REPUBLIC OF SOUTH AFRICA

SOUTH GAUTENG HIGH COURT, JOHANNESBURG

CASE NO: 38587/2011

(1) REPORTABLE: YES / NO
(2) OF INTEREST TO OTHER JUDGES: YES/NO
(3) REVISED.

12/04/2012
DATE

SIGNATURE

In the matter between:

KUKAMA, AOBAKWE REGINALD KOKETSO	Applicant
and	
LOBELO, KAGISHO LAMBERT	First Respondent
PEOLWANE PROPERTIES (PTY) LIMITED	Second Respondent
DIPHUKA CONSTRUCTION (PTY) LIMITED	Third Respondent
THE COMPANIES AND INTELLECTUAL PROPERTY COMMISSION	Fourth Respondent

JUDGMENT

TSHABALALA, J:

[1] The applicant has launched the present application on a semi-urgent basis to declare the first respondent a delinquent director and for his removal as a director of the second and third respondents. The applicant also seeks an order for leave to bring proceedings against the first respondent on behalf of the second and third respondents for payment of the amount of R22 715 909,22 and for costs on attorney and own client scale.

[2] The following background facts are common cause:

2.1 The first respondent and applicant are each 50% shareholders of the issued shares in the second and third respondents.

2.2 The first respondent and the applicant are both directors of the second respondent and the first respondent is the sole director of the third respondent.

2.3 During December 2010 and May 2011, SARS made two payments of R22 715 909,22 and R39 023 656,00 respectively into the banking account of the third respondent.

2.4 These payments were rebates from SARS allegedly incurred by and due to the second respondent and not the third respondent.

2.5 The refund of R39 023 656,00 was not due by SARS to either the second or third respondents, nor had it at the time when this matter was argued before me, been refunded to SARS.

2.6 The refund of R22 715 909,22 was not utilised by the first respondent for the sole benefit and expenses of the second defendant, but also for other entities and for their benefits.

2.7 The R39 023 656,04 claimed from SARS was made up of fictitious tax invoices submitted by Royal Alliance on behalf of the second respondent to SARS.

2.7.1 This would have entailed that the 2nd respondent had spent R278 740 400 more than it actually spent on the items that attracted VAT.

2.8 The two amounts paid by SARS into the account of the third respondent, were not transferred into the correct account of the second respondent, but were dispersed to various entities.

2.9 The first respondent acted as the sole director of the second respondent on or about the 25th November 2010 and in particular during the period material to the two payments.

2.10 Royal Alliance was engaged by the first respondent to handle the tax affairs of the second respondent which led to the payment of the two SARS "*refunds*".

[3] According to the applicant, the first respondent:-

3.1 had engaged the services of Royal Alliance without his consent as both a shareholder and/or director of the second respondent. He was also not advised of the payment of the two amounts by SARS into the account of the third respondent;

3.2 had also authorised payment by SARS of a refund due to the second respondent into the third respondent's account;

3.3 had not informed the applicant of such payment;

3.4 utilised the refund from SARS for the benefit of entities other than the second respondent.

[4] The following sections of the New Companies Act 71 of 2008 are relevant for the determination I am called upon to make:

4.1 Section 3(1) which reads as follows:

> *"(1) A company is –*
>
> *(a) a subsidiary of another juristic person if that juristic person, one or more other subsidiaries of that juristic person, or one or more nominee of that juristic person or any of its subsidiaries, alone or in any combination –*
>
> *(i) is or are directly or indirectly able to exercise, or control the exercise of, a majority of the general voting rights associated with issued securities of that company, whether pursuant to a shareholder agreement or otherwise; or*
>
> *(ii) has or have the right to appoint or elect, or control the appointment or election of, directors of that company who control a majority of the votes at a meeting of the board; or*
>
> *(b) a wholly-owned subsidiary of another juristic person if all of the general voting rights associated with issued securities of the company are held or controlled, alone or in any combination, by persons contemplated in paragraph (a).*"

4.2 Section 22.Reckless trading prohibited.-(1), (2) and (3) which reads as follows:

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

(2) If the Commission has reasonable grounds to believe that a company is engaging in conduct prohibited by subsection (1), or is unable to pay its debts as they become due and payable in the normal course of business, the Commission may issue a notice to the company to show cause why the company should be permitted to continue carrying on its business, or to trade, as the case may be.

(3) If a company to whom a notice has been issued in terms of subsection (2) fails within 20 business days to satisfy the Commission that it is not engaging in conduct prohibited by subsection (1), or that it is able to pay its debts as they become due and payable in the normal course of business, the Commission may issue a compliance notice to the company requiring it to cease carrying on its business or trading, as the case may be"

4.3 Section 76(2) reads as follows:

"*(2) A director of a company must –*

(a) not use the position of director, or any information obtained while acting in the capacity of a director –

(i) to gain an advantage for the director, or for another person other than the company or a wholly-owned subsidiary of the company; or

(ii) to knowingly cause harm to the company or a subsidiary of the company; and

(b) communicate to the board at the earliest practicable opportunity any information that comes to the director's attention, unless the director –

(i). reasonably believes that the information is –

(aa) immaterial to the company; or

(bb) generally available to the public, or known to the other directors; or

(ii) is bound not to disclose that information by a legal or ethical obligation of confidentiality."

4.4 Section 76(3) reads:

"(3) Subject to 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 interests of the company; and

(c) with the 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."

4.5 Section 77(3) reads:

"(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 –

(a) acted in the name of the company, signed anything on behalf of the company, or purported to bind the company or authorise the taking of any action by or on behalf of

the company, despite knowing that the director lacked the authority to do so;

(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) 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;"

4.6 Section 162(5) reads:

"*(5) A court must make an order declaring a person to be a delinquent director if the person –*

(a) ...

(b) ...

(c) while a director –

(i) grossly abused the position of director;

(ii) took personal advantage of information or an opportunity, contrary to section 76(2)(a);

(iii) intentionally, or by gross negligence, inflicted harm upon the company or a subsidiary of the company, contrary to section 76(2)(a);

(iv) acted in a manner –

(aa) that amounted to gross negligence, wilful misconduct or breach of trust in relation to the performance of the director's functions within, and duties to, the company; or

(bb) contemplated in section 77(3)(a), (b) or (c);"

4.7 Section 332(1) and (2) of the Criminal Procedure Act 51 of 1977 (as amended) reads:

"(1) For the purpose of imposing upon a corporate body criminal liability for any offence, whether under any law or at common law –

(a) any act performed, with or without a particular intent, by or on instructions or with permissions, express or implied, given by a director or servant of that corporate body; and

(b) the omission, with or without a particular intent, of any act which ought to have been but was not performed by or on instructions given by a director or servant of that corporate body,

in the exercise of his powers or in the performance of his duties as such director or servant or in furthering or endeavouring to further the interests of that corporate body, shall be deemed to have been performed (and with the same intent, if any) by that corporate body or, as the case may be, to have been an omission (and with the same intent, if any) on the part of that corporate body.

(2) In any prosecution against a corporate body, a director or servant of that corporate body shall be cited, as representative of that corporate body, as the offender, and thereupon the person so cited may, as such representative, be dealt with as if he were the person accused of having committed the offence in question ... (with certain limitations discussed infra)."

[5] According to the applicant, the first respondent has by his conduct, contravened the provisions of sections 22, 76(2) and (3), 77(3)(a), (b) and (c) and 162(5)(c)(i) to (iv) of Act 71 of 2008.

[6] The respondents on the other hand dispute the contravention and contend that:

6.1 Whatever the first respondent did, was for the benefit of the second respondent and the subsidiaries of or entities forming a group of companies with the second respondent;

6.2 The first respondent was not a party to defrauding SARS;

6.3 The applicant had shown no interest to and in the proper running and management of particularly the second and third respondents.

6.4 It was necessary for the first respondent to appoint Royal Alliance, the tax consultancy responsible for submitting the fictitious invoices to SARS because of the state of the tax affairs of the second respondent.

6.5 The applicant has not made out a case for the order it seeks against the first respondent and in particular against the second and third respondents generally.

[7] On the 12th February 2010, the second respondent entered into a loan contract with Firstrand Bank Limited in terms whereof the latter loaned the second respondent certain amounts for purposes of meeting its VAT obligations to SARS. It was an express term of such a loan contract that the VAT refunds from SARS will be paid into a VAT facility account which the second respondent was obliged to open and maintain for the specific purpose of effecting payment of the VAT obligations of the second respondent.

[8] The agreement between the second respondent and Royal Alliance in terms whereof the services of the latter were engaged by the former, was signed by the first respondent on the 22nd February 2011, i.e. two months after SARS had made a payment of R22 715 909,22 into the account of the third respondent.

[8] In terms of the Companies and Intellectual Property Report attached to the answering affidavit (p 156 – Annexure "LKL1"), the applicant resigned as a director on the 25th November 2010 when his shareholding in Tau Pride Projects (Pty) Ltd ceased.

[9] The fact that the first respondent who for all ends and purposes acted as the sole and *de facto* director of the second respondent:

9.1 Allowed money destined for the second respondent to be paid into an account other than that of the second respondent;

9.2 Failed to detect the fraud to SARS of R39m, when it should have done, regard being had to what I have stated in paragraph 2.7.1 above;

9.3 Utilised the two amounts paid by SARS into an incorrect account of the third respondent for the benefit and interest of other companies to the detriment of the second respondent;

9.4 Failed to pay the two amounts paid by SARS into the account of the second respondent and to refund SARS the fraudulent claim of R39m after the fraud was detected;

9.5 Failed to alert his co-director and co-shareholder of the fraudulent transaction and the repayment by SARS of the R22 715 909, 22 into an account of the third respondent over which the applicant holds no directorship;

demonstrate at least that, the conduct of the first respondent in his dealings with the affairs of the second respondent did not measure up to the standard required and expected of a director and was in breach of his fiduciary duties to the second respondent.

[10] Section 76(2)(b) of Act 71 of 2008 creates a duty on the part of a director to communicate at the earliest practicable opportunity any information

that comes to his attention to his board. It is common cause that the 1st respondent did not communicate the information referred to in 9.5 above to the applicant.

[11] The effect of the first respondent's failure to refund SARS the R39m did not only cause irreparable harm upon the second respondent as envisaged in section 162(5)(c)(iii) of Act 71 of 2008, but also exposed the second respondent and the applicant to criminal liability as envisaged in section 332(1) and (2) of the Criminal Procedure Act 51 of 1977 as amended.

[12] By utilising the funds destined for the second respondent for the benefit of other companies who are not subsidiaries of the second respondent, the first respondent also inflicted harm upon the second respondent in terms of section 162(5)(c)(iii) of the Companies Act and in breach of the fiduciary duties he owed to the second respondent.

[13] By failing to detect the fraud of R39m to SARS, the conduct of the first respondent amounted to gross negligence, and by failing to pay it back to SARS and/or to the account that it should have been paid into initially i.e. either the second respondent's account or the VAT facility account that was or should have been opened to service the VAT obligations of the second respondent as required by the loan agreement between the Firstrand Bank Ltd and the second respondent, the first respondent's conduct amounted to wilful misconduct or breach of trust as envisaged in section 162(5)(c)(iv)(aa) and (bb).

[14] I will now proceed to deal with the issue of whether the first respondent was entitled to deal with the funds destined for the second respondent's account in the manner that he has done, and to the detriment of the second respondent. I will also deal with the issue of whether the other sister companies in which the applicant and the first respondent have or had an interest in the past, should be regarded as, or qualify to be subsidiaries of the second respondent.

[15] From the outset, and looking at the CIPC Reports annexed to the answering affidavit of the first respondent, there is no suggestion, expressed or implied, that all the entities that the first respondent and the applicant have or had a common interest in, are not independent of each other, nor is there any indication that all the debits reflected as the second respondent's expenses (at pages 277-8) do not also cover the expenses of the other sister entities of the second respondent. In any event, the applicant had resigned his directorship from almost all but one of such entities; viz. the second respondent. This fact alone emphasises the reason why the applicant was entitled to be advised of when and how the refund from SARS came to be paid into the third respondent's account, and how and why it was dispersed in the manner that the first respondent dispersed it.

[16] It has not been suggested nor indicated to me, that the ownership of the applicant and the first respondent of their shares in the sister entities of the second respondent was acquired or exercised through the second

respondent. The fact that both the applicant and the first respondent held shares in such sister entities, does not, in my view, lead to the conclusion that such entities are subsidiaries of the second respondent.

[17] Although both the applicant and first respondent together held the majority of the general voting rights in the sister entities of the second respondent, none of them singularly and separately held any majority vote. None of them could therefore on his own, exercise any control over the majority of the voting rights nor the election and appointment of directors of those sister entities. In any event some of those entities were:-

17.1 in the process of being deregistered, or,

17.2 the applicant and the first respondent were in the process of resigning therefrom or,

17.3 the applicant had already resigned therefrom.

[18] On my understanding of section 3 of Act 71 of 2008, I do not find that any of the sister entities of the second respondent are its subsidiaries.

[19] Having regard to all that I have set out above, I am satisfied that:

19.1 The first respondent's conduct fell short of the standard expected of a director of the 2nd respondent to such an extent

that it amounts to wilful misconduct, breach of trust and a gross abuse of his position as a director.

19.2 He was grossly negligent in failing to detect the fraud and in not suspecting fowl play, given the substantial refunds paid by SARS and the remuneration package which had been concluded with Royal Alliance, regard also being had to the fact that the letter of engagement of Royal Alliance was only signed on the 22nd February 2011. This, in my view, creates the impression that the package covered future recoveries of refunds from SARS and not recoveries already made.

19.3 The first respondent's gross negligence inflicted harm upon the second respondent and exposed it to unnecessary litigation and to criminal liability, especially having regard to the liability it accepted in its agreement with Royal Alliance to safeguard against fraud, its detection and prevention – see Annexure "LKC12" page 245 of the bundle.

19.4 The first respondent should not have paid the amount to the various entities that he had paid to from the third respondent's account, but should have transferred the amount of R22 715 909,22 into the second respondent's account and dealt with same in consultation with his co-director and shareholder from that account.

19.5 The first respondent should have atleast, in its founding affidavit, dealt with the expenses of Tau Pride Projects and the third respondent and the income of Tau Pride Projects to demonstrate that the second respondent was settling its liabilities to these entities and not merely taking over their burdens or liablities.

19.6 The first respondent did not explain why the following disbursements were made and what their equivalent are in the Tau Pride Projects and the third respondent, and their contributions to the following:- donations, salaries, legal fees, including Werksmans Attorneys' account, petty cash, transport costs, withdrawals, payments to Tau Pride Projects costs and to the first respondent, Tau Pride transfers, petty cash, withdrawals and payments to Royal Alliance to mention but a few. (See page 277 Annexure LKL19). In view of the fact that only Tau Pride Project was an income generating vehicle in the stable of companies wherein the applicant and first respondent had had interests in, (according to the first respondent), Tau Pride Projects and the third respondent must have had their expenses and Tau Pride Projects at least also an income.

19.7 Payment to Royal Alliance also included payment of the account due by Tau Pride Projects of R1 200 230,00, as it is clear from

the letter of engagement that Royal Alliance also did consultancy work for it and that only R923 145,00 was paid to Royal Alliance for the account of the second respondent (see para 52.3 of answering affidavit at p 139).

19.8 The payment from the tax refund proceeds due by SARS to the second respondent of certain invoices, such as the Escom and Royal Alliance invoices should not have been paid from such proceeds particularly when no reason for so doing has been given or justified.

19.9 There is no reason why the amount of R3 995 232,17 (Annexure "LKC10A" p 235) should be borne by the second respondent when the invoice specifically stipulated that it was for the account of Tau Pride Projects.

[20] Notwithstanding the strained relationship between the applicant and the first respondent as both directors and shareholders of the second and third respondents, the legal obligations of a director bound the first respondent to discharge his duties in the same manner that it should, had the relationship between the two been normal.

[21] In view of the effect of an order declaring a director delinquent it is in my view, not necessary to also order his removal as such due to the automatic inherent effect of such a declaration.

[22] The effect of declaring the first respondent a delinquent director also has the effect of reducing the second respondent's directors to one, unless and until the first respondent as a shareholder, exercises his right to appoint a co-director, if the memorandum of incorporation ("*MOI*") allows him to do that. If no provision is made for such an appointment, it is not necessary for me to grant an order in terms of prayer 3, as the applicant will then have the authority he seeks in terms of this prayer as the only director of the first respondent.

[23] I am, however, not privy to the provisions of the MOI in respect of this issue. If the MOI does not provide for this eventuality or mechanism, I am then at liberty to make an order in terms of prayer 3.

[24] Although some information has been provided in the answering affidavit relating to prayer 2, not all the details requested therein have been furnished. The information requested in prayer 2 was certainly necessary to support the present applicant's application. It may be necessary for other purposes going forward. I have, however, not been made aware of such other purposes in the present application.

[25] The applicant has, in the present application sued the second respondent. He is co-director of the second respondent. One of the two directors has to act for the second respondent. It can therefore not make legal sense that the other director, if there be only two of them, cannot act in the

defence of the second respondent. Should this have not been the case, either director would sue the second respondent with impunity well aware of the paralysis that the second respondent would suffer from. In any event, I was not called upon to pronounce upon the Rule 7 Notice and will refrain from so doing as this issue is not before me.

[26] I am not satisfied that this is one of those cases where costs should be awarded on a punitive scale.

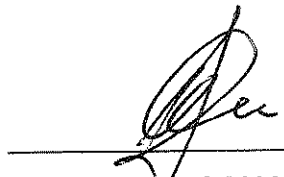
[27] Accordingly I grant an order in the following terms:

1. The first respondent is declared a delinquent director.

2. The applicant is granted leave to institute legal proceedings against the third respondent for payment of R22 715 909,22 or such other amount together with interest and costs without making the demand contemplated in section 165 of Act 71 of 2008 in the name and on behalf of the second respondent.

3. The applicant is granted leave to institute legal proceedings in the name and on behalf of the second respondent against the first respondent for the payment of R22 715 909,22 or such other amount together with interest and costs in terms of section 77(2) and (3) of Act 72 of 2008 (under the alternative relief).

4. The first respondent is ordered to pay the costs on the party and party scale.



N D TSAHABALALA
JUDGE OF THE SOUTH GAUTENG
HIGH COURT, JOHANNESBURG

Date of Judgement :-

12 April 2012

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