CASES / VONNISSE

PERSONAL LIABILITY OF A DIRECTOR IN TERMS OF SECTION 424(1) OF THE COMPANIES ACT 61 OF 1973 IN RELATION TO DEFAULT JUDGMENT IN TERMS OF RULE 39 OF THE UNIFORM RULES OF THE HIGH COURT: AN ANALYSIS OF

Minnaar v Van Rooyen NO
[2015] ZASCA 114

1 Introduction

The Uniform Rules of the High Court regulate procedure to be followed from the beginning of the matter until it is settled or decided by the courts. The Rules provide for the procedure to be followed prior to the litigation process when the court is not yet involved. During the litigation process, when the court is involved, the court establishes whether proper procedure has been followed before the matter is heard. The court will then conduct the litigation process, either the application process or the action process, and make a determination. The Rules may again provide guidance to the court when granting an order in that specific matter. However, complications may arise when the Uniform Rules clash with the procedures to be followed by the court in terms of the Statute.

In *Minnaar v Van Rooyen NO* ([2015] ZASCA 114) the Supreme Court of Appeal was called upon to interpret section 424(1) of the Companies Act of 1973, in order to determine whether section 39(1) of the Uniform Rules allowed the court to grant a default judgment for a relief under section 424(1). The Supreme Court of Appeal upheld the appeal against the decision of the *court a quo*, that the court has the discretion to grant a default judgment for a relief under section 424(1), without evidence. The SCA held that there must be evidence establishing – on a balance of probabilities – that a former director of a company has acted recklessly before such an order can be granted. In the absence of that evidence an order granted under section 424(1) of the Companies Act is erroneously made, and had to be set aside. Since this is the first case decided by the Supreme Court of Appeal regarding the interpretation of Rule 39(1) and section 424(1), it is imperative that attention is drawn to the decision and

how it has impacted on the Uniform Rules of the High Court. The aim of this paper is to interpret and determine how the court reached this conclusion, and how this conclusion has set out a new approach of interpreting Rule 39(1) of the Uniform Rules of the High Court and section 424(1) of the Companies Act.

2 Facts

This was an appeal against the High Court decision refusing to rescind the default judgment against the appellant. The appellant was Mr Minnaar and the respondent Mr Van Rooyen. The order was made by Keightley AJ, in the North Gauteng High Court, where she refused to grant a rescission of the default judgment order granted against the appellant. The facts leading to the appeal were that the appellant had been appointed as a consultant in 1999 and later a financial advisor of Askari Mining and Equipment Ltd (in Liquidation). The Commissioner had been appointed to conduct an enquiry into the affairs of the company, in terms of section 417 of the Companies Act 61 of 1973. The Commissioner reported that section 424(1) of the said Act could be applied in order to identify the conduct of the directors and the trading of the company, as well as that an action could be brought under section 424(1).

In May 2008, the liquidators instituted an action in terms of section 424(1) against the appellant and the other four directors, in terms of which they sought an order holding the appellant and other directors personally liable for all the debts of Askari. The other four directors reached a settlement for the debts while the appellant refused to do so, contending that he was not liable.

Prior to the trial date, the appellant had known of the pre-trial conference, but had not attended. He further did not attend the trial, and the respondent applied for, and was granted, a default-judgment order. Ten months later, the appellant applied for the rescission of the default judgment, but this was refused because the initial court ("initial court" is the High Court, where the default judgment was granted and the *court a quo* is the High Court, where application for rescission for that default judgment was refused) had not erred in granting the order. This led to the appeal in the present case.

3 Issue

The issue before the Court was whether granting a default-judgment order under section 424(1) of the Companies Act 61 of 1973 is erroneous, within the meaning of Rule 42(1)(a) of the Uniform Rules of the Court.

4 High Court Decision (*Minaar v Van Rooyen NO* [2013] ZAGPPHC 375)

(Minnaar has been spelled incorrectly in the citation of the case. In this article, when reference is made to the High Court decision, "Minaar" is used,

but when reference is made to the Supreme Court of Appeal decision, "Minnaar" will be used.)

The issue before the Court was whether the applicant (Mr Minaar) was entitled to a rescission on the basis that the court (initial court) had erred in granting a default-judgment order. Relying on Rule 42(1)(a), section 424(1), and the common law, the applicant argued that the initial court had erred in granting the order, and therefore the order should be rescinded. However, the Court refused to grant the order and held that the applicant failed to persuade the Court that the initial court had erred in granting a default-judgment order (par 79). The Court held there was no irregularity or error in the process to support a rescission under section 42(1)(a), and the initial court was competent to make the order in the manner that it did (par 62).

In deciding the case, Keightley AJ started by dealing with section 42(1)(a) (in terms of Rule 42(1)(a), "the court may, in addition to any other powers it may have, *mero motu* or upon the application of any affected party, rescind or vary an order or judgment erroneously sought or erroneously granted in the absence of any party affected"), and whether the applicant had satisfied its requirements. The Court held that the applicant bears the *onus* of satisfying the Court that he or she has met the requirements under Rule 42(1)(a), before the Court may grant a rescission order (par 21). However, the Court was not prepared to accept that the applicant had satisfied these requirements. The Court held that the applicant did no more than setting out the facts and did not identify the critical facts that would lead the Court to come to a different conclusion, had it known those facts (par 21). The Court held that the duty to convince the Court that it should grant a rescission order should not be to set out in narrative facts, and that doing so was an improper approach (par 21). The Court further held that, even if it was to regard the facts given by the applicant, it was not convinced that they established a ground for rescission, in terms of section 42(1)(a) (par 22).

The applicant argued that because of the nature of an order under section 424(1), (this section 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 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 Court cannot grant a default-judgment order without the evidence being led. In supporting this argument, the appellant argued that a Court may not grant a declaration under section 424(1) merely on a *prima facie* case, and that the Court must be able to make an individual value judgment on the defendant's knowledge and involvement (par 28). The appellant further argued that granting an order without hearing evidence makes such order vulnerable to a rescission under Rule 42(1)(a), on the basis that it was erroneously granted (par 28). Therefore, the Court is not competent to grant such an order.

However, the Court rejected the applicant's argument that the relief under section 424(1) cannot be granted by default. The Court held that an application for a declaration under section 424(1) was novel. However, before interpreting this section with case law the Court considered Rule 39(1) which allows the Court to grant default judgment. (This Rule provides that "[i]f, when a trial is called, the plaintiff appears and the defendant does not appear, the plaintiff may prove his claim so far as the burden of proof lies upon him; and judgment shall be given accordingly, in so far as he has discharged such burden. Provided that where the claim is for a debt or liquidated demand no evidence shall be necessary unless the Court otherwise orders".) It held that the provision of Rule 39(1) allowed the Court to grant a default judgment declaring liability in terms of section 424(1) – without evidence being led to support the claim (par 43 and 47). Keightley AJ held that the words "debt or liquidated demand" were not limited to claims for the repayment of money, and would include claims for the transfer of property, cancellation of contracts, ejectment, and declaration of rights (par 44). In this regard, the Court accepted the initial court's decision to grant a default judgment without evidence being led. In reaching this decision, the Court cited *Abraham v City of Choice* (1995 (2) SA 319 (C)), where the Court granted a judgment by default in a delictual claim, without evidence being led. The Court held that when granting a default judgment in terms of Rule 39(1), the presiding judge has the discretion to decide whether it is necessary to lead evidence, and therefore Van der Merwe DJP of the initial Court had done no more than exercise his discretion in granting the order without evidence being led (par 55).

The applicant argued that a section 424(1) application was a special one that could not be treated in the same manner as other claims covered by the *proviso* in Rule 39(1), and therefore an order under section 424(1) cannot be granted unless the Court hears evidence. However, the Court rejected this argument, and held that:

> "To the extent that there is a subjective element to the assessment of a director's conduct, it is limited to this extent and does not alter the inquiry into a subjective one. In addition, the conduct envisaged is not limited to the taking of positive steps in connection with the conduct of the company's business. It may also include support for, or concurrence in such conduct. It must also be borne in mind that a director has a duty to observe the utmost good faith towards the company and to exercise reasonable skill and diligence, and has an affirmative duty to safeguard and protect the affairs the company. A director may be held to be a party to reckless conduct 'even in the absence of some positive steps by him in the carrying on of the company's business'. These factors are all indicative of the fact that liability under section 424(1) is not dependent on establishing active, individual conduct, and actual knowledge and intent on the part of a particular director in every case" (par 59).

Therefore, there was nothing in section 424(1) to indicate that the legislature intended the relief under this section to be treated differently from other civil cases (par 61).

The Court further rejected that the applicant was entitled to a relief under the common law. Keightley AJ held that in order to succeed under common law, the applicant had to show good cause as to why the default judgment

should be granted. The applicant argued that failure by his attorney to advise him expressly that the matter was proceeding against him, was a good cause to show that he had *bona fide* believed that the matter was not proceeding against him (par 69). However, the Court rejected this argument and held that a defendant who *bona fide* intends to defend a matter against himself does not sit and wait for others to inform him, or irrationally assume, when he is not informed, that the matter is not proceeding against him (par 70). In this regard, Keightley AJ cited *De Wet v Western Bank Ltd* (1977 (4) SA 770 (T)), where it was held that the defendants had a responsibility to communicate with their legal representatives and if they fail to adhere to that responsibility, they cannot complain that their representative had failed them. Therefore, the applicant failed to satisfy the Court that the rescission order should be granted. The application was dismissed.

5 Supreme Court of Appeal Decision (*Minnaar v Van Rooyen NO* ([2015] ZASCA 114)

The Court had to deal with whether the default judgment against the appellant was competent. The appellant argued that in order to determine liability under section 424(1), the evidence must be led because the Court must determine whether the director's conduct was reckless or whether the business of the company was carried on with an intention to defraud creditors of the company (par 13). The Court accepted this argument and held that even though it is correct that a Court may exercise its discretion in granting a default-judgment order, it cannot make a finding of recklessness on a balance of probabilities, when there is no evidence being led (par 14). In accepting the appellant's argument, Lewis JA (with Tshiqi JA, Majiedt JA, Dambuza JA, and Baartman AJA, concurring) cited *Philotex (Pty) Ltd v JR Snyman* (1998 (2) SA 138 (SCA) 142H–J), where Howie JA held that a remedy under section 424(1) is a punitive one, and therefore a director may be held personally liable for the liabilities of the company without the proof of any causal link between his conduct and those liabilities – and the *onus* is on the party alleging recklessness to prove it on the balance of probabilities.

The Court held that the default judgment should not have been granted because no evidence was led, and none of the allegations against the appellant were supported by evidence (par 16). Lewis JA took the view that granting an order declaring a director personally liable for the debts of the company, without evidence being led, was inconceivable (par 17), and therefore the liquidators were not entitled to the default judgment without leading evidence (par 19). The default-judgment order was thus erroneously granted, and therefore needed to be rescinded in terms of Rule 42(1)(a). Lewis JA held that "by its very nature, the right to the relief sought under section 424(1) had to be proved on a balance of probabilities" (par 19). The appeal was accordingly upheld, with costs.

6 Analysis

6 1 Section 424(1) of the Companies Act 61 of 1973

The directors of the company have a fiduciary duty to exercise their powers *bona fide* in the best interest of the company (McLennan "Reckless or Fraudulent Conduct of Corporate Business" 1998 115(4) *SALJ* 597). If they fail to act *bona fide* and the company is in liquidation, the creditors may claim against the directors in terms of section 424(1) (*Pressma Services (Pty) Ltd v Schuttler* 1990 (2) SA 411 (C) 416). However, a creditor has to prove that there has been reckless or fraudulent trading by the company (see McLennan 1998 115(4) *SALJ* 597, as he argues that "the plaintiff has the onus of proving that the defendant had knowingly been a party to the fraudulent and reckless carrying on of the business of the close corporation"). Sigwadi ("Personal Liability for the Debts of a Close Corporation" 2003 15(2) *South African Mercantile LJ* 303) argues out that to hold a person liable under section 424(1), the applicant has to prove on balance of probabilities that the company's business was carried on recklessly, or with an intent to defraud creditors. This is supported by Williams ("Liability for Reckless Trading by Companies: South African Experience" 1984 33(3) *International and Comparative Law Quarterly* 686), who argues that when the court declares a person liable in terms of section 424(1), "the court must be satisfied on balance of probabilities that the creditor's claim exists and that it is quantified by acceptable evidence".

In a series of decisions, the courts have deemed it not necessary to prove a causal link between the conduct of a director and the debts and liabilities of the company. They have taken section 424(1) as a punitive remedy that can be granted without the proof of a causal link between the director's conduct and liabilities of the company – but the onus is on the plaintiff to prove recklessness on the part of the defendant. Commencing with *Howard v Herrigel NNO* (1991 (2) SA 660 (A) 672D–E), where the appellant had appealed to the court that an order granted against him to be personally liable for the debts of the company, be set aside, the Appellate Division recognized section 424(1) as a punitive remedy. The court held that, in order to be liable under section 424(1), it must be established that he had been knowingly a party to the carrying on of the business recklessly, or with intent to defraud creditors of the company. This was followed by the court in *Philotex (Pty) Ltd v Snyman* (*supra*), where Howie JA held that a section 424(1) remedy is a punitive one, and that a director can be held personally liable for liabilities of the company without proof of any causal link between his conduct and those liabilities.

6 2 Rule 39(1) or section 424(1)?

Clearly, in this case, there was a clash between the procedure in terms of section 424(1) the Companies Act 1973 which requires proof on the balance of probabilities for an application to be granted – and Rule 39(1) which allows the court to grant default judgment. It is true that the respondent did

not appear and the default judgment was granted, but the initial Court failed to consider the importance of section 424(1). The initial court should not have relied on the allegations on paper without hearing the other side. The allegations were denied in the joint plea, and therefore the court should have considered that before granting a default-judgment order. Section 39(1) of the Uniform Rules provide that a default judgment can be granted if the court has been satisfied that the plaintiff had discharged a burden resting upon him or her. If section 424(1) is interpreted correctly, it appears that the onus had not been discharged here, since the papers provided no more than allegations and denials by both parties. The SCA was therefore correct in holding that evidence should have been led – before the court granted an order.

Furthermore, the c*ourt a quo* erred in holding that the court has a discretion to decide whether a section 424(1) application can be granted without leading evidence. Keightley AJ found that section 39(1) allowed the court to grant a default-judgment order declaring liability under section 424(1) without adducing evidence (par 51). In reaching her decision, Keightley AJ cited *Abraham v City of Cape Town* (*supra*), where the court refused to grant a Rule 42(1)(a) rescission order even though the default judgment had been granted without evidence having being led. Keightley AJ differentiated the *Abraham* case from the one he was faced with, on the basis that in the *Abraham* case the defendant had not filed a plea. She nevertheless found that the principle in *Abraham* applied to Minnaar's circumstances. However, the court failed to consider the importance of a plea that was filed by Minnaar. The plea had an impact on the case because it meant that the evidence was needed to disprove such a plea. If Keightley AJ considered the defendant's plea, possibly she would have reached a different conclusion. This submission is drawn from the fact that Lewis JA, in the SCA considered that none of the allegations against the appellant were supported by evidence – and therefore default judgment should not have been granted (par 18).

6 3 Was the SCA correct in rescinding the default judgment?

The appellant argued that the default judgment was not legally competent and was erroneously granted (par 18). In terms of Rule 42(1)(a), the Court will grant a rescission where a default-judgment order was erroneously granted in the absence of the affected party. Therefore, there must be an error when the order was granted. Lewis JA interpreted this Rule as suggesting that a default judgment will be rescinded where there has been a procedural irregularity. She took the view that the respondent was not entitled procedurally to the default judgment – without leading evidence (par 19). Consequently, the decision of the *court a quo* to allow that a section 424(1) be granted by default judgment without leading evidence, was not accepted by Lewis JA. While the *court a quo* held that there is nothing in section 424(1) which indicated that the legislature intended that section 424(1) be treated differently from other civil cases when granting default judgment, the SCA interpreted section 424(1) as a relief that can be granted

on the balance of probabilities – and therefore the respondent was not entitled to rely on the allegations that appeared in the particulars of the claim. Lewis JA held that the respondent had to prove on the balance of probabilities, or the very least should have lead witnesses to show that the appellant had acted recklessly or with an intention to defraud creditors (par 19).

The Court accepted that a court can exercise its discretion in granting judgment by default, but it cannot make a finding of recklessness on a balance of probabilities without evidence being led (par 14). This view seems to be an approach that is important if there is any case that involves the granting of default judgment for the relief under section 424(1). While the Court has discretion to grant an order by default, when it comes to section 424(1) there must be evidence that the director was reckless in conducting the business of the company. The principle is that the onus is on the party who is alleging recklessness, and it must be proved on balance of probabilities. Therefore, it is highly unlikely that proof on a balance of probabilities may be established without evidence being led. Therefore, the SCA was correct in holding that the default judgment was erroneously granted within the meaning of Rule 42(1)(a).

7 Conclusion

The personal liability of directors or any party involved in fraudulent or reckless conduct under section 424(1) of the Companies Act of 1973, requires proof of such recklessness or fraud. Therefore even if the matter is not defended, the liquidators or creditors must prove that the directors acted recklessly or with intention to defraud creditors. The judgment in *Minnaar v Van Rooyen* is important in making liquidators, creditors, and other courts aware of the potential application of section 424(1) as a relief. As it stands, this relief may not be granted by default judgment without evidence being led by the plaintiff. The judgment emphasized the novelty of section 424(1) – in that the onus is on the plaintiff to prove that the defendant acted recklessly, or with an intention to defraud creditors. If there is no evidence, the Court may not grant an order to render such defendant liable under section 424(1). Therefore, as much as Rule 39(1) allows the Court to grant a default-judgment order, it may not do so in the application of section 424(1), except where there is evidence that proves there was reckless or fraudulent conduct by the defendant. If there is a clash between Rule 39(1) and section 424(1), it seems that section 424(1) will take over should the plaintiff fail to lead evidence that proves recklessness or fraud on balance of probabilities. If the order is granted by default judgment without evidence being led to prove recklessness or fraud on balance of probabilities, such an order will be granted erroneously. The Court dealing with a rescission application relating to the matter, may rescind an order in terms of Rule 42(1)(a).

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