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Fourie v FirstRand Bank Ltd (578/2012) [2012] ZASCA 19 (18 September 2012)

1 Introduction

The personal liability of managers and executives for damages arising out of fraudulent and reckless conduct of their employees is an emotive and important issue. The prestige that was once associated with holding a position in top management in a company is now overshadowed by the potential of increased personal vulnerability. The case of *Fourie v FirstRand Bank Ltd* ((578/2012) [2012] ZASCA 119 (18 September 2012)) sends out a strong message to those who occupy management positions and who conduct the affairs of a company in a fraudulent or reckless manner that such conduct will not be tolerated and that should they produce false and misleading financial statements regarding the affairs of their company they run the risk of being held personally liable for any damages that may be incurred. The Supreme Court of Appeal (SCA) stated that any damages that arise from such managers' fraud or recklessness under section 424 of the Companies Act 61 of 1973 will be paid by the perpetrators in their personal capacity.

2 Facts and Legal Issues

This case was an appeal from the North Gauteng High Court (Southwood J sitting in the court of first instance). The appellant is Mr Conrad Fourie, an accountant by profession, who was employed as an auditor by Mr Francios Du Preez. The first respondent is FirstRand Bank Limited that trades under various names, in this instance Wesbank. During the course of the trial in the court *a quo*, Du Preez took his own life. As a result, the second respondent, Mr Jacobus Spangenberg, was appointed as the executor in his deceased estate and then substituted as a party to the action in his stead (par [1] and [2]).

The proceedings commenced in the court *a quo* when FirstRand instituted action against Fourie and Du Preez for payment of about R10 million, together with interest and costs. The action against Fourie was brought in terms of section 424 of the Companies Act 61 of 1973 (hereinafter "the 1973 Act"), alternatively, on the basis of the *actio legis Aquiliae*. The action against Du Preez, was based on a claim by FirstRand that he was liable in delict for the same amount, jointly and severally with Fourie, on the basis that he was vicariously responsible for the wrongdoings of the latter (par [1]).

The basis of FirstRand's claim under section 424 arose out of the conduct of the business of XHRS Investments 71 (Pty) Ltd, t/a Supreme Car

(Supreme Car). Du Preez was appointed auditor of the company. Du Preez instructed his employee, Fourie, to assist in the financial administration of Supreme Car. It was an undisputed fact that Fourie prepared certain documents, nine in all, on behalf of Supreme Car. According to Fourie, these documents were no more than working papers, prepared with the sole purpose of facilitating discussions with management. Mrs Rey Naudé, the sole director and shareholder of the company, was not involved with the financial undertakings of the business of Supreme Car, neither was her son Danie Naudé who was the *de facto* manager of the company. The financial administration of the company was left to Du Preez and Fourie. Both Mrs Rey Naudé and her son Danie passed away either shortly before or after the commencement of the proceedings in the court *a quo* (par [7]–[8]). During the period of 16 August 2001 to 20 April 2004 Supreme Car was a trader in second-hand motor vehicles, first in Polokwane and later also in Tzaneen. On the 16 November 2001 it entered into an agreement with FirstRand Bank t/a WesBank. This agreement was described as a "Used Car Floor Plan Agreement" (the agreement). In terms of this agreement WesBank would advance substantial amounts of money to Supreme Car for the purchase of second-hand motor vehicles which would then become the property of WesBank and thus constituted its security for the loan. WesBank observed the following internal procedure every time an increase in the credit facility was sought: Supreme Car was required formally to apply to the branch manager in Polokwane and provide sufficient information to justify the increase. In order to meet this requirement, Supreme Car included its most recent financial statement, prepared by Fourie, to every one of its applications. Though Fourie prepared nine of these, FirstRand relied on the information contained in five of them when it increased the facility available to Supreme Car (par [10]).

Upon receipt of the application, the branch manager (Mr Pienaar) referred it to WesBank's head office together with his or her recommendation that the application be approved. At head office it was assessed by one or more managers in the credit department. What was emphasized by WesBank's credit manager (Mr Symes) was that the application would only succeed if it appeared that the client's business was profitable and that it generated sufficient turnover to justify the credit limit requested. This was primarily determined with reference to the financial statements furnished by Fourie. It was common cause that according to the financial statements prepared by Fourie, Supreme Car's business was growing, it was making substantial profits and was financially sound. WesBank's branch manager testified that, if he knew that the financial statements provided by Supreme Car misrepresented its financial position in that its business was in fact not profitable nor financially sound, he would not have recommended an increase in the floor-plan credit facility as and when he did. In the same vein, WesBank's credit manager testified that, had the credit department in Wesbank's head-office been aware that the financial statements relied upon constituted a misrepresentation of Supreme Car's financial situation, the recurring increases in the credit facilities would not have been approved (par [11]).

An essential term of the agreement was that upon resale of the vehicle by Supreme Car, it was obliged to repay the sum advanced by FirstRand for the purchase of that vehicle within the following week (par [4]).

In early 2004 WesBank discovered that Supreme Car was in breach of the essential term of the agreement in that vehicles that were financed in terms of the agreement were resold without the repayment of the purchase price. On 20 April 2004, the agreement was then cancelled by WesBank. At the time that the agreement was cancelled there were 136 vehicles that were subject to the agreement which Wesbank had financed and for which Supreme Car had not paid. When FirstRand went to Supreme Car's premises to repossess the vehicles, it found only 84 of them. The remaining 52 were missing and could not be accounted for. Supreme Car was provisionally wound up on 17 May 2004 and placed under final liquidation on 15 June 2004. Upon winding up it became clear that Supreme Car was insolvent. The amount in which judgment was granted against Fourie in the court *a quo* represented the agreed amount of Supreme Car's outstanding liability to Wesbank under the agreement and which was not recovered from the liquidation process (par [5] and [6]).

It was contended by FirstRand that Fourie acted in the course and scope of his employment as Du Preez's employee when he prepared the financial statements that were subsequently found to be fraudulent. If Fourie were to be held liable in delict for the loss resulting from the statements, Du Preez's vicarious responsibility would automatically follow (par [32]).

The court *a quo* found that Fourie was not delictually liable, because FirstRand had failed to establish a causal link between the fraudulent statements and the damages claimed (*FirstRand Bank v Fourie* (5944/07) [2011] ZAGPPHC 94 (6 May 2011) par 53).

The court found that Fourie was personally liable for the debts of Supreme Car in terms of section 424 of the 1973 Act. The court held that Fourie had knowingly made false representations on behalf of Supreme Car to FirstRand by preparing false financial statements and that the business of Supreme Car was conducted in a manner that was reckless and that Fourie was knowingly a party to this conduct (*FirstRand Bank v Fourie supra* par 39,44 and 61).

In the SCA, Fourie brought an appeal against the finding of the court *a quo* which was in favour of FirstRand, and FirstRand in turn sought to appeal against the court *a quo's* judgment in favour of Spangenberg (the cross – appeal), now cited and as the second respondent (par [2]).

3 Judgment

The SCA dismissed the appeal with costs, including the costs of two counsel and upheld the cross-appeal with costs including the costs of two counsel.

The SCA held that the statements prepared by Fourie were clearly false and misleading. They ordered Fourie and Du Preez's estate to pay FirstRand R7.34 million with interest. Fourie and Du Preez's estate also had to pay the legal costs in the High Court and SCA actions, bringing their joint liability to R13 million.

The SCA set aside the order of the High Court and replaced it with the following (par [41]):

"(a) That paragraph III of the order of the court *a quo* is set aside and replaced with the following:

That the second defendant is ordered to pay to the plaintiff, jointly and severally with the first defendant, the one paying the other to be absolved:

(i) the capital amount of R7 340 229.73;

(ii) interest up to and including 31 October 2010 in the sum of R5 361 200.93, less the sum of R1 193 595.21;

(iii) on the capital amount of R7 340 229.73 at the rate of 11,5 per cent per annum from November 2010 to date of payment.

(b) That paragraph IV of the order of the court *a quo* is amended to read as follows:

IV The first and second defendants, jointly and severally, the one paying the other to be absolved, are ordered to pay the plaintiff's costs of suit, such costs to include the costs consequent upon the employment of two counsel and the qualifying fees of Messrs S Harcourt-Cooke and J Rhoda."

4 Analysis and discussion

(a) The claim against Fourie in terms of section 424 of the 1973 Act.

Section 424(1) states:

> "When it appears, whether it be in 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. (2) (a) Where the Court makes any such declaration, it may give such further directions as it thinks proper for the purpose of giving effect to the declaration, and in particular may make provision ..."

Reckless trading is defined as there being "no reasonable grounds to believe that the company will be able to pay the debt when it falls due" (Williams *Concise Corporate and Partnership Law* 2ed (1997) 99).

The court in *Ebrahim v Airport Cold Storage (Pty) Ltd* (2008 (6) SA 585 (SCA)) stated that (par [6]), "[a]cting recklessly consists in an entire failure to give consideration to the consequences of one's actions, in other words, an attitude of reckless disregard of such consequences".

In order to determine whether the conduct in question is reckless may involve both a subjective and objective test (Flynn "A Comparative Study of Statutory Liability for Culpable Mismanagement" 1992 17(2) *Tydskrif vir Regswetenskap* 52). In terms of the objective test recklessness exists when the company incurs a debt when a reasonable business person, in the same position as the director, would have been of the opinion that there was no reasonable way of paying the debt when it fell due (Williams *Concise Corporate and Partnership Law* 99; and see also *Ozinsky NO v Lloyd* 1992 (3) SA 396 (C)). The subjective test requires the defendant's knowledge to

be taken into account (Cassim *et al Contemporary Company Law* 2ed (2012) 591). In *Ozinsky NO v Lloyd* (*supra*) the court held that if a company carried on business and incurs debts when, in the opinion of a reasonable businessman, there would be no reasonable prospect of creditors receiving monies due, it would be inferred that the business was being carried on recklessly (Cassim *et al Contemporary Company Law* 591).

In *McLuckie v Sullivan* (2011 (1) SA 365 (GSJ)) the court stated that "recklessly" in terms of section 424 of the Companies Act 61 of 1973 meant failing to give consideration to the consequences of one's actions. Likewise in *Fourie NO v Newton* ([2010] JOL 26517 (SCA)), the court stated that "recklessly" was an entire failure to give consideration to the consequences of one's actions. The court in *Fourie NO v Newton* (*supra* par [29]) stated that:

> "In the context of s 424, the court should have regard, amongst other things, to the scope of operations of the company, the role, functions and powers of the directors, the amount of the debts, the extent of the company's financial difficulties and the prospects, if any, of recovery."

In *McLuckie v Sullivan* (*supra* par [50]) the court stated that recklessness occured when "a party who owns all the shares and is in control of a company [who attempts], uses its formal identity to avoid it paying a debt due by it to a creditor, where he on behalf of that company caused it to incur that debt at a time he knew it could not pay it without his financial assistance".

Fourie contended that his conduct in the management of the financial affairs of the business did not constitute recklessness. He explained this by stating at the outset that his authority in the business extended to no more than cash-flow management. FirstRand contended that Fourie's authority extended to more than cash-flow management and that he was in effect the financial manager of Supreme Car. Southwood J in the court *a quo* agreed with this contention. Fourie had prepared nine documents. According to Fourie these documents were no more than working papers that were prepared for the sole purpose of facilitating his discussions with management. The SCA was of the view that *prima facie* these documents had the trappings of audited financial statements (par [8]).

At the outset the credit facility in terms of the agreement between Supreme Car and FirstRand was limited to R3 million. As the business expanded Supreme Car applied for and was granted a credit facility in the amount of R13 million. The evidence provided by the manager of WesBank in Polokwane (Mr Pienaar) and the credit manager at WesBank's head office credit-control department (Mr Symes) indicated that they had relied on the abovementioned documents provided by Fourie. WesBank had observed the required internal procedure on every occasion an increase in the credit facility was requested by Supreme Car. FirstRand relied on information provided in five of the nine documents prepared by Fourie (par [9] and [10].

According to the documents presented and prepared by Fourie, Supreme Car's business was growing. In fact, according to the documents the business was making substantial profits and was financially sound. Both Mr Pienaar and Mr Symes had indicated that if they had known that the financial

statements provided by Supreme Car misrepresented its financial position in that in that its business was in fact not profitable nor financially sound they would not have recommended an increase in the credit facility (par [11]).

Fourie argued that the financial statements were not intended to communicate any representations to third parties about Supreme Car's financial position. He argued that in so far these statements did in fact constitute representations, that these representations were in fact true. Fourie denied that Wesbank had relied on these financial statements or the representations when they approved the granting of an increase of the credit facility. He further contended that even if these increases in credit facilities were induced by fraudulent misrepresentations in the financial statements, FirstRand had failed to establish any causal link between these forces and misrepresentation (par [12]).

The court *a quo* found Fourie to be a most unsatisfactory witness about whom there was no doubt that he would say anything to avoid being held liable for Supreme Car's indebtedness to FirstRand. The court *a quo's* factual findings against Fourie in this respect were endorsed by this court. In this regard the court referred to the case of *R v Dhlumayo* (1948 (2) SA 677 (A) 705–706), where the court stated in that case that a time-honoured approach by this court was, in sum, that absent any misdirections on the part of the trial court, a court of appeal was not permitted to interfere with findings of fact (par [14]).

(b) Did the financial statements constitute fraudulent misrepresentations?

Fourie argued that four of the five documents that were prepared by him constituted working papers only and not financial statements. The court stated that the four documents for all intents and purposes were the same as the first document which was contended by Fourie to be an audited financial statement. The four documents were reflected as the financial statements of Supreme Car and they also purported to include an unqualified opinion by an independent auditor that the statement represented the financial position of Supreme Car. This was also accompanied by a director's report to the same effect. The court went on to add that most of the financial statements were signed by Fourie and Du Preez (par [15]).

Fourie argued that since the documents had to comply with the provisions of the Companies Act 61 of 1973 with reference to financial statements they should not be regarded as such. This argument was correctly rejected by this court. Brand J stated that these documents were held out as a true and fair reflection of the financial position of Supreme Car, which was vouched for by an independent financial expert; they were prepared by Fourie for that very purpose; they were relied upon by Supreme Car in its recurring applications to FirstRand for an increase in its credit facility under the floor-plan agreement; and Fourie knew that they would be used by Supreme Car for that purpose (par [16]).

Fourie maintained that during the period covered by the statements, Supreme Car's business was in fact growing; that they were making a profit

and business was financially sound. FirstRand rejected this and relied on expert testimony by an independent chartered accountant who stated that the documents presented by Fourie were in fact misleading. FirstRand also relied on admissions that the contents of the financial statements were misleading which were made by Fourie under oath on two occasions preceding trial (par [17]).

(c) Was the granting of credit induced by fraudulent representations?

Fourie challenged the court *a quo's* finding that the recurring increases in Supreme Car's credit facilities under the floor-plan management agreement had been induced by the misleading financial statements. The argument that was actually raised by Fourie is that, despite the stable and profitable picture painted of Supreme Car's financial position in the misleading financial statements, the officials of Wesbank knew that Supreme Car had experienced cash-flow problems. Yet the applications for increase credits were consistently approved. Brand J rejected this argument, the judge was of the opinion that the evidence supported the contrary position, namely that because the misleading financial statements had painted such a prosperous picture of Supreme Car's overall financial position, the Wesbank officials were prepared to overlook the cash-flow problems that Supreme Car experienced from time to time. This, according to Brand J, meant that but for the misleading financial statements, the cash-flow problems would have made Wesbank reconsider increasing Supreme Car's credit facilities. In support of this statement Brand J cited the case of *Oranje Benefit Society v Central Merchant Bank Ltd* (1976 (4) SA 659 (A)), were the appeal court said the following (673H):

> "But it appears to me that when once it is established that there has been any fraudulent misrepresentation or wilful concealment by which a person has been induced to enter into a contract it is no answer to his claim to be relieved from it to tell him that he might have known the truth by proper enquiry" (see also *Central Merchant Bank Ltd v Oranje Benefit Society* 1975 (4) SA 588 (C) 594E–H; and De Wet and Van Wyk *Die Suid-Afrikaanse Kontraktereg & Handelsreg Vol 1* 5ed (1992) 47.)

(d) The requirement of a causal link between the fraudulent conduct and Supreme Car's inability to pay

Fourie argued that section 424 of the 1973 Act required there had to be a causal link between the fraudulent or reckless conduct of the company's business and its inability to pay. Fourie alleged that the court *a quo* had reached an incorrect decision in holding him liable under section 424. According to Fourie, this was so, due to FirstRand's failing to establish the causal link between his fraudulent conduct and Supreme Car's inability to pay its debts. In support of his contention Fourie relied on the decisions of the SCA in the cases of *L & P Plant Hire BK v Bosch* (2002 (2) SA 662 (SCA) par 39 and 40) and *Saincic v Industro-Clean (Pty) Ltd* (2009 (1) SA 538 (SCA) par [23]).

Southwood J in the court *a quo* stated that even if it was to be accepted that the above decisions constituted authority on which the Fourie's argument was founded, the judge was of the view that Fourie's conduct constituted sufficient reason for him to be liable in terms of section 424. This was so, because Fourie knew what the Naudés were doing, there was no suggestion that he took any steps to stop them from using Supreme Car's funds nor did he threaten to resign if the Naudés' continued to use Supreme Car's funds for their personal use (*FirstRand Bank v Fourie supra* par 43).

In *L & P Plant Hire BK v Bosch* (*supra*) the court had to consider section 64 of the Close Corporations Act 69 of 1984 (hereinafter "the Close Corporations Act"). Fourie argued that section 424 of the 1973 Act must be interpreted in the same manner as section 64 of the Close Corporations Act. The argument by Fourie as it went was that section 64 required that there had to be a causal link between the reckless or fraudulent conduct relied upon and the close corporations inability to pay and that this requirement had to be important into section 424. In *Saincic v Industro-Clean (Pty) Ltd* (*supra*), Harms JA said the following (par 29):

> "These statements [in par 39 and 40 of *L & P Plant Hire*] imply at least that as far as creditors are concerned there must be some or other causal link between the fraudulent conduct and the inability to pay the debt. In other words, it must be due to the fraudulent conduct that a particular creditor's debt cannot be repaid. In this regard the statements appear to be in conflict with some generalised earlier dicta that the section applies irrespective of causation. These conflicting approaches should be seen in context. Take the example of company A that incurs a liability towards creditor B for debt C while the business of A was conducted in a fraudulent manner. The fraud did not affect the solvency of the company and debt C was paid. Thereafter A incurs debt D at a time when the business was properly conducted. Due to other circumstances A cannot pay this amount to B. There can be little doubt that B would not be entitled to rely on s 424(1) in these circumstances. This example illustrates that the provision could not have intended that causation does not play any role at least as far as creditors are concerned. Whether the matter should rather be considered as part of the general discretion (as Farlam JA has done) or as a prerequisite (as *L & P Plant Hire* has done), makes no difference to the outcome of this case."

Brand J expressed difficulty with this interpretation as expressed in the cases of *L & P Plant Hire BK v Bosch* (*supra*) and *Saincic v Industro-Clean (Pty) Ltd* (*supra*). According to the judge, the context of *L & P Plant Hire BK v Bosch* (*supra*) was that there was no evidence that the close corporation concerned was unable to pay its debts. The judgment in *L & P Plant Hire BK v Bosch* (*supra*) was in the view of Brand J rightly to be understood as saying: if, despite the reckless conduct of the company's business, it was nevertheless able to pay its debt to particular creditor, that creditor had no cause of action under section 64 or section 424 against those responsible for the reckless conduct. Section 424 was not intended to create a joint and several liability between the company and those responsible for the reckless conduct of its business, but rather to protect creditors against the prejudice they might suffer as a result of the business of the company being carried on in that way (Meskin, Galgut, Kunst, King and Vorster *Henochsberg on the Companies Act Vol 1* 5ed (1994) 913) (par [28]).

Therefore, *L & P Plant Hire BK v Bosch* (*supra*) had no application in cases where a company proved to be hopelessly insolvent and unable to

pay the debts which the plaintiff sought to recover from the defendant who had conducted the company's business in a fraudulent or reckless way in terms of section 424. The court held that there was no authority for the proposition that in the circumstances described section 424 the plaintiff was required to establish a causal link between the fraudulent or reckless conduct relied upon in the company's inability to pay its debt. Brand J further stated that the case of *L & P Plant Hire BK v Bosch* (*supra*) was never intended to deviate from the decisions of the courts which explicitly laid down the general principle that section 424 did not require proof of a causal link between the relevant conduct and the company's inability to pay the debt (*Howard v Herrigel* 1991 (2) SA 660 (A) 672C–E; and *Philotex (Pty) Ltd v Snyman* 1998 (2) SA 138 (SCA) 142G–I) (par [30]).

Brand J did acknowledge that there was an exception to the general principle. This was so where there was plainly no causal connection between the relevant conduct and the debt incurred (*Saincic v Industro-Clean (Pty) Ltd supra* par 29). The judge stated that on the facts of the present case, the envisaged exception did not apply (par [31]).

(e) FirstRand's cross – appeal.

It was common cause that Fourie had acted in the course and scope of his employment as Du Preez's employee when he prepared financial statements that were found to be fraudulent. Therefore, if Fourie were to be found liable in delict for the loss that resulted from the financial statements, Du Preez's vicarious responsibility would follow (Van der Walt and Midgley *Principles of Delict* (2005) 38; Manamela "Vicarious Liability: 'Paying for the Sins of Others'" 2004 16(1) *SA Merc LJ* 126; Calitz "Vicarious Liability of Employers: Reconsidering Risk as the Basis for Liability" 2005 2 *TSAR* 215; and Van Zyl "An Employer's Vicarious Liability with Reference to the Internet and e-mail" 2006 39(1) *De Jure* 131) (par [36]).

The court *a quo* found that Fourie was not delictually liable because FirstRand had failed to establish a causal link between the fraudulent statements and the damages claimed (par [34]). Southwood J in the court *a quo* referred to the concepts of factual causation ("'but-for' test") and legal causation (*International Shipping Co (Pty) Ltd v Bentley* 1990 (1) SA 680 (A) 700E–701C). The judge explained that FirstRand had failed to establish a causal link between each of the five individual misrepresentations relied upon for the damages it eventually suffered. Furthermore, that FirstRand failed to establish that the damages they suffered were caused by Fourie's misrepresentations, because on the evidence the damages resulted from the reckless spending of the Naudés (par [36]).

Brand J did not agree, holding that but for the misrepresentations made by Fourie the total credit facility of R13 million would not have been granted and furthermore Supreme Car's indebtedness at the time of the termination of the agreement was directly caused by these misrepresentations. The judge went on to state that Fourie's misrepresentations was used to conceal the uncontrolled spending and to induce FirstRand to increase the credit facilities. The judge concluded by stating that but for Fourie's misrepresentations FirstRand would not have been exposed to the risk of the

claim proved to be irrecoverable or have suffered the agreed amount of damages (par [39]).

5 Conclusion

It is incumbent on the managers and executives in a company to ensure that they conduct the affairs of the company in an honest and lawful manner. Managers and executives who allow the affairs of the company to be conducted in a fraudulent and reckless manner or trade in situations of financial distress or insolvency and are responsible for providing and concocting misleading and false financial statements will run the risk of facing personal liability for damages that are incurred. In current local and world financial markets, a frank and realistic review by managers and executives of the manner in which their companies' trade and the current financial position of the businesses will be essential for survival as well as to avoid personal liability. Section 424(1) of the 1973 Act was replaced by section 77 of the Companies Act 2008 which, while worded differently, retains the essence of the old section 424. Section 77, as read with section 22 of the Act, penalizes and holds individuals personally liable for any loss incurred through knowingly carrying on the business of the company recklessly or with the intent to defraud creditors and other stakeholders. The judgment in *Fourie v FirstRand Bank Ltd* (*supra*) is important in making managers and executives aware for the potential of personal liability for damages in terms of section 77 and section 22 of the Companies Act 2008.

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