Republic of South Africa
In the High Court of South Africa
(Western Cape Division, Cape Town)

[REPORTABLE]

CASE NO. 22288/2014

In the matter between:

BLUE FARM FASHION LIMITED	**Plaintiff**
And	
RAPITRADE 6 (PTY) LTD	**First Defendant**
MARCEL PHILIP JOUBERT	**Second Defendant**
WARRICK KINGSMAN GAUTIER	**Third Defendant**
HERSCHEL OPPEL	**Fourth Defendant**
MOIRA TANYA O'REILLY	**Fifth Defendant**

JUDGMENT DELIVERED ON: 01 APRIL 2016

MANTAME, J

A INTRODUCTION

[1] This matter relates to the two exceptions raised by defendants on the plaintiff's particulars of claim. Plaintiff sued first defendant for breach of contract in the amount of US$414 665.90 and seeks an order that the second to fifth defendants who are directors of the first defendant, be declared personally liable for the debt in terms of Sections 77(3)(b), 22(1) and 77(6) of the Companies Act 71 of 2008 ("the Act") and or Sections 77(3) and 77(6) of the said Act.

[2] Mr Howie legally represented the plaintiff and Mr Loots the defendants.

B SUMMARY OF FACTS

[3] In December 2013, Plaintiff and first defendant concluded an agreement at its instance and requested that plaintiff deliver the clothing ordered to the first defendant in one shipment in Cape Town in January 2014. On conclusion of the agreement, plaintiff delivered the clothing in Cape Town whereupon the purchase price of US$414 665.90 became due and payable.

[4] First defendant breached the agreement by failing to pay the purchase price despite demand on numerous occasions.

[5] Plaintiff proceeded filing summons in this Court on 12 December 2014 against first defendant and its four (4) directors being second to fifth defendant. Second to fifth defendant were sued on the basis that they knew that the first defendant had no cash or liquid assets with which to pay the debt it would incur by purchasing the clothing from the plaintiff; nevertheless caused the first defendant to conclude the agreement; knowingly misled the plaintiff into believing that it would receive payment of the purchase price; and were therefore knowingly party to the carrying-on of the business of the first defendant recklessly and / or in a manner calculated to defraud the plaintiff as a creditor of the first defendant and / or for a fraudulent purpose.

[6] Subsequent to filing of plaintiff's summons, defendants noted two (2) exceptions to the plaintiff's particulars of claim on the basis that it does not disclose a cause of action and is bad in law.

C EXCEPTIONS

[7] Defendants' exceptions are set out as follows:-

7.1 First, that there is a misjoinder of plaintiff. Annexure "**POC 2**" relied on by the plaintiff as being the written agreement between the plaintiff and first defendant (referred to in paragraph 9 of the particulars of claim) identify the contracting party with the first defendant as **Blue Farm Textile Ltd** and not **Blue Farm Fashion Limited**, the latter being the plaintiff in this action.

7.2 Second, that plaintiff's only relationship to the first defendant is as its alleged creditor. Plaintiff does not have *locus standi* to seek to impose personal liability upon the second, third, fourth and fifth defendants as directors of the first defendant by virtue of the provisions of sections 22 and / or 77 of the Act. For instance, plaintiff's claim against the second to fifth defendants is based upon the provisions of sections 77(3)(b), 22(1) and 77(6) of the Act. Whilst Section 22(1) establishes a prohibition against reckless trading, it does not, of itself, provide for personal liability of directors. Section 77(3)(b) provides that a director of a company may be held liable if he or she "*acquiesced in the carrying on of the company's business despite knowing that it was being conducted in a manner prohibited by Section 22(1).*" The first part of Section 77(3) states that liability is "*for any loss, damages or costs sustained **by the company***." This subsection does not grant a creditor of a company a statutory cause of action to claim the loss, damages and or costs it has suffered from a director of a company. Section 77(6) does not establish a substantive basis for personal liability, it merely provides that "*[t]he liability of a person in terms of this section is joint and several with any other person who is or may be held liable for the same act.*"

D ISSUES

[8] The issues for determination are whether these two (2) grounds of exceptions have merit and / or are good in law.

E ARGUMENTS BY BOTH PLAINTIFF AND DEFENDANT

[9] At the commencement of the hearing, defendants' Counsel stated from the onset that defendants are no longer pursuing the first exception. The Court asked Mr Loots for defendants if the first exception was abandoned by the defendants. Counsel's response was that he does not have instructions to that effect, but was no longer pursuing the first exception. Defendants' arguments were therefore based on the second exception. As a result thereof, the arguments and the finding will be dealt with as if there was one exception before this Court, i.e. the second exception dealing with the *locus standi* of the second to fifth defendants.

[10] Mr Loots for the defendants argued that the plaintiff is not entitled, as a third party creditor, to rely on the provisions of Section 77(3)(b), 22(1) and 77(6) of the Act to hold the directors of the company personally liable for a debt allegedly due to it by the company of which they are directors. In this case, plaintiff should have relied on Sections 22, 76 and 218 of the Act. Section 77(3)(b) and (c) of the Act reads as follows:

> *"77(3)(b) 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 acquiesced in the carrying on the companies' business despite knowing that it was conducted in a manner prohibited by Section 22(1).*
>
> *77(3)(c) A director of the company is liable for any loss, damages or costs* ***sustained by the company*** *as a direct or indirect consequence of the director having been a party to an act or omission by the company despite knowing that the act or omission was calculated to defraud a creditor, employee or*

> *shareholder of the company, or had another fraudulent purpose."*

According to defendants' counsel, these aforementioned sections contemplate that the company may recover any loss suffered by it as a result of the directors having acted in the manners contemplated by the various sub-sections of Section 77(3).

[11] Section 77(3) of the 2008 Act was compared by the defendants with Section 424 of the old companies Act 61 of 1973 which reads as follows:

> *"**Liability of directors and others for fraudulent conduct of business.** – (1) 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 the company or creditors of any other person or for any fraudulent purpose, **the Court may, on 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 of liability, **for all or any of the debts or other liabilities of the company as the Court may direct.**"*

It was submitted on behalf of the defendants that the section envisaged that the Master, liquidator, the judicial manager, any creditor or member or contributory of the company may apply for an order in Court directing that a person is to be held personally liable for the debts of a company to the third parties. Section 77 does not do that. Section 77(3) contemplates a liability towards the company for any loss or damages suffered by it as a result of a claim brought against it by a third party creditor. It does not create a *lis* between the director and a third party. One party cannot ordinarily claim the loss sustained by another. Whereas Section 424 contemplates that the directors or other persons, found by the Court to be liable for the debts and liabilities of the company, has a direct liability towards the third party creditors of a company. Had the legislature wished to create a liability in the manner contemplated by Section 424, Section 77 would have been drafted in similar terms, but this was not done."

[12] It was submitted further by the defendants that, on reading the wording of Sections 424 and 77 of the different Acts as clearly and correctly set out, Section 77 is not available as a remedy to third party creditors and that was illustrated in the finding by Fourie J in ***Grancy Property Ltd and Another v Gihwala and Others [2014] ZAWCHC 97*** at paragraphs 103 and 104 which stated that:

> *"[103] The next question which arises, is whether, in these circumstances, it is open for Grancy to invoke Section 77(3) of the 2008 Companies Act and thereby have Gihwala and Manala declared statutorily liable for this debt. The difficulty that I have with a declaration on this basis, is that Section 77(3) of the 2008 Companies Act provides that a director of a company is liable for any loss, damages or costs sustained by the company (my emphasis) as a direct or indirect consequence of the director having acted in the manner set out in the subsection. On my reading of Section 77(3), it renders the director liable to the company and not to a third party creditor. Grancy argues that, in view of the remedy which a creditor had to hold a director personally liable under Section 424 of the 1973 Companies Act, it is unthinkable that the legislature has now put paid to the remedy which previously availed creditors to hold a director personally liable for his or her reckless and fraudulent conduct.*
>
> *[104] It appears to me that this submission does not take proper account of the fact that the remedy under Section 424 of the 1973 Companies Act, was available in a different context, i.e. in circumstances where the company was liable to the creditor and the director who acted fraudulently or negligently, may be declared liable for the debt in circumstances where the company is unable to pay its debts. This is not the aim of Section 77(3), which, in my opinion, does not, on a proper interpretation of the plain wording thereof, confer standing on anyone other than the company. In any event, Section*

> *218(2) of the 2008 Companies Act, provides that any person (this would include a director of a company) who contravenes any provision of the Act, is liable to any other person for any loss or damage suffered by that person as a result of that contravention. It follows that a director who does not comply with the standards of directors' conduct as set out in Section 76 of the 2008 Companies Act, would be liable to any person suffering a loss as a consequence thereof."*

According to defendants, as stated at paragraph [104], the appropriate route for a third party creditor to follow in circumstances where the Act, finds application is to rely on the provisions of Section 218 of the Act read with Sections 22 and 76 of the Act, rather than Section 77(3)(b) of the Act. So, Section 218(2) of the Act reads as follows:-

> *"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."*

As per defendants' interpretation, this section provides a general remedy to any person to sue another person who contravenes any provision of the Act for any loss or damage suffered as a result of the contravention. Similarly in this matter, should the plaintiff be able to establish a contravention of the Act, plaintiff would be enabled to sue the directors of the first defendant for any loss or damage suffered as a result of the contraventions of the Act.

[13] On the other hand, it was submitted by the defendants that Section 22(1) of the Act which provides that:

> *"a company must not carry on its business recklessly, with gross negligence, with intent to defraud any person or for any fraudulent purpose."*

It was defendant's argument that if plaintiff intended to invoke this Section, its claim should have been directed to the company not to its directors.

[14] Mr Loots submitted that relevant to the present case is Section 76(3) of the Act which provides as follows:

> *"76(3) Subject to the subsections (4) and (5), a director of a company, when acting in that capacity, must exercise the powers and perform the functions of director –*
>
> *(a) in good faith and for a proper purpose;*
>
> *(b) in the best interest of the company; and*
>
> *(c) with a degree of care, skill, and diligence that may reasonably be expected of a person –*
>
> *(i) carrying out the same functions in relation to the company as those carried out by that director; and*
>
> *(ii) having the general knowledge, skill and experience of that director."*

In essence, Section 22(1) prohibits a company from conducting its affairs in a reckless or fraudulent manner, and Section 76(3) provides that the director of a company must exercise the powers and perform the functions of a director in good faith and for proper purpose, in the best interest of the company as the directors manage the company. Should the directors allow the company to conduct its affairs in a reckless or fraudulent manner and with the intent to defraud third party creditors, such directors would be breaching their fiduciary duties as provided in Section 76. In turn, that would allow the third party creditor who have suffered loss to institute action against the directors through Section 218(2) of the Act, that is the enabling provision. The approach adopted in ***Grancy*** (*supra*) should have been the correct approach to be adopted by the plaintiff. The approach in ***Grancy*** (*supra*) was further followed in ***Sanlam Capital Markets (Pty) Ltd v Mettle Manco (Pty) Ltd and Others [2014] 3 All 454 (GJ)*** at para [40] – [43]. Defendants argued that this exception should be upheld.

[15] Plaintiff's Counsel in turn submitted that, central to the determination of the second ground of exception is the meaning of Section 77(3)(b), and whether it can be a basis to found the personal liability of a director in favour of the creditor of a

company. Primary to this inquiry is the requirement for statutory interpretation. The Supreme Court of Appeal in ***Natal Joint Municipal Pension Fund v Endumeni Municipality 2012 (4) SA 593 (SCA)*** *para 18* stated that:

> *"Interpretation is the process of attributing meaning to the words used in a document … having regard to the context provided by reading the particular provision or provisions in the light of the document as a whole and the circumstances attendant upon its coming into existence.*
>
> *Where more than one meaning is possible each possibility must be weighed in the light of all these factors.*
> *A sensible meaning is to be preferred to one that leads to insensible or unbusinesslike results or undermines the apparent purpose of the document."*

Mr Howie contended that, if the words used must be considered in context and, in terms of s39(2) of the Constitution of the Republic of South Africa, Act 108 of 1996, the statute must be construed in a manner which promotes the spirit, purport and objects of the Bill of Rights, which protect everybody's rights – See - ***Bato Star Fishing (Pty) Ltd v Minister of Environmental Affairs 2004 (4) 490 (CC) para [87] to [91].***

[16] All that plaintiff needs to show is that the meaning it attributes to s77(3)(b), read with Sections 22(1) and 77(6) is a reasonably possible one. This principle was set out in ***Fairlands (Pty) Ltd v Inter-Continental Motors (Pty) Ltd 1972 (2) SA 270 (A)***, the Appellate Division dismissed an exception taken by the respondent on the basis that:

> *"As we are dealing with the matter at the exception stage, the question is not whether the meaning contended for by the appellant [the plaintiff in this case] is necessarily the correct one, but whether it is a reasonably possible one. If the suggested meaning is a reasonably possible one, the exception should not be upheld …"*

The interpretation and construction of this section is to be found in the case of ***__Rabinowitz v Van Graan and Others 2013 (5) SA 315 (GSJ)__*** when analysing Section 77(3) of the 2008 Companies Act, it was held at paragraph [22] that:

> *"[22] … 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 Section 22(1) thereof."*

[17] Therefore defendants reliance on Sections 76 and 218 is misplaced. What was stated by Fourie, J in ***__Grancy__*** (*supra*) in respect of Sections 77(3), 76 and 218 was clear *obiter* and, was not the result of a thorough investigation as to their meaning and operation in the context of the provisions themselves or the Act as a whole, and the meaning which the directors seek to give to these sections fails to take into account the provisions of Section 158(a) and a series of binding presumptions applicable to statutory interpretation. Section 76 deals with the standards of conduct which directors must adhere to. The Legislature did not make any reference to reckless trading or fraudulent conduct, which is expressly reserved for Sections 77(3)(b) and (c) as being the basis upon which a director **__is__** liable.

[18] The other section in the Act which makes reference to reckless trading or fraudulent conduct in connection with directors is Section 162(5)(c)(iv)(bb), which provides that a Court must make an order declaring a person to be a delinquent director if that person, while a director, acted in a manner contemplated in Sections 77(3)(a), (b) or (c). Even from this section, when it comes to a director being personally liable for the losses or damages of a company which is __not in liquidation__, the Legislature has expressly indicated that the applicable sections are Section 77(3)(b) and (c), and not Section 76.

[19] Defendants in turn submitted that Section 162(5)(c)(iv)(bb) has nothing to do with the directors vis-à-vis third parties (or even the company) for reckless or fraudulent trading. Plaintiff's argument in this regard is misplaced.

[20] It was plaintiff's submission that the defendant's argument on Section 218(1) is without merit. On proper interpretation and construction of the section, it is nothing

more than an enabling section which allows third parties such as a creditor (in this case, the plaintiff) from instituting civil proceedings to recover monies. It cannot be involved in order to have a director held personally liable.

[21] Even if Section 218 is applicable to this instance, which plaintiff do not admit, the fact that it need not be expressly relied upon in the particulars of claim is borne out by the judgment in ***Fundstrust (Pty) Ltd (in liquidation) v Van Deventer 1997 (1) SA 710 (A)*** which was approved by the Constitutional Court in ***Bato Star Fishing (Pty) Ltd v Minister of Environmental Affairs 2004 (4) SA 490 (CC) at 507 C – D.*** The principle laid down by Hefer JA in ***Fundstrust (Pty) Ltd*** (*supra*) was that:

> *"What he does not seem to have realised, because the particulars of claim did not tell him so, was the the allegations in para 26.1, in particular the allegation that the company's memorandum of association provided for the liability of directors, were aimed at Section 53(b) of the 1973 Companies Act, which provided for the joint and several liability of directors in the event that it was provided for in the memorandum of the company."*

Hefer JA held further that although it was apparent that the particulars of claim were lacking a specific reference to Section 53(b), express reliance to the section need not be made in that the facts alleged in the particulars of claim bring this section into operation. The exception was refused, and the same principle was confirmed in ***Bato Star Fishing*** *(supra) at 507 C – D*, where O'Regan J held that:

> *"Where a litigant relies upon a statutory provision, it is not necessary to specify it, but it must be clear from the facts alleged by the litigant that the section is relevant and operative."*

[22] It was plaintiff's contention that in its particulars of claim, it has instituted a civil action against the directors, and claims that they be personally held liable for a loss or damage (US$414 665.90) because they were knowingly party to the reckless or fraudulent conduct of the company's business as provided for in Section 77(3)(b) and (c). The absence of an express reliance by the plaintiff on Section 218 does not result in the particulars of claim disclosing no cause of action.

[23] In the alternative, plaintiff argued that Section 218 need not be expressly relied upon because it is simply an enabling provision allowing for the institution of civil actions and not a section in terms of which the personal liability of directors is expressly provided for. So, defendants' reliance on Section 218 as a basis of exception must fail as plaintiff's interpretation of the section is a reasonably possible one.

[24] It was denied by the plaintiff that in order to seek this kind of relief, it should have relied on Section 424 of the Companies Act 61 of 1973. Plaintiffs submitted that in terms of Section 9 of Schedule 5, it is expressly provided that the 1973 Act only applies to liquidations. This section could not be applicable in the present dispute.

[25] Lastly, it was contended by plaintiff that it has a right to pursue the directors personally for them being party to the carrying-on of the business of the first defendant recklessly and in a manner calculated to defraud the plaintiff as a creditor. Further, since this is a matter that involves interpretation of statute, where two (2) meanings may be given to a section (in this case Section 77(3)), and the one meaning leads to harshness and injustice, while the other does not, the Court must hold that the Legislature rather intended the milder than the harsher meaning – See (***Principal Immigration Officer v Bhula 1931 AD 323 at 336 in fin***). Also, the Supreme Court of Appeal in ***Chetty v Hart (20323/14) [2015] ZASCA 112 (4 September 2015)*** at para [8] – where it was stated that the words used are reasonably capable of bearing more than one meaning, the consequences of the divergent interpretations must be examined so that a meaning that is likely to further rather than hinder its purpose is adopted. In this regard, a meaning that is more sensible and businesslike is to be preferred over one that has a contrary effect. For these reasons, plaintiff submitted that the meaning that the defendants request is a harsh one which would lead to the injustice of depriving a creditor such as the plaintiff, the right to pursue them for personal liability, whereas the interpretation placed upon the section by the plaintiff is the milder one. The plaintiff's interpretation also leads to the more sensible and businesslike result. Plaintiff submitted that the first ground of exception should be dismissed with costs as it was in any event not

pursued by the directors in argument at the hearing, and further dismiss the second exception with costs.

F ANALYSIS OF EVIDENCE AND APPLICABLE LEGISLATION

[26] In essence this exception turns on the interpretation of the statutory provisions. The defendants objected to the plaintiff's particulars of claim on the basis that it is not entitled as a third party creditor to rely on the provisions of Sections 77(3)(b), 22(1) and 77(6) of the Act to hold the directors of the company personally liable for a debt allegedly due to it by the company of which they are directors. Section 77(3) of the Act was compared by the defendants with Section 424 of the 1973 Act. Plaintiff correctly stated that section 424 is not applicable in this matter, as this is not a liquidation matter, I agree with plaintiff's submission in this regard. It would therefore, not be worth analysing this comparison.

[27] I will now turn to Section 77(3)(b) that plaintiff relied on in its pleading. For the purpose of deciding an exception, it is trite that the Court must assume the correctness of the factual averments made in the relevant pleading, unless they are palpably untrue or so improbable that they cannot be accepted – See ***Francis v Sharp and Others 2004 (3) SA 230 (C).*** This therefore means that this Court should interpret the objects of Section 77(3)(b) as pleaded by the plaintiff. At this point, it would not be necessary to deal with alternative reliance on Sections 77(3)(c) and 77(6). According to plaintiff, central to the determination of this ground of exception is the meaning of Section 77(3)(b), and whether it can be a basis to found the personal liability of a director in favour of a creditor of the company. Plaintiff submitted that the interpretation of Section 77(3)(b) is not only a reasonably possible one, but one of a number of reasonably possible ones, and it reads 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 section 22(1);*

(c) *being a party to an act or omission by the company despite knowing that the act or omission was calculated to defraud a creditor … or had another fraudulent purpose;"*

[28] It is indeed so that this is a matter for the interpretation of statute. On consideration of plaintiff's submission, it would appear that they acknowledged that this section of the statute is capable of more than one meaning. Although it opposes this exception, it does not completely discard the interpretation by the defendants. This therefore means that this section has an ambiguous meaning, including the meaning employed by the defendant. On first cursory reading of this section, one may conclude that the section relates to the liability of directors as a result of damages sustained by the company as a result of having acquiesced in the carrying on of company's business, knowing very well that such conduct is prohibited by Section 22(1). Whereas on the second reading of this section, one may conclude that a director of a company is liable for any loss, damages or costs sustained by the company itself, as a direct or indirect consequence of the director having acted in the manner set out in that subsection.

[29] G E Devenish, in his book, Interpretation of Statues at page [61] suggested two (2) different approaches in the interpretation of statutes - that is narrow and wider approach:-

"(a) The first (a narrow approach) provides that only where the language is ambiguous can the Court construe it so as to avoid an absurd result …"

(b) The second (a wider approach) permits a departure from the clear, unambiguous language of a statute, if to do otherwise would lead to an absurdity so glaring that it could never have been contemplated by the legislature, or where it could lead to a result contrary to the intention of the legislature as shown by the context or by such other considerations as the Court is justified in taking into account."

[30] In interpreting this section, it would be born in mind that a company is a juristic person. It cannot incur losses, damages or cost without the actions of its directors. It might be so that the section envisages the directors being accountable to the company. In the circumstances of this case, the directors made orders of the clothing, accepted delivery of the same and thereafter did not pay on behalf of the company. In my view, they acted recklessly with the possibility of intent to defraud plaintiff and cannot escape liability for their actions.

[31] In my opinion, the approach to be adopted when interpreting this section is the narrow approach because of the ambiguity of the section. This Court can only interpret this section to mean that directors of a company are liable for <u>loss</u>, <u>damages</u> or <u>costs</u> sustained by the company as a direct or indirect consequence of the director having acquiesced in the carrying on of the company's business despite knowing that such conduct is prohibited by Section 22(1). Otherwise, if one were to adopt the second reading, it would result into wider meaning that would result in an absurdity and or further inquiry into the section itself. For instance, if the director is liable for the loss, damages or costs <u>sustained by the company</u> – who would ordinarily enforce the civil claim against the directors, as that is not provided for in the Act. This approach would create a *lacuna.* Such enforcement is only provided for when the company is sequestrated and or in liquidation. In such circumstances, the liquidator will inadvertently proceed against the director if necessary. In a case such as the present – damages claim, the meaning employed by the defendants is not desirable as it is not sensible or practicable.

[32] In the present instance, I am therefore satisfied that the legislature never intended or contemplated the interpretation as argued for by the defendants, as this will create a *lacuna.* If this Court were to adopt such an approach, it would lead to absurd results.

[33] Besides, plaintiff's pleadings are not constructed in such a way that defendants would not be able to plead. Defendants are fully aware of the case to meet. Having said so, I agree with the plaintiff that defendants' exception should be dismissed.

[34] In the result, I make the following order.

- The exception is dismissed with costs.

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MANTAME, J