IN THE HIGH COURT OF SOUTH AFRICA

(WESTERN CAPE HIGH COURT, CAPE TOWN)

CASE NUMBER: 4448/2003

DATE: 26 NOVEMBER 2009

In the matter between:

RODNEY STUART HEMPHILL	1st Plaintiff
17 STEENSWAY LLANDUDNO (PTY) LTD	2nd Plaintiff
and	
CHRISTOPHER DAVID SHONE N.O.	1st Defendant
DUNFORD NICHOLAS PAXTON	2nd Defendant
CHRISTOPHER JOHN PAXTON	3rd Defendant

J U D G M E N T

BAARTMAN, J:

In this application, Rodney Stuart Hemphill, (**the first plaintiff**) and 17 Steensway Llandudno (Pty) Ltd, (**the second plaintiff**), issued summons and claimed relief in terms of section 424(1) of the Companies Act 61 of 1973 as amended. The plaintiff sought an order in terms of which the two directors and the general manager of Natile Products (Pty) Ltd (**the company**) be held personally liable for the claim the

plaintiffs have against the company.

The deceased, Mr Paxton senior, was the general manager of the company he ran with his two sons, the second and third defendants. Christopher David Shone, in his capacity as curator of the deceased's estate of Paxton senior, (**the first defendant**) is the first defendant in these proceedings. The first and third defendants failed to appear at the hearing of the matter and the second defendant appeared in person.

Background:

The company traded as a natural tile retailer from premises situated at 99 Gabriel Road, Plumstead in the Western Cape. As indicated above, the second and third defendants were directors and employees of the company. On 31 May 2008, at Plumstead, the business premises of the company, the first plaintiff representing the second plaintiff, placed an order with the company, at the time represented by the first defendant. The material terms of that contract were:

> "1. The company would supply the second plaintiff with 820 square metres of Travertine tiles, 457 x 457, honed and filed at the second plaintiff's premises at 17 Steensway, Llandudn;

2. The cost thereof to the second plaintiff would be R185,00 per square metre (exclusive of Value Added Tax);

3. The total price of R151 700.00 (exclusive of Valued Added Tax) would be secured by a bank guarantee furnished by the first plaintiff's bank, Standard Bank of South Africa Ltd, to the company's bank, First National Bank Ltd, which guarantee:

3.1 Would be subject to full delivery of the said 820 square metres of Travertine tiles, 457 x 457, honed and fold at 17 Steensway, Llandudno;

3.2 Would be payable on demand and would expire on 30 September 2002."

The plaintiffs furnished the bank guarantee under the above terms through a guarantee that inadvertently reflected the first plaintiff instead of the second plaintiff, as the party who contracted with the company. I do not deal with that mistake, because it is irrelevant for the purposes of this judgment. However, in order to secure its liability under the guarantee, the first plaintiff's bank had earmarked R151 700 from the first plaintiff's personal funds in a special account.

On 5 September 2002, before delivering the second plaintiff's

tiles, the company called up the guarantee. The first plaintiff's bank deducted the sum earmarked and paid it over to the company.

On 27 January 2003, the Court placed the company in provisional liquidation. Dan Apteker (**Apteker**), the company's financier, was the applicant in the liquidation application. He alleged that the company was commercially and factually insolvent. The first defendant, duly authorised, confirmed the company's financial position as alleged by Apteker and indicated that the company did not oppose the liquidation application. On 18 March 2003, this Court confirmed the provisional order.

The first plaintiff learnt from an acquaintance about the company's liquidation. He enquired into the rumour and the first defendant denied that the company was in liquidation. The third defendant led the first plaintiff to believe that the tiles were in the company's warehouse. They were not. The company failed to honour its obligation to the plaintiffs.

The second plaintiff, through a company named Natural Stone Warehouse, at an additional cost of R45 090.20, over and above the money paid to the company, acquired the tiles it had ordered from the company. It was not in dispute that the

plaintiffs acquired the tiles at the best available price at the time.

The second defendant testified and said that he had known since October 2000 that the company was in financial trouble. He said that the third defendant and he were not involved in the financial administration of the company. He indicated that in October 2002, the company received a large supply of travertine tiles from Turkey. At the time, he enquired from his father whether they would service the plaintiffs' order. The first defendant informed the second defendant that the plaintiffs were not ready for delivery.

The first plaintiff testified and said that he would have been able to receive the tiles if the company had offered delivery. The second defendant was unable to deny that the company never offered delivery. I accept that evidence of the first plaintiff. The second defendant said that after the conversation with the first defendant, he became aware that the first defendant "had processed the plaintiffs' payment".

The second defendant could not explain, to any satisfactory degree, how he knew about the payment in view of his earlier evidence that the first defendant kept him and the third defendant out of the company's financial affairs.

He further indicated that when he learnt of the liquidation, he then realised that they should have delivered to the plaintiffs.

The second defendant testified that the first defendant was not a good business person and that he, the second defendant, was at all times concerned about the company's financial affairs. He admitted that, although able to obtain alternative employment, he remained in the company as director and employee even though the first defendant refused him access to the company's financial records.

Section 424 of the Companies Act reads as follows:

> "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 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 of liability, for all or any of the debts or other liabilities of the company as the Court may direct."

The company called up the guarantee in contravention of its terms. It did so fraudulently. The first defendant, as general manager, cannot escape liability. The second defendant knew that they had not delivered the tiles when the first defendant processed the payment. He also knew that the company was financially unsound. The third defendant misled the plaintiff and pretended that the tiles were in their warehouse. The second and third defendants allowed the first defendant to conduct the company's affairs, even though he was, in the opinion of at least the second defendant, incapable of doing so.

The second defendant said that the company had been in financial trouble since 2000. That situation had worsened to the extent that they took money from Apteker, a micro-lender, who had secured his loan to the company by a notarial bond. The second defendant indicated that he had felt uneasy about Apteker's involvement in the company because Apteker was the micro-lender and was not in their industry. Despite his misgivings, the second defendant was party to the process. As director, the second defendant had to have been a party to the

registration of the notarial bond.

The first defendant acted recklessly and fraudulently when he called up the guarantee. According to the second defendant, the third defendant and he were not involved in the decision to call up the guarantee. Even if I accept his evidence, it does not necessarily follow that they can escape liability.

In the matter of **Philotex (Pty) Ltd & Others v Snyman & Others** 1998(2) SA 138 (SCA) Howie JA said the following at 142G-J:

> "The precursor of the section, s185 bis of the previous Companies Act 46 of 1926 (introduced into that act in 1939), did not include reckless trading and only applied to the case of a winding-up and judicial management. Obviously, therefore, the legislative intention in him in acting s424, was to broaden the scope of the earlier provision and to extend the remedy by means of which a restraining influence can be exercised on "over-sanguine directors." **Gordon N.O. & Rennie N.O. v Standard Merchant Bank Ltd & Others** 1984(2) SA 519(C) at 527-B. That, of course, does not mean that the recklessness is likely to be found. The

remedy is a punitive one; A director can be held personally liable for liabilities of the company without proof of any cause or link between his conduct and those liabilities: **Howard v Herrigel & Another N.N.O.** 1991(2) SA 660(A) at 672E. The onus is upon the party seeking recklessness to prove it and, these being civil proceedings, to establish the necessary facts according to the required standard, which is on a balance of probabilities. (In prosecution under s424(3), the meaning of recklessness would be no different, but the necessary facts would, of course, have to be proved beyond a reasonable doubt.)"

The second and third defendants, on the second defendant's version, stood passively by while the first defendant traded recklessly. The second defendant said that he was uneasy about the first defendant having no business sense and that the way the first defendant managed the business was of concern to him. The second defendant also said that he was concerned that Apteker was taking large amounts of money out of the company. The second defendant excused his inaction by saying "I had to think of my family." He seemed to have forgotten his duties as director of the company. (See **Fisheries Development Corporation of SA Ltd v Jorgensen &**

Another; Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd & Others 1980(4) SA 156 (W) at 170B-C).

I am of the view that the second and the third defendants cannot escape liability. Howie JA in the matter of **Filotex** said the following at 143A-B:

> "Knowing means having knowledge of the fact from which the conclusion is properly to be drawn that the business of the company was or is being carried on recklessly; It does not entail knowledge of the legal consequences of the fact ... It follows that knowing does not necessarily mean consciousness of recklessness. Being a party to conduct of the company's business does not have to involve the taking of positive steps in carrying on the business. It may be enough to support or concur in the conduct of the business."

Order:

I, for the reasons stated above make the following order: The order against the second defendant represents the amendment by agreement.

IN THE HIGH COURT OF SOUTH AFRICA
(WESTERN CAPE HIGH COURT, CAPE TOWN)

Cape Town: Thursday, **26 November 2009**
Before the **Honourable Ms. Justice Baartman**

CASE NUMBER: 4448/2003

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17 STEENSWAY LLANDUDNO (PTY) LTD	2nd Plaintiff

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DUNFORD NICHOLAS PAXTON	2nd Defendant
CHRISTOPHER JOHN PAXTON	3rd Defendant

ORDER

BAARTMAN, J:

Having heard counsel and second defendant and having read the documentation filed of record,

It is ordered that:

1. The defendants are declared liable, in terms of section 424(1) of the Companies Act 61 of 1973 (as amended), for the debts and liabilities of Natile Products (Pty) Ltd

(in liquidation) to the first and second plaintiff.

2. Judgment is granted against the defendants jointly and severely as follows:

3. **The first and third defendant:** Payment of the amount of R190 961.60.

4. **The second defendant**: Payment of the amount of R196 798,20.

5. Interest on the above mentioned amounts at the prescribed rate of interest from 5 September 2002 to date of payment.

6. Costs on an attorney and client scale.

BAARTMAN, J