalay* (1993) 2 ACLC 7 where it was held that a creditor may have standing to seek either an injunction or damages in relation to an alleged breach of directors` duties and *Airpeak Pty Ltd v Jetstream Aircraft Ltd* (1997) 73 FCR 161 at 166-167 which held that a creditor did have standing to apply for an injunction under s 1324 of the Corporations Act pursuant to a breach of directors` duties. See also Baumfield op cit note 108 at 459.

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Coastline Constructions Pty Ltd and Others, which was subsequently, successfully taken on appeal to the Queensland court of appeal in *McCracken v Phoenix Constructions Queensland Pty Ltd* ('McCracken').[112] The *McCracken* case is worthy of analysis considering that it gives rise to the issue 'whether directors may be liable to creditors for breaches of directors` duties' a potentially alarming expansion of the law as recognised by Baumfield.[113]

McCracken concerned the plaintiff creditor Phoenix, having approached the court of first instance seeking an injunction, alternatively damages, in terms s 1324(10) for the purpose of holding a solitary defendant director, Mr. McCracken, personally liable for the damages caused by a debtor company named, Coastline. Phoenix alleged that the defendant director had stripped Coastline of its remaining assets in favour of a third party, Ms. McCracken, which rendered Coastline unable to satisfy a claim for damages *vis a vis* Phoenix.[114]

The court of first instance found that Phoenix *qua* creditor had established its damages claim against the defendant director personally, considering his contravention of s 182 of the Corporations Act by having transferred assets out of Coastline to Ms McCracken, which ultimately represented an improper use of his position *qua* sole director and caused detriment to Coastline itself, in light of the fact that Coastline had no other assets to pay its debt to Phoenix.[115] To this end, Phoenix *qua* creditor was regarded a person whose 'interests were affected' for the purpose of s 1324(1) as a result of the defendant director`s breach of s 182.[116]

On appeal, the finding that Phoenix had the necessary *locus standi* to claim damages under s 1324(10) of the Corporations Act was reversed.[117] The Queensland appeal court considered it had no power to award damages to a creditor for a director`s contravention of s 182, where the only injury, in the court`s view, was to the company itself *qua* victim of the statutory contravention. Rather, so the appeal court held, damages to remedy a breach of s 182 should be limited to the party whose interests are protected by s 182 ie. the company itself and only as a substitute or supplementary remedy to the extent that an injunction could not be

[112] *Phoenix Constructions Queensland Pty Ltd v Coastline Constructions Pty Ltd and McCracken & Another* (2011) 84 ACSR 562 comprising the lower court judgment as opposed to *McCracken v Phoenix Construction (Qld) Pty Ltd* (2012) QCA 129 comprising the appeal court judgment.
[113] Baumfield op cit note 108 at 462.
[114] *Phoenix* supra note 112 paras 1-6.
[115] Ibid paras 48-53.
[116] Ibid.
[117] *McCracken* supra note 112 para 64.

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granted.[118] The appeal court further reasoned that an express civil penalty provision under Pt 9.4B of the Corporations Act, precluded an interpretation in favour of a creditor`s standing under s 1324(10), considering that the statutory duty prescribed in terms of s 182 and its subsequent contravention, fell to be pursued by either the regulator ASIC or the wronged company Coastline itself, under the auspices of Pt 9.4B.[119]

It appears that the driving force behind the appeal court`s rationale was the concept of separate legal personality and that the loss or damage of Phoenix was merely 'derivative' or 'reflective' of Coastline`s loss, particularly considering that Phoenix retained its entire claim against Coastline and in that sense, did not lose anything.[120] The concept of 'reflective loss' and the so-called 'no reflective loss rule' was initially developed within the context of a shareholder`s claim in the English case of *Prudential (No 2)*.[121] In *Prudential* (*No 2)* the appeal court held that a shareholder could not:

> Recover damages merely because the company in which he is interested has suffered damage. He cannot recover a sum equal to the diminution in the market value of his shares, or equal to the likely diminution in dividend, because such a "loss' is merely a reflection of the loss suffered by the company. The shareholder does not suffer any personal loss. His only "loss" is through the company in the diminution in the value of the net assets of the company in which he has a particular percentage shareholding.[122]

Since *Prudential (No 2)*, some of the highest ranking courts in England and Hong Kong have intimated that the 'no reflective loss rule' could be extended to creditors who have suffered damages as a result of the debtor company having been harmed or wronged by its directors.[123] From the perspective of the appeal court in *McCracken*, the driving policy considerations for the 'no reflective loss rule' being extended to creditors, appear to have been first, the risk of double recovery against directors from both the debtor company and its

[118] Ibid paras 44-46. This interpretation of the appeal court shares similarities with the view of Stein & Everingham op cit note 5 at 402 & 452-453 where the authors interpret s 22 of the 2008 Act within the context of a civil penalty provision which facilitates compliance demands in terms of s 22(2).
[119] Ibid paras 26-29.
[120] Ibid para 28. See also Baumfield op cit note 142 at 465.
[121] *Prudential Assurance Co Ltd v Newman Industries Ltd* (No 2) [1982] 1 Ch 204; [1982] 1 All ER 354 (CA). The appeal court`s *ratio* on the no reflective loss rule was confirmed by the House of Lords in *Johnson v Gore & Wood* [2001] 1 All ER 481 at 35F-36A.
[122] Ibid at 222-223.
[123] *Johnson* supra note 121 at 66H-67C and *Gardner v Parker* [2004] EWCA Civ 781 para 70-71 and *Waddington Ltd v Chan Chun Hoo* [2009] 4 HKC 381. See also *Sevilleja Garcia v Marex Financial Ltd* [2018] EWCA Civ 1468 para 66-72 where the English Court of Appeal confirmed that it was bound by *Prudential No 2* and *Johnson* for purposes of applying the no reflective loss rule to the claim of a creditor.

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creditors and secondly, the preference of individual creditors at the expense of the debtor company and its body of creditors.[124]

Whilst Baumfield regards the appeal court`s reliance in *McCracken* on the 'no reflective loss rule' as its most powerful point, the commentator highlights and raises the following considerations seeking to challenge the rationale of *McCracken*:

(a) That relief aimed at ordering the payment of damages to the victim company rather than the creditor directly, would potentially obviate against the mischief prevented by the rule against reflective loss.[125]

(b) That legislature has not expressly barred claims for reflective loss, rather it has expressly recognised the interests of creditors in situations such as 'the insolvency of the company is an element of the contravention'.[126]

(c) Furthermore, s 1324 makes no distinction between 'direct' or 'indirect' loss and therefore from an interpretational point of view, there is no justification for excluding a creditor`s standing to pursue a claim for reflective loss under the broad scope of s 1324(10).[127]

(d) An inclusive stakeholder approach within modern day corporate law justifies a broader interpretation of potential remedies affording stakeholders, such as creditors, primary recourse against miscreant directors.[128]

From the perspective of South African creditors and within the context of invoking the civil liability remedy, *McCracken* raises the question whether or not the 'no reflective loss rule' would similarly constitute a potential hurdle for creditors seeking to hold directors liable for either a debtor`s company`s contravention of s 22(1) or their own contravention of other statutory duties owed to the debtor company in terms of the 2008 Act.

[124] *McCracken* supra note 112 para 28. In a South African insolvency context, the body of creditors is colloquially referred to as the 'concursus creditorum', a legal recognition which ensures that creditors` rights are not altered at the expense of one another as recognised in *Walker v Syfret NO* 1911 AD 141 at 160.
[125] Baumfield op cit note 108 at 466 where it is opined that the court in *McCracken* left a 'back door open' for a creditor to potentially pursue a damages claim under s 1324(10), qualified by the fact that such damages are to be awarded to the wronged company itself. See also Herzberg & Anderson op cit note 108 at 203.
[126] Ibid at 468-469.
[127] Ibid at 467-468.
[128] Ibid at 469.

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Chapter 5: Discussion of the Primary Research Question

I INTRODUCTION

The primary research question can be answered with due regard to first, whether on a unitary interpretation of s 22(1) and other interrelated provisions of the 2008 Act, it favours creditors being able to hold directors personally liable in terms of s 218(2) and secondly, whether specific policy considerations relevant to company law justify the operation of the civil liability remedy in favour of creditors.

The prevailing state of South African law prescribes a 'unitary approach' to the interpretation of statutes.[129] Within the context of this unitary approach, it is accepted that a 'plain reading' of the civil liability remedy and interrelated provisions of the 2008 Act is required, which also involves considering the 'context and purpose' within which the civil liability remedy was incorporated by the 2008 Act. To this end, a 'sensible interpretation' in line with the purpose of the 2008 Act is to be preferred as opposed to an interpretation which creates 'anomalies' and may lead to 'unbusinesslike' results.[130]

II UNITARY APPROACH TO SECTION 218(2) AND INTERRELATED PROVISIONS

(a) Plain reading with due regard to context and purpose

Considering the inclusion of the words 'any person', the civil liability remedy is framed wide enough to afford standing to creditors. However, whether a creditor could invoke s 218(2) would ultimately depend on whether a provision of the 2008 Act was in fact 'contravened' and whether the creditor suffered loss or damage 'as a result of that particular contravention.[131]

Whether a provision of the 2008 Act was 'contravened' naturally depends on whether a particular provision of the 2008 Act is capable of contravention.[132] Therefore, an interrelated provision of the 2008 Act would essentially have to be either 'peremptory or substantially directory or either prescriptive in nature, alternatively in some way aim to regulate conduct capable of contravention'.[133] Considering the causative element created by the words 'as a result of that contravention', the question arises whether a particular duty or obligation created

[129] *Endumeni* supra note 24 para 18 has been applied in more than one hundred reported judgments to date.
[130] Within a company law context, the most recent judgments having applied *Endumeni* are *Diener NO v Minister of Justice and Correctional Services and Others* 2019 (4) SA 374 (CC) paras 37, 52 and 63 as well as *FirstRand Bank Ltd v KJ Foods CC* 2017 (5) SA 40 (SCA) para 75.
[131] Delport et al. op cit note 9 at 639-640.
[132] Stevens & De Beer op cit note 4 at 274 where a hermeneutic interpretation of s 218(2) in the context of s 22(1) is proffered.
[133] Ibid.

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by a particular provision of the 2008 Act, is in fact owed to a particular 'person' such as creditors?[134]

Turning to the *Rabinowitz* interpretation, a plain reading of s 22(1) showcases that it is 'prescriptive' considering it creates a positive obligation for a company not to 'carry on its business with intent to defraud any person'. In turn, the word 'person' would logically include creditors. However, and quite decisively, the fact that s 22(1) specifically prohibits 'a company' from trading recklessly and does not refer to its board of directors cannot be obscured.[135] This leads to the straightforward conclusion that s 22(1) is indeed capable of contravention, however, only by the debtor company itself.[136] Furthermore, withing the context of reckless trading it should be uncontroversial that the interests of creditors are paramount, particularly so, if regard is had to the stringent solvency and liquidity test prescribed by s 4 of the 2008 Act.[137] Such an interpretation would mean that creditors would be able to formulate a sustainable cause of action against the 'debtor company itself' and not its directors personally, by relying on s 218(2) as read with s 22(1).

To interpret s 22(1) in the abstract, as being capable of contravention by directors personally, would essentially involve reading into the prohibition something which is not there. From a contextual and purposive perspective, s 22 of the 2008 Act considered as a whole, appears to prescribe a method for the CIPC to issue compliance notices to a company which it 'has reasonable grounds to believe' is contravening s 22(1), with the corollary that a company could be ordered by the regulator to cease trading.[138] This proffered interpretation is fortified by the 2008 Act`s adoption of the enlightened shareholder value model and the reasoning articulated in both the 2004 policy document and 2007 draft bill.[139]

To justify reading into s 22(1), *Rabinowitz* and related authorities appear to have reasoned that legislature 'intended' to prohibit directors from trading recklessly as much as it

[134] Ibid at 275.
[135] *Meatworld CC* supra note 80 para 31 where, also relying on the general principles enunciated in *Endumeni*, it was held that words 'cannot be read into a statute by implication, unless it is a necessary implication' to make the legislation 'workable'.
[136] Ibid para 35.
[137] Stevens & De Beer op cit note 4 at 276. The interests of creditors gain ever-increasing significance when the debtor company reaches the 'zone of insolvency'. See also HH Rajak 'Director and Officer Liability in the Zone of Insolvency : A Comparative Analysis' (2008) 1 *Potchefstroom Electronic Law Journal* 31 in so far the development and scope of the 'zone of insolvency' is concerned and a creditor`s interest *vis a vis* the managers of the debtor company.
[138] Stein & Everingham op cit note 5 at 452-453.
[139] Supra Ch 3 V.

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prohibits a company from doing so. The proposed 'intention' of legislature was ascertained with reference to predominantly s 214(1)*(c)* and s 77(3)*(b)*.[140]

Turning first then to s 214(1)*(c)*, it appears to place the focus on a person knowingly being a party to an act or omission of the company calculated to 'defraud' a creditor. The focal point of fraud in terms of s 214(1)*(c)* would be sensible, considering that chapter nine of the 2008 Act is concerned with 'Offences, Miscellaneous Matters and General Provisions'. In turn, s 216 expressly provides for 'penalties' as a result of committing an offence in terms of s 214(1)*(c)*, taking the form of either, or both, a fine and/or imprisonment. To give effect to s 216 of the 2008 Act, magistrates courts` are afforded the necessary jurisdiction to impose a fine and/or imprisonment on a person through s 217 of the 2008 Act. Therefore, in so far the defrauding of creditors referred to in s 214(1)*(c)* could be connected with the 'fraud' component contained in s 22(1), it appears to serve the purpose of imposing fines and/or imprisonment on directors being knowingly party to a 'fraud' committed by the company itself, without a need for disregarding separate legal personality in favour of creditors.[141]

Turning then secondly to s 77(3)*(b)*, its wording can be directly correlated to the reckless trading prohibited by s 22(1). Holistically considered, the interplay between s 77(3)*(b)* and s 22(1) does not appear to be a possible 'clue' regarding legislature`s so called 'intention' to prevent directors personally from acting contrary to s 22(1).[142] Rather, Stevens and De Beer argue that the interplay facilitates a so called 'loop of liability' aimed at granting the company itself a co-relative right against its own directing minds.[143] The proffered rationale for such a co-relative right is that s 22(1) imposes a standard of conduct on the company itself and it is the consequent harm done by the company to itself, that actuates s 22(1) and creates the need for a subsidiary duty on directors in terms of s 77(3)*(b)*, to allow the company to take action against its 'directing minds'.[144]

The view by various commentators and authorities that the statutory duty of care and skill in terms of s 76(3)*(c)*, as well as the statutory duties of directors to act in the 'best interests' of the company, 'in good faith' and 'for a proper purpose' in terms of sections 76(3)*(a)* and *(b)*

[140] *Endumeni* supra note 24 para 20, it was held that the reference to 'the intention of parliament' was a misnomer and that it was more appropriate to consider the context and purpose within which a particular statutory provision was incorporated.
[141] This is also fortified by the posture of legislature prior to the 2008 Act coming into operation, if regard is had to the 2004 policy document and 2007 draft bill.
[142] *Rabinowitz* supra note 16 para 21.
[143] Stevens & De Beer op cit note 4 at 275.
[144] Ibid.

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are potentially actionable by creditors under s 218(2) cannot be sustained.[145] This is so, considering that legislature saw it fit to combine the entire s 76(3) with a consequential liability provision in terms of s 77(2), which serves to create a presumption against the invocation of s 218(2) *qua* general liability remedy, in order to avoid co-ordinate liability.[146] If regard is had to the view that the statutory threshold for the purpose of fixing personal liability in terms of s 76(3)*(c)* is less onerous, compared to its common law equivalent, then the better view appears to be that the potential interplay between s 76(3), 77(2) and the civil liability remedy operates in favour of the wronged company itself.[147]

This interpretation, that the relevant interrelated provisions of the 2008 Act do not create direct rights for creditors *vis a vis* company directors, would be a sensible interpretation considering the existence of various policy considerations flowing from the concept of separate legal personality which ultimately negate against an interpretation to the contrary.[148]

(b) Sensible interpretation with due regard to specific policy considerations

The rationale driving the interpretation proffered in *Rabinowitz* was the ‘policy consideration’ that ‘it is hard to conceive any basis upon which the legislature intended to prevent a company from acting in the manner provided for in s 22, but did not intend to prevent the directors responsible for the management of the company from acting in that manner’.[149]

It should be quite clear from the body of this study that sections 4, 22(1) and 77(3)*(b)* of the 2008 Act are aimed at the prevention and prohibition of a company`s reckless trading and its directors having ‘knowingly acquiesced in such prohibited conduct’. Therefore, once it is accepted, as it should be, that creditors have a direct interest in a company`s potential contravention of s 22(1), the question appears not be ‘whether creditors should be protected from reckless trading, but rather, how best are creditors to be protected’?[150]

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[145] Esser & Delport op cit note 5 at 106 and Stevens & De Beer op cit note 4 at 281 and *Grancy* supra note 64 para 104 as well as *Sanlam Capital* supra note 69 para 42. However, in *Hlumisa* supra note 19 para 28-30, after having considered the interplay between s 76(3) and 77(2) of the 2008 Act, the court regarded an attempt to invoke s 76(3) by way of s 218(2) to have the effect of ‘impermissibly creating co-ordinate liability’ and relied on the *generalia specialibus non derogant* maxim of interpretation as discussed in *Gentiruco AG v Firestone SA Pty Limited* 1972 (1) SA 589 (A) at 603.
[146] *Hlumisa* supra note 21 para 30.
[147] Stevens & De Beer op cit note 4 at 260. The wronged company could either pursue individual directors or interested parties could pursue a true derivative action in terms of s 165(2) of the 2008 Act.
[148] Ibid at 275-281 where a ‘policy analysis of the company as the plaintiff of preference’ is undertaken.
[149] *Rabinowitz* supra note 16.
[150] Stevens & De Beer op cit note 4 at 276.

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Considering then that creditor protection should be at heart of the *Rabinowitz* interpretation, the difficulty faced by such interpretation is that it necessitates a recognition that both a creditor and the wronged debtor company itself, would have separate and distinctive causes of action premised on s 218(2) read with s 22(1), and the other interrelated provisions of the 2008 Act, *vis a vis* delinquent directors.[151]

The potential co-existence of civil claims in favour of both a creditor and the wronged debtor company itself, could lead to a possibility of double recovery against the defendant directors. To this end, if the plaintiff creditor is successful and the company is found to have traded recklessly, it would most likely leave any subsequent appointed liquidator unable to recover any 'meaningful amount of money', considering that the plaintiff creditor`s judgment could render the defendant directors 'men of straw'. Consequently, the debtor company`s body of creditors would be prejudiced by receiving a reduced payment in winding up, whilst the successful plaintiff creditor could potentially prove a residual claim in the debtor company`s insolvent estate and essentially 'drink twice from the well'. Allowing the co-existence of claims invariably favour creditors with deep pockets and an appetite for litigation at the direct expense of the company`s remaining 'weaker' creditors.[152] These undesirable consequences inherent in the *Rabinowitz* interpretation, would lead to unbusinesslike results and should not be regarded as the best manner to protect a debtor company`s body of creditors.[153]

Instead, as postulated by Stevens and De Beer, the 'plaintiff of preference' principle, involving various nuanced legal-economic policy considerations, appear to constitute the best manner in which to protect a debtor company`s body of creditors from the prejudice inherent in reckless trading under s 22(1).[154] This so called 'plaintiff of preference' principle leads to a sensible interpretation of s 218(2) read with s 22(1) and deserves further consideration.[155]

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[151] The wronged company itself qualifies as 'any person' for purposes of s 218(2) and a particular director`s 'contravention' would arise out of his or her contravention of either or both s 76(3)*(b)* and s 22(1) of the 2008 Act.
[152] Stevens & De Beer op cit note 4 at 279.
[153] To a certain extent, these undesirable consequences were also recognised by the Queensland appeal court in *McCracken* supra note 112.
[154] Stevens & De Beer op cit note 4 at 275.
[155] *Foss v Harbottle* supra note 26, which rests on the principle that 'if a wrong has been committed against a company, the decision whether or not to seek redress from the wrongdoers lies with the company'. The focus of this study does not allow for an in depth exposition and discussion of the theory behind various legal-economic considerations that inform the umbrella 'plaintiff of preference' principle, instead, a succinct and practical approach that highlights the most relevant considerations will be undertaken.

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III THE PLAINTIFF OF PREFERNECE PRINCIPLE

The plaintiff of preference principle recognises that a company`s statutory existence and functionality is facilitated through the so called 'nexus of contracts' theory, which theory in turn, allows for a 'creditor-centric' economic function known as the 'partitioning' of company assets.[156] Importantly, such legal-economic policy considerations allow the debtor company to sue in its own name, absorb any losses it may have suffered as a result of its directors having knowingly acquiesced in the company`s reckless trading, and return the quantum of such loss to the company`s own recognised 'partitioned group of assets', thereby facilitating the efficient allocation of credit by company creditors and a fair distribution of harm.[157]

To this end, the plaintiff of preference principle recognises another important legal-economic consideration, namely that whilst a company remains a going concern, it should be respected as an autonomous economic unit, which respect, is premised on the theory that the legal machinery which allows it to function as a legal fiction is sufficiently 'calibrated' to ensure that any harm done to the company itself, by its controlling minds, are proportionately and fairly discounted amongst its stakeholders.[158]

This legal-economic perspective underpinning the plaintiff of preference principle comprise the same considerations which have ultimately informed the policy considerations in favour of the 'no reflective loss rule'.[159] Invariably, the harm sustained by creditors as a result of reckless trading as envisaged by both the 2008 Act and the 1973 Act respectively, are 'reflective' of the wrongful acts committed by the directors *vis a vis* the company itself.[160]

The no reflective loss rule is a corollary of recognising separate legal personality and in line with the rationale driving the plaintiff of preference principle.[161] It appears that the development of the rule, as result of courts having considered various relevant legal-economic policy considerations, serves as an 'enforcement mechanism' to prevent the undesirable

[156] Henry Hansmann & Reinier Kraakman 'Organizational Law as Asset Partitioning' (2000) 44 *European Economic Review* 807 at 810-811. The authors postulate that in an attempt to 'coordinate economic activity' natural persons, whether it be shareholders, directors, employees or creditors, contract separately with the legal fiction that is a company and afford it a 'discretion to undertake the economic coordination through separate contracts'. The authors also describe 'asset partitioning' as the 'division of a fixed pool of assets into sub-pools, each of which is separately pledged as security to a different creditor or group of creditors'. See also Michael C Jensen and William H Meckling 'Theory of the firm: Managerial behaviour, agency costs, and ownership structure' (1976) 3 Journal of Financial Economics 305.

[157] Stevens & De Beer op cit note 4 at 277-278.

[158] Ibid.

[159] *Sevilleja* supra note 123 para 32.

[160] Stevens & De Beer op cite note 4 at 278.

[161] *Johnson* supra note 156 at 35-36. See also *Itzikowitz v Absa Bank Ltd* 2016 (4) SA 432 (SCA).

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consequences justifying the various legal-economic policy considerations.[162] To this end, the rule serves to respect and preserve separate legal personality, subject to certain recognised exceptions.[163]

From a South African perspective, the no reflective loss rule arising within the context of the civil liability remedy, was considered in *Hlumisa.*[164] The plaintiff shareholders invoked s 218(2) read with s 76(3) and 22(1) of the 2008 Act and the nub of their contentions were that the defendant directors conducted the business of African Bank and another subsidiary company, recklessly and in contravention of both s 22(1) and s 76(3).[165] At an interlocutory stage, the defendant directors` took a legal objection to the pleaded case of the plaintiff which lead to the court taking the view, that in order for the shareholders to successfully sustain their pleaded cause of action in terms of the civil liability remedy, they would have to persuade the court from an interpretational perspective that s 218(2) has altered and extinguished the common law which does not permit a claim for 'reflective loss'.[166] In answering this question, the court restated the common law position in accordance with *Prudential* (No 2).[167] Furthermore, relying on principles of statutory interpretation which prescribe that a 'rebuttable presumption' exists against the 'alteration of the common law' by statute, the court concluded that nothing in the wording of s 218(2) indicated an 'intention' of legislature to alter the common law rule against shareholders claiming reflective loss.[168]

The findings of the court in *Hlumisa* are straightforward and legally sound.[169] In light of both *McCracken* and *Sevilleja* and notwithstanding that the claim in *Hlumisa* was pursued by shareholders, it is submitted that the interpretation of the civil liability remedy applies *mutatis mutandis* to a claim *qua* creditor.[170]

[162] Ibid.
[163] Exceptions such as s 424 of the 1973 Act and the *sui generis* remedy of 'piercing the corporate veil'.
[164] *Hlumisa* supra note 19.
[165] Ibid para 11.
[166] Ibid para 24.1-24.2.
[167] *Prudential (No 2)* supra note 156.
[168] Ibid para 39.
[169] The *ratio* in *Hlumisa* supra note 21 is in contrast to the views expressed by Esser & Delport op cit note 5 and Stevens & De Beer op cit note 4, regarding the ability of s 76(3) to unlock the civil liability remedy in favour of third parties.
[170] *McCracken* supra note 112 and *Sevilleja* supra note 123. The judgment in *Sevilleja* is currently under appeal to the UK Supreme Court of Appeal under case ID: UKSC 2018/0178 and may change legal position regarding the operation of the no reflective loss rule *vis a vis* creditors.

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Chapter 6: Recommendations and Conclusions

On its face, the civil liability remedy appears to constitute an attractive novel and primary remedy for creditors. However, on closer consideration and with due regard to the interpretative difficulties and adverse policy considerations, its effective operation is drawn into serious question.[171]

From the perspective of creditors, once a unitary interpretation of s 218(2) read with s 22(1) and related provisions of the 2008 Act is adopted, a plain and sensible reading of the relevant provisions with due regard to the best interests of creditors as a collective, justify the conclusion that a debtor company itself should remain the 'plaintiff of preference'. This view entails that the debtor company itself should invoke the civil liability remedy for the purpose of fixing personal liability on its own directors for having contravened either s 77(3)*(b)* or s 76(3) of the 2008 Act. To this end, it should be recognised that creditors retain s 424 of the 1973 Act which is an accepted statutory 'exception' to the preservation of separate legal personality.[172]

In light of the contrasting judgments in *Rabinowitz* juxtaposed with *Hlumisa*, the positive law in South African on whether creditors are able to formulate a sustainable cause of action premised on the civil liability remedy as read with s 22(1) remains slightly uncertain.[173] However, this uncertainty should not compromise a proper unitary interpretation of the relevant provisions with due regard to legal-economic policy considerations which negate against the standing of creditors *vis a vis* directors for the purpose of fixing personal liability.[174]

All things considered, s 424 of the 1973 Act remains the most effective remedy for unsecured creditors to impose personal liability on delinquent directors for the reckless trading of a debtor company. From the perspective of creditors, it appears that s 218(2) is much ado about nothing.[175]

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[171] Supra Ch 5 I-II.
[172] Stevens & De Beer op cit note 4 at 280 ague that s 22 (1) of the 2008 Act serves the purposes of 'correcting a disparity created by s 424 of the 1973 Act' when s 424 applied simultaneously to a company both in winding up and whilst still trading. This dual applicability of s 424, so it is argued, 'compromised' the equal treatment of creditors in winding up considering that individual creditors could recover from delinquent directors on 'the cusp of liquidation' at the expenses of the body of creditors.
[173] Supra Ch 5 at (b).
[174] Supra Ch 5 at (b).
[175] See https://www.phrases.org.uk/meanings/much-ado-about-nothing.html. The phrase 'much ado about nothing' colloquially used when a 'big fuss is made about something of little importance' is today probably best known, albeit not originating from, the similarly titled comedic play authored by William Shakespeare.

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