Liability for fraudulent and reckless trading: a critical analysis of *Engelbrecht NO and Others NNO v Zuma and Others* [2015] 3 All SA 590 (GP)

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ABSTRACT

The recent case of *Engelbrecht NO and Others v Zuma and Others* [2015] 3 All SA (GP) deals with the application of section 424 of the Companies Act 61 of 1973 dealing with the personal liability of directors and others for the fraudulent or reckless conduct in the carrying on of the business of the company. This takes into account the relevance and applicability of section 424 in view of the promulgation of the Companies Act 71of 2008, which came into effect in May of 2011. The approach adopted is that of looking at the requirements that give rise to personal liability by taking into account the provisions of legislation, literature and previous decisions by the courts on the matter. Our courts continue to protect the rights of creditors against unscrupulous directors or individuals who knowingly participate in carrying on of the business of the company in a manner prohibited by law.

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1. INTRODUCTION

"The area of directors' personal civil liability that is most often litigated is that which may arise when a company is trading in a fraudulent or reckless manner."[1]

The recent case of *Engelbrecht NO and Others NNO v Zuma and Others*[2] bears testimony to the above statement through a judgement recently delivered by Judge E Bertelsmann in the High Court, Gauteng North Division. In this case the court was asked to make a declaratory order in terms of section 424 of the 1973 Companies act read with section 77 and schedule 5 item 9 of the 2008 Companies Act.[3] Section 424 of the 1973 act deals with the liability of directors and others for the fraudulent or reckless conduct of business and provides that:

"When it appears, whether it be in a winding-up; judicial management or otherwise, that any business of the company was or is being carried on recklessly or with intent to defraud creditors of a company or creditors of any other person or for any fraudulent purpose, the court may, on the application of the master, the liquidator, the judicial manager, any creditor or member or contributory of the company, declare that any person who was knowingly a party to the carrying on of the business in the manner aforesaid, shall be personally responsible, without any limitation to liability, for all or any of the debts or other liabilities of the company as the court may direct. [4]

Under the new dispensation pursuant to the coming into effect of the 2008 Companies act in May 2011, section 424 of the 1973 act continued to apply. [5] Item 9 of schedule 5 deals with the continued application of the previous act to winding-up and liquidation and provides that:

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[1] Van Der Linde "The personal liability of directors for corporate fault - An exploration" 2008 *SA Merc LJ* 440 443. Some of the recent cases include *Fourie v First Rand Bank Ltd* 2013 (1) SA (SCA) and *Tsung v IDC* (173/2012) [2013] ZASCA 26.
[2] *Engelbrecht NO and Others NNO v Zuma and Others* [2015] 3 All SA 590 (GP)
[3] Companies Act 61 of 1973 and Companies Act 71 of 2008.
[4] Section 424 Companies Act 61 of 1973.
[5] Chapter 14 of Act 71 of 2008.

"Despite the repeal of the previous Act, until the date determined by the [Minister] Chapter 14 of the Act continues to apply with respect to winding up and liquidation of companies under this Act, as if that Act had not been repealed…"

The difference in the application of section 424 under the 2008 act is that, it applies only when a company is in winding up and in liquidation. Whereas the application of this section under the 1973 act was applicable even when the company was still trading as long as there was a claim that the business of the company was being carried out recklessly or fraudulently.[6] Under the 2008 act, a company that is not in winding up or liquidation would be dealt with under section 22, which basically states that a company must not carry on its business recklessly, with gross negligence, with intent to defraud any person or for any fraudulent purpose.

The similarity between the provisions of section 22(1) with those of section 424 is that the transgression that both sections seek to address is the conduct of the business of the company in a reckless or fraudulent manner. Thus the conduct of a particular director does not constitute a breach of these sections as that would be dealt with under section 76 and 77 of the Act. This raises another issue that as in the present case that our courts in delivering judgements under section 424 tend to look or focus on the conduct of the respondent or the party that is eventually held liable rather than the way the business of the company was being carried on. One might argue that there is a thin line between the two as it is those individuals who act on behalf of the company. It could also be argued that this is so to deter individuals from abusing limited liability by alleging that the company is the one carrying on its business in a prohibited manner. In *Ebrahim v Airport Cold Storage (Pty) Ltd,*[7] Cameron JA pointed out "It need hardly be added that the function of the statutory provision also shapes its application. Although juristic persons are recognised by the Bill of Rights – they may be bound by its provisions, and may even receive its benefits – it is an apposite truism that close corporations and companies are imbued with identity only by virtue of statute. In this sense their separate existence remains a figment of law, liable to be curtailed or withdrawn when the objects of their creation are abused or

[6]Section 424 states that "When it appears, whether it be in a winding-up; judicial management or otherwise……."

[7] *Ebrahim v Airport Cold Storage (Pty)* Ltd 2008 6 SA 585 (SCA) par 15.

thwarted. The section retracts the fundamental attribute of corporate personality, namely separate legal existence, with its corollary of autonomous and independent liability for debts, when the level of mismanagement of the corporation's affairs exceeds the merely inept or incompetent and becomes heedlessly gross or dishonest. The provision in effect exacts a quid pro quo: for the benefit of immunity from liability for its debts, those running the corporation may not use its formal identity to incur obligations recklessly, grossly negligently or fraudulently. If they do, they risk being made personally liable."

The liquidators brought an application against the directors (first to third respondents) and the consultants of Aurora Empowerment Systems (Pty) Ltd and the consultants (fourth and fifth respondents) for a declaratory order in terms of section 424 of the Companies act read with section 77.

2. FACTS AND CLAIMS

Aurora Empowerment Systems (Pty) Ltd ("Aurora") was born out of an idea by the respondents to embark on business on a large scale, which would require extensive funding which the fourth and fifth respondents would be required to secure.[8] The latter approached an acquaintance of theirs one Dato Rajah Shah ("Shah") and a Malaysian equity fund known as AM Equity Ltd (BV) ("AME").[9]

AME expressed willingness to provide the required funding provided that Aurora sourced a listed entity that would acquire shares in Aurora. Further that the first respondent would be the chairman of Aurora, the second respondent the managing director and the third respondent together with Shah executive directors. The fourth and the fifth respondent's involvement would be that of consultants who would be remunerated for their services. They would procure finance for Aurora.

The applicants approached the court in their capacity as provisional liquidators of Pamodzi group of companies, with their powers duly extended to bring about the

[8] (n2) par 16.4.
[9] (n2) par16.5.

application.[10] The applicants were granted extensive powers by the court to deal with the assets and business of the companies. The Pamodzi Group of Companies consisted of a total of six companies whose core business was in the mining space. Over time all six companies were placed under provisional liquidation, which orders were extended from time to time. Due to all the Pamodzi companies being found to be insolvent without any prospects of being restored to trade profitably by the liquidators, it was decided that a single buyer should be sought for all of them with a view to achieve the best possible return. Standard Bank of South Africa was instructed to execute the process of finding a preferred bidder to acquire the mines.[11]

On the other hand, the respondents continued with the endeavours to secure funding for Aurora through various initiatives and with various listed entities. In some instances agreements were entered into as a result of transactions engineered by the fourth and fifth respondents. Even though some of those transactions looked promising for Aurora to be able to achieve its funding goals and to fulfil the condition precedent by AME for the latter to provide funding, nothing seemed to have finally materialised in that regard.

With the passing of time it was becoming imperative and of utmost urgency for the liquidators of Pamodzi to dispose of the mines as they found themselves in a position of having to borrow money to enable them to care for the mines. Amongst some of the loans advanced to the liquidators for this purpose was from the Industrial Development Corporation to the tune of R50,8 million and one from HVB Bank to the amount of R50 million.[12] It was important for the liquidators to keep the mines afloat in order not to lose their license as this could be a critical aspect for the disposal or sale to a third party.

A call for tenders for the insolvent mines was subsequently issued and the Aurora directors showed considerable interest to acquire them, to the extent that they commissioned a surface assessment of the value and state of the mines. Subsequently, Aurora submitted an offer to the liquidator of the mines that was signed

[10] (n2) par12.
[11] (n2) par 16.8.
[12] (n2) par 16.28.

by the second respondent, who was also the managing director of Aurora. The date of the submission of the offer by Aurora for the mines was 27 July 2009. At the request of the fifth respondent, Shah and AME provided a letter dated 14 September 2009 to the first respondent, the chairman of Aurora for onward transmission to Standard Bank providing confirmation of AME's willingness to fund the project for the acquisition of the mines. The letter confirmed availability of R200 million for the acquisition for one of the mines Pamodzi Gold Orkney (Pty) Ltd.[13]

Aurora proceeded to submit its second bid for one of the mines being Pamodzi Gold mines on the East Rand on 1 October 2009 that was also signed by Aurora managing director, the second respondent. The offer was a total amount of R350 million. AME again provided a confirmation letter to the chairman of Aurora, the first respondent with an undertaking that R350 million would be made available to acquire the East Rand mines.[14] The liquidators accepted both offers from Aurora.

Upon Aurora moving into the two mines on 15 September 2009 and 15 October 2009 respectively, an agreement known as the interim trading and contract mining agreement "ITCMA") was concluded between Aurora and the liquidators. [15] Contained in the agreement were a number of undertakings by Aurora pertaining to the running of the mines that it had occupied. To mention but a few provisions of the said agreement in as far as Aurora's responsibilities towards the running of the mines are the following:

1. Aurora would commence the mining of the mines as the agent of the liquidators in order to protect the assets;
2. Aurora would inject cash into the business of the insolvent companies;
3. Aurora would commence mining against a fee and would provide care and maintenance of the mines
4. Such care would include but not be limited to the payment of wages and salaries; hostel fees, water and electricity; premiums of all insurance policies and others;

[13] (n2) par 16.34.
[14] (n2) par 16.37.
[15] (n2) par 16.40.

5. The proceeds of all gold mining activities would be paid into a specified bank account;
6. Aurora would comply to all the applicable laws and regulations to protect the mining rights;
7. Aurora would keep proper accounting records; and
8. Aurora warranted that it had the necessary skill and expertise to conduct mining operations.

No other agreement was entered into with Aurora in respect of the insolvent companies. The funding expected from AME never materialised and Shah and AME subsequently pulled out of the deal, citing several reasons including unfulfilled conditions precedent to the granting of the loans and poor corporate governance by Aurora directors. The fourth and fifth respondents in their capacities as consultants for Aurora managed to source funding of R15 million for Aurora but that was not sufficient for the running of the mines as expected.[16] A series of unfortunate events over time started to befall the mine operations, ranging from fatalities, threat of loosing the mining license and repayment of creditors' loans became due and payable and workers going on strike demanding a bonus. This all happened because Aurora failed and was not able to perform according to the agreement and therefore breached its provisions. The respondents failed to maintain insurances and correspondence from the applicants' lawyers followed signalling their intention to terminate the agreement. Finally a letter of demand placing the respondents *in mora* and threatening the cancellation of the contract if they failed to comply therewith dated 2 March 2010 was sent to Aurora.[17]

Upon the liquidators calling upon Shah and AME to comply with the latter's undertaking to providing funding to Aurora for the purchase of the insolvent companies, the response received was that AME was no longer willing to provide such funds due to the company being unsafe and corporate governance breaches by Aurora and its directors and that it had failed to fulfil the conditions precedent to the provision of such funding.

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[16] (n2) par 16.42.
[17] (n2) par 16.53.

3. THE SCOPE OF SECTION 424

Section 424 is enforceable by creditors of the company; liquidator; member or contributory of the company against a director or anyone who carries the company's business in a reckless or fraudulent manner. The applicants brought an application in terms of section 424 read with section 77.[18] Before dealing with the provisions of section 424, I think it is important to deal with section 77 as mentioned in the relief sought. There has been some controversy as to whether the fiduciary duties owed by the directors to the company can be extended to creditors.[19] Section 77 of the 2008 act, in my view has brought clarity as to who directors of the company owe their fiduciary duty to and that is to the Company. Section 77 deals with the liability of directors to the Company in that a director may be held personally liable for any damages or costs sustained by the company as a result of a director breaching his fiduciary duties as set out in the act and under common law.[20] Section 77 would be relevant had there been an allegation of breach of a fiduciary duty towards the company as envisaged under section 76 and such an application would have to be brought by the company.[21] It would seem from the relief sought by the applicants that they sought a declaratory order in terms of section 424 read with section 77. It is not clear from the judgement what the relevance of section 77 is in the order sought by the applicants. In his judgement the judge does not make any reference to section 77 understandably so as the applicants have no *locus standi* to bring an application based on section 77 of the 2008 Companies act.

In dealing with section 424, schedule 5 of the 2008 act delineates the transactional arrangements as they relate to those provisions of the 1973 act, which continue to apply despite the repeal of the 1973 act. Included in schedule 5 is the continued application of chapter 14 of the 1973 act where the provisions of section 424 will continue to apply with respect to the winding-up and liquidation of companies under the 2008 act. Item 10 (1) of schedule 5, which deals with the preservation and

[18] (n 2) par 13.
[19] Havenga "Creditors; Directors and Personal Liability Under Section 424 of the Companies Act" 1992 SA *Merc LJ* 63.
[20] s77(2) and (3). See also section 77(8)(b) where the director would have to restore to the company any money improperly paid by it as a result of the impugned act.
[21] Section 165 of the 2008 Act also allows for the commencement or continuation of legal proceedings or the taking of related steps to protect the legal interests of a company by certain people as set out in that section.

continuation of court proceedings and orders states that, any proceedings in any court in terms of the previous act immediately before the effective date are continued in terms of that act, as if it had not been repealed. The parties in the present case agreed that section 424 under the 1973 Companies act was applicable in their dispute. [22]

It is common cause that as Aurora was in liquidation and there was no dispute in its indubitable state of insolvency, the provisions of Section 424 are therefore applicable. The respondents knowing very well the position of Aurora made undertakings and misrepresented the position and capabilities or lack thereof to the liquidators of Pamodzi, which the company could not fulfil.

4. REQUIREMENTS FOR LIABILITY

In order for the court to be able to pass a declaratory order as prayed for by the applicants in their notice of motion, it had to establish that there was reckless or fraudulent conduct in the manner that the business of the company was carried out and that the respondents knowingly participated in such conduct which resulted in a creditor(s) being defrauded. Below is a detailed analysis and application of the legal elements that should be established in order for the court to attribute personal liability under section 424.

4.1. Recklessness

Recklessness is not an error of judgement; it is rather a disregard for the consequences of one's actions.[23] It has always been the view of the courts that recklessness is not lightly found as even mentioned by the judge Bertelsmann referring to *Strut Ahead Natal (Pty) Ltd v Burns.*[24] The courts have expressed more than once that a blind hope into the affairs of the company into the future in that its misfortunes will turn around bringing about prosperity cannot stand as a valid reason to conduct the affairs of the company recklessly.

[22] (n 2) par 17.
[23] Cassim "The Duties and Liability of Directors" in Editor (ed)*Contemporary Company Law* (2012) 505 591.
[24] *Strut Ahead Natal (Pty) Ltd v Burns* 2007 4 SA 600 (D&CLD)

The test to establish recklessness is objective insofar as the defendant's actions are measured against the standard of conduct of the notional reasonable person and is subjective as one has to postulate the notional being as belonging to the same groups or class as the defendants moving in the same spheres and having the same knowledge or means to knowledge.[25] In the matter of *Philotex (Pty) Ltd v Snyman, Braitex (Pty) Ltd v Snyman*[26], the court a quo dismissed the appellants claim on the ground that recklessness had not been proved. Howie JA, at 141 stated that in enacting section 424, the intention of the legislature was to broaden the scope and to extend the remedy by means of which a restraining influence can be exercised on "over-sanguine" directors. The court referred to the fact that before section 424, its predecessor only applied in winding up and judicial management of a company if the business thereof had been carried on with intent to defraud creditors or for any fraudulent purpose. Section 424 on the other hand expressly includes recklessness and applies also in other circumstances where the company is not in winding up.

De Kock J in *Gordon and Rennie v Standard Merchant Bank*[27], states that when one looks at the words of section 424 (1) in their content there is no reason to interpret them in such a way as to exclude a single reckless or fraudulent transaction from the ambit of that section. In establishing recklessness another question may arise whether recklessness can be established only from a positive duty to act in your capacity as a director of the company. In other words can recklessness be found in a director's failure to act to prevent certain behaviour by the company or can a "non-involved" director be held personally liable under section 424.

In *Cronje NO v Stone en 'n Ander*[28]; it was alleged by the liquidator that the second respondent who was one of the directors had recklessly refrained from exercising proper control over the management of the business when she was or should have been aware of its management by the first respondent. The question crisply raised was therefore whether her conduct, which was constituted largely by failing to act at

[25] Pretorius, Delport, Havenga and Vermaass "Winding-up; Judicial Management; corporate Deliquents" (eds) *Hahlo's South African Company Law through the Cases* (1999) 585 605.
[26] *Philotex (Pty) Ltd v Snyman, Braitex (Pty) Ltd VC Snyman* 1998 2 SA 138 (SCA).
[27] *Gordon and Rennie v Standard Merchant Bank* 1984 2 SA 519 at 528.
[28] *Cronje NO v Stone en 'n Ander* 1985 3 SA 597 (T).

all make her knowingly a party to the carrying on of the company's business recklessly[29].

There has been various views from the courts on how recklessness can be established. One of those is that held by Howie JA in the Philotex case referring to *Fisheries Development Corporation of SA Ltd Jorgensen; Fisheries Development Corporation of SA Ltd V AWJ Investments (Pty) Ltd*,[30] where the learned judge said that, in the application of the recklessness test to the evidence before it, a court should have regard *inter alia,* to the scope of operations of the company; the role, functions and powers of the directors, the amount of debts, the extent of the company's financial difficulties amid the prospects, if any, of recovery. However this does not mean a director may be indifferent or shelter behind culpable ignorance or failure to understand the company's affairs. In Cronje's Case above the judge said of the second respondent's conduct that it must be judged by considering what a reasonable man with a similar background and education would have done in the circumstances. He concluded that "... like that honest but foolish optimist in Goertz decision, she was not up to standard as was expected of her in her position as a businesswoman". In my view the same could be said of the first respondent in the present case.

In paragraph 18 in the Engelbrecht case, the court states that the first respondent's situation differs from that of the other respondents. The first respondent was not involved in the day-to-day management of the affairs of running Aurora's business.[31]
In paragraph 19 the court stated that recklessness may consist of blameworthy conduct characterised by a failure to take any due care in the management of a company and others and exhibit a high degree of disregard for the standards observed by honest and diligent men of the state of affairs. It may however also be demonstrated by similarly uncaring and careless failure to attend to the company's business or to prevent foreseeable harm from being caused by failing to take reasonable preventative measures against eventualities. This the court based on Cronje above and also seeks to answer to the affirmative the question of whether or not a failure to act or non-action by a director may be construed to be recklessness.

[29] Luiz "Extending the Liability of Directors" 1988 *S. African L.J* 788 790.
[30] *Fisheries Development Corporation of SA Ltd v Jorgensen; Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd* 1980 4 SA 156 (W) 170 B-C.
[31] (n 2) par 44.

That he was not directly involved in the negotiations with liquidators and therefore must be judged in light of his personal circumstances and knowledge of Aurora affairs. The court goes on to say that it is not suggested, however that he was not fully informed of the serious problems that developed almost from the outset in Aurora's management of the mines. It is in view of the latter statement by the court that I submit the liability of the first respondent should not be treated differently from the rest of the respondents in as far as recklessness is concerned. The fact that he was aware of what developed from the outset in Aurora's management of the mines in my view suffices to hold him equally liable as the other defendants. The fact that he was not involved in the day-to-day management should not absolve him of his duties or indicate a lesser level of accountability than would otherwise been the case from the period before 1 December 2009. The first respondent from the onset was part of the idea for setting up or "embarking on business on a large scale which would require extensive funding…"[32]

The involvement of Aurora with the applicants by submitting the bids to take over the mines was "embarking on business on a large scale" if one were to consider not just the nature of the business Pamodzi was involved in but the state in which the mines were under when Aurora decided to bid for them; what was at stake considering the future of the mines whether or not a suitable buyer was found. It is common cause that Aurora had no assets and the taking over of the mines was big business to the company. In addition the plight of the Pamodzi mines was in the public domain and had become a matter of public interest. It therefore is a bit concerning to find that a person in the position of the first respondent was not or was seen by the court not to be involved in such a transaction for Aurora and that liability can only be attributed to him for part of the failure of such a transaction. The first respondent should in his capacity as a businessman with the interest he had, been involved in acquiring the said opportunity for Aurora. Furthermore having been advised from time to time about the management of the mines by Aurora from the onset after Aurora had moved in around September 2009. I agree with the court that coupled with the above, his failure to act

[32] (n 2) par 16.4.

once he knew of the dire state of affairs was clear reckless disregard of his duties as a director.

The fact that the first respondent was not involved in the day to day business of the company should not absolve him from personally liability for all liabilities incurred by Aurora to Pamodzi for the period stated by the court instead he should have been held liable in the same manner as the second to fifth respondent. In addressing the classification of directors into executive and non-executive directors, (the latter pre supposing intermittent involvement), Goldstone JA in the *Howard v Herrigel NO* regarded as unhelpful and even misleading to use the classification to ascertain the duties of directors to the company or the a specific or positive action required from them.[33] Yes the court thought it a factor to be considered in the assessment of a director's liability that she is not involved in the management of the company on a fulltime basis. The fact that a director is non-executive does not generally indicate that they have less onerous duties than would otherwise been the case.[34] It can be inferred from the finding by the court in respect of the first respondent for the period between June 2009 and November 2009 that there was an implied classification between non-executive and executive directors.

The liquidators of Pamodzi called for tenders, this was a public call which the first respondent knowing the position of the company from inception; should have taken an interest on the basis upon which Aurora submitted the bids for the Pamodzi mines. At the time Aurora submitted the bids for the insolvent mines, it was "indubitably" insolvent, the first respondent should have at least been aware of the status of the company at that point and should have acted to prevent it from biting more than it can chew. There is no evidence that Aurora was involved in any other kind of business or had any other focus other than that of acquiring and running the Pamodzi mines.

Lastly on the issue of liability regarding the first respondent, section 424 empowers the Court to declare on the application of the envisaged applicants that the respondents are to be held personally liable, for all the debts or liabilities of the company, including those incurred prior to the alleged reckless or fraudulent conduct

[33] *Howard v Herrigel NO* 991 2 SA 660 (A)
[34] Havenga "Directors' Secret Profit – Accounting to the Company" 1991 *SA Merc LJ* 95

of the company or any of them. It has been held that there is no requirement to prove a causal link between the relevant conduct and the debts or liabilities in respect of which a declaration of personal liability is sought[35]. In *Saincic v Industro–Clean (Pty) Ltd* at paragraph 20, [36] Farlam JA stated that the absence of a causal link is a factor to be taken into account by the court in exercising its discretion whether or not to grant an order. Previous decisions have expressly laid down the general principle that section 424 does not require proof of a causal link between the relevant conduct and the company's inability to pay the debt.[37]

This in my view does not mean that the non-existence of a causal link should necessarily absolve the respondent from liability certainly in the present case for the period before 1 December 2009 as ordered by the court. It is my view that the court was lenient to the first respondent and should have imposed an order similar to that imposed on the second to fifth respondents or at the least be held partially liable for his reckless behaviour or failure to act during that period.

4.2. Fraudulently or with intent to defraud

An alternative element for liability under section 424 is that of fraud or an intention to defraud. A clear discussion on the issue of fraud was set out in *Ex parte Lebowa Development Corporation Ltd.*[38] In this case, Stegmann J started with the definition of fraud by PMA Hunt in the South African Criminal Law and Procedure 2 Edition Vol. II at 755:

> "Fraud consists in unlawfully making, with intent to defraud, a misrepresentation which causes actual prejudice or which is potentially prejudicial to another"

It was said in the Lebowa case that intent to defraud may take the form of *dolus directus,* where the person making the misrepresentation is proved to be aware of its falsity and to intend that the represented should be deceived and should act on the induced misapprehension. Intent to defraud may also take the form of *dolus eventualis,* where a person makes a representation of fact to another whilst not

[35] *Philotex* case (n 26) 142.
[36] *Saincic v Industro–Clean (Pty) Ltd* 2009 (1) SA 538 (SCA).
[37] *Howard* case (n 33); *Philotex* case (n 18) and *Fourie* case (n 1).
[38] *Ex parte Lebowa Development Corporation Ltd* 1989 3 SA 71 (T).

knowing whether such representation is true or false, the representor knows that his representation may be false and associates himself to the risk entailed in suggesting it to be true to the actual or potential prejudice of someone else.[39] He basically disregards the possible danger that his statement could be false and proceeds to make it anyway. The court went on to analyse fraud by *dolus eventualis* in that the representor makes two distinct representations when he makes a representation of the facts while not knowing such is true or false. The first part of that representation is presently a fact, which he does not know whether to be true or false; and the second is taking into account his state of mind, he actually has an honest belief in the truth of the first representation this is where *dolus directus* is established and it is what the respondents in the Aurora case believed. The respondents basically reconciled themselves with facts which they had no confirmation or conclusion of and proceeded to present the same as if they were the truth without taking cognisance of the risk they were exposing the insolvent mines, the workers and the provisional liquidators for that matter. The argument advanced by the respondents was that, they reasonably expected their efforts to secure funding to come to fruition and that their actions are justified by this reasonable expectation.[40] The court regarded the argument of the respondents as fallacious.

The above was also confirmed in the Supreme Court of Appeal in the case of *Fourie v First Rand Ltd*[41], where the decision of the court a quo was confirmed on appeal that, the appellant Fourie knowingly made false representations on behalf of the company to First Rand by preparing false financial statements and thus committed fraud. It is clear that a bigger part of the respondents' liability is attributed to the misrepresentation of Aurora and its capabilities as set out in the bid documents and its breach of the interim trading and contract mining agreement. The respondents made various representations, which were false and untrue statements about the status of Aurora in the submission of the bids. They blatantly lied about holding a controlling interest in a listed company called Cenmag Limited; the company being in the forefront of global timber supplies and its presence or strong links to the Gulf and Far East, which were non-existent. Aurora went as far as to state that it was sufficiently

[39] Hahlo (n 25) 371.
[40] (n 2) par 39.
[41] *Fourie* case (n 1).

liquid to enter into the transaction for the acquisition of the mines, when in fact it was already insolvent.[42] Knowing very well that Aurora did not have a controlling stake in a JSE listed company; the respondents went on to state that they would raise funds through a rights issue of the shares of Aurora's listed entity.

The respondents also relied on the "promised" funding by AME, the Malaysian investor, which even if it was to materialise was dependent upon Aurora fulfilling a certain condition that of acquiring a listed entity, which they failed to do, but by the figment of the respondents' imagination existed through Cenmag. The court stated and rightly so that the respondents' argument in relying on this expected funding was "fallacious".[43] There is no way on the facts before it, that the court could conclude that there was a reasonable prospect that the liquidators would receive payment for the mines at the back of the AME undertaking. Ordinarily, if a company, while carrying on its business, incurs debts at a time when to the knowledge of its directors there is no reasonable prospects of the creditors ever receiving payment, there is a carrying on of its business with intent to defraud those creditors.[44]

In paragraph 43, the court found that the second to fifth respondents were guilty of wilful deception by presenting the bid documents containing numerous false assertions to the liquidators and for handling the affairs of Aurora recklessly from the inception of the ITCMA agreement to the date of cancellation. The court went on to state that, "The applicants are therefore entitled to the order they seek…on the basis of fraudulent misrepresentation in the bid documents and on the grounds of the reckless conduct of the insolvent companies". I fully agree with the findings of the court in this regard since the second to fifth respondents deliberately included facts in the bid documents and the agreement thereafter, which they knew not to be true. By doing this, they led the liquidators to believe that which they knew not to be true. They intentionally misled the applicants and led them into awarding the tender to award the management of the mines to Aurora. The latter part of this sentence "reckless conduct of the insolvent mines" basically refers to the business of Aurora

[42] (n 2) par 26.
[43] (n 2) par 39.
[44] Delport and Forster *Henochsberg on the Companies Act 71 of 2008* (2011).

which was the management of the mines as a result of the bid that Aurora was awarded to do so.

4.3. Knowingly a party

Another key element for finding someone personally liable under section 424 that the court considers is that, the responded must have been knowingly a party to the prohibited conduct. Knowingly means that there must be proof on a balance of probabilities that the person sought to be held liable had knowledge of the facts from which the conclusion is properly drawn that the business of the company was or is being carried on such a manner. In *Howard v Herrigel NO* and in *Ebrahim v Airport Cold Storage (Pty) Ltd;*[45] it was stated that it would not be necessary to go further and prove that the person also had actual knowledge of the legal consequences of those facts.[46] In the Cronje case above, a question was asked whether a non-executive director owes the company a duty to become actively involved in its management and whether a failure to perform that duty would render him a party to carrying on the company's business.

There is no denying that the directors of Aurora and the fourth and fifth respondents knew the state of the company's affairs in all respects including its finances or lack thereof coupled by the fact that they did not have any experience in the mining business and continued to make undertakings that were unfounded. However, it could not be said of the first respondent that he was knowingly a party to the fraudulent manner in which the company was carried on through the false statements made in the bids. As an independent chairman of the company he was not involved in the day to day carrying on of the business of the company and relied on the second to fifth respondents to do so. Even though he was informed by his lawyers of what was going on, it cannot be said that he had actual knowledge of the fraudulent manner the business of the company was carried. What the court however failed to deal with was the fact that the first respondent was knowingly a party to the reckless manner in which the company's business was carried and he failed to take any action until it was too late. One wonders if the definition of knowingly as provided in section 1 of the 2008 Act if applied could have resulted in a different finding in as far as the first

[45] *Howard* case (n 33) and *Ebrahim* case (n7).

respondent was concerned. Section 1 of the 2008 act defines "knowing"; "Knowingly" or "knows" and provides that:

"when used with respect to a person and in relation to a particular matter, means that the person either (a) had actual knowledge of the matter, or (b) was in a position in which the person reasonably ought to have (i) had actual knowledge (ii) investigated the matter to an extent that would have provided the person with actual knowledge of the matter"

It is clear on the facts before the court that the first respondent was not a party to fraudulent carrying on of the business of the company.

In paragraph 45 the court said that the first respondent was in a slightly different position from the other respondents and that it was common cause that he was not involved in the day-to-day management of Aurora's business. He was not directly involved in the negotiations with the liquidators and was informed from time to time about the state of affairs by the other respondents. Basing its views on the Jorgensen case, the court stated that his position must be judged in the light of his personal circumstances and knowledge of Aurora affairs.[47] Based on the fact that the first respondent had knowledge of certain facts that it could be probably drawn that the business of the company was carried on recklessly and such conclusion could be established on a balance of probabilities.

I am of the view that the first respondent could have been held liable for what occurred during the period 1 June 2009 to November 2009. Taking into account the fact that the first respondent is a businessman and knowing that Aurora required funding to embark in business on a large scale, why did he not question how Aurora managed to secure the bid for the running of the mines? He certainly was aware that confirmation to Aurora from AME was required by the liquidators and he in his capacity as chairman received a letter from AME with such confirmation for funding to the amount of R200 million and R350 million in respect of the Orkney and East Rand mines. These letters were dated 14 September 2009 and 8 October 2009

[47] (n 2) par 11.

respectively before Aurora moved into the two mines on 15 September and 15 October 2009. Based on these letters confirming the availability of funding to him during this period, which is within the time the court found him not to have been liable, the first respondent could and should have acted, as it was clear yet again that Aurora had over committed itself.

When it comes to establishing the context of being a party to the conduct of carrying on the business of the company in a manner prohibited by section 424; it means to participate in or to take part or concur in such transaction.[48] Being a party is not only limited to taking positive steps of involvement in the prohibited act but may also include support for or concurrence with such conduct.[49] There is even a more compelling argument when it comes to a director of a company that he is more likely to be considered a party to the prohibited conduct if one has to consider his duties in terms of section 76 of the 2008. Directors have a duty to observe the utmost good faith towards the company, to exercise reasonable skill and diligence and have an affirmative duty to safe guard and protect the affairs of the company. To prove that a person was "party to", it must be shown that he was knowingly a party to and that he knew that the business was carried on in the way envisaged by section 424 and acquiesced in the relevant conduct. Goldstone JA in the Howard case above stated that "a director has an affirmative duty to safeguard and protect the affairs of the company. In my opinion, it follows that ….a director may well be party to the reckless or fraudulent conduct of the company's business even in the absence of some positive steps by him in the carrying on of the company's business. His supine attitude may, I suppose even amount to concurrence in that conduct. Whether such inference could properly be drawn will depend upon the facts and circumstances of the particular case". Again, it is my view that the first respondent was at all times party to the carrying on of the business of Aurora in a manner prohibited by section 424 including the submission of the bids. This is drawn on the facts and circumstances of the case.

[48] *Gordon* case (n 27) 301.
[49] *Fisheries Development* case (n 30) at 143.

I will not discuss the involvement of the fourth and fifth respondents save to say that the court found correctly as to their involvement and being party to the reckless and fraudulent conduct of Aurora's business.

5. CONCLUSION

It is clear that the intention of section 424 is to provide relief and/or remedy to creditors who have been defrauded by unscrupulous directors or runners of business who carry out such businesses in a fraudulent and reckless manner to the detriment of creditors. Without cases as the present case, there is no impetus provided to directors or those conducting business to ensure that their conduct is above board to the benefit not only of the company but to the creditors of the company as well. Further that the days of hiding behind the corporate veil are long gone. Overall and save for the analysis above in how the law was applied to the first responded, I believe the purpose of section 424(1) has been satisfied by the decision of this case.

The fact that the parties involved in this case were from prominent backgrounds of the society, the publicity that this case attracted and the number of livelihoods it affected in the form of the miners or employees of Pamodzi will certainly go a long way in sending out a message to those who are parties to the carrying on of the business of the company not to do so in a reckless or fraudulent manner. It is however unfortunate that nothing happened to the directors of the Pamodzi companies or those who were involved in the carrying on of the business of the insolvent mines before Aurora came into the scene.

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