



Piercing the corporate veil: when and how can a director be held personally liable?

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1 Introduction

A director of a company has a fiduciary duty to act in the best interests of a company as enshrined in our common law. This duty was partially cemented within Section 76 of the Companies Act.¹ Section 76(3) for example states that a director must in all instances with regard to the company act in good faith and with a degree of care and skill with diligence which can be reasonably expected from that person in his/her capacity.

In today's modern aged of fast paced business undertakings, it is imperative for good leadership and directorship to govern a company to be financially successful. A director that fails to uphold his or her duties, be it statutory or in common law, may drive a company to its financial ruin. In the past, bad management on the part of a director could have aggravated a creditor's position, as the said director could have escaped liability on the basis that the

¹ Act 71 of 2008.

creditor contracted with the company. Therefore any claim the creditor may have, would be hollow in case of liquidation. However, as previously stated, the Companies Act has tried to prevent the cumbersome situation by incorporating Section 76 into the Act.

The act of holding a director personally liable is known as “piercing the corporate veil.” The Act thus allows for the deprivation of the company’s protection and for a director to be held accountable for creditors’ debts in his or her personal capacity. This begs the question, how and when can one pierce the corporate veil?

2 MOKHUTAMANE KENNETH MAAKE AND OTHERS // CHEMFIT FINECHEMICAL (PTY) LTD CASE NO. 5772/2016

In the court a quo, the court investigated the question of whether the conduct of directors in a company trading under insolvent circumstances despite being in financial distress. The court a quo found that trading under such circumstances is a direct contravention of section 22(1) and 218(2) of the Companies Act and therefore the directors were consequently found to be held personally liable for the debts of the company. The court a quo accordingly granted judgment in favour of the Respondent.

The Appellants in the matter challenged the decision of the court a quo, which led to the Court having to analyze whether the directors can in fact be held personally accountable for the damages suffered by creditors in the matter.

Section 218(2) of the Companies Act states the following:

*“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.”*²

The section imposes liability on any person who contravenes any provision of the Act and in doing so caused damage to that said person, which includes a creditor of the company.³ A creditor may take action against a director of a company in his or her personal capacity for the damage he or she suffered due to the director's actions.⁴

A creditor who wishes to take action against a director in his personal capacity must specify the section in the Act contravened and which attributed to the damage or loss and plead sufficient facts to the proof thereof.

In the case mentioned, the Respondents failed to state with sufficient particularity the exact contravention of the directors for them to be held personally liable.⁵ Their founding affidavit's main focus was the Appellants trading in insolvent circumstances, but it failed to disclose and to specify which contravening acts they allegedly committed which led to the Respondents' loss.⁶

In paragraph 30 of the judgment the Court quoted an extract from *Ex Parte De Villiers & Another NNO: In Re Carbon Developments*⁷ regarding fraudulent credit. The learned Judge stated that there is nothing wrong for a company to incur debt at a time when, to the director's knowledge, the company is not able to meet their liabilities when they fall due. However, it is fraudulent if directors allow a company to incur credit at a time when the business is being carried on in such

² MOKHUTAMANE KENNETH MAAKE AND OTHERS // CHEMFIT FINECHEMICAL (PTY) LTD CASE NO. 5772/2016 para 26.

³ Para 27.

⁴ Para 28.

⁵ Para 29.

⁶ Para 29.

⁷ 1993 (1) SA 493 (A).

circumstances that is clear that the company will never be able to satisfy its creditors. Even though the Appellants in the matter traded under insolvent circumstances, it was genuinely hopeful that it will bounce back on its feet.

The Respondent relied on section 22(1) of the Act, which provides for the following:

“A company must not carry on its business recklessly, with gross negligence, with intent to defraud any person or any fraudulent purpose.”⁸

The interpretation of section 22(1) is focused on gross negligence. For example in a situation where a reasonable businessman would realize that in all the given circumstances he would not be able to make payment when due, would be a departure from the required standard in which businessmen should conduct themselves.

3 Conclusion

Section 22(1) of the Companies Act requires factual evidence sufficient to proof/show the recklessness or the gross negligence of the director whose intention is to defraud any person or entity or who has any fraudulent purpose in mind.

Section 218(2) of Companies Act allows a creditor seeking to hold a director personally liable for a debt arising from a contractual relationship with a company, must provide factual evidence to the court as to the specific section of the Act, which was transgressed and cause him or her detriment.

⁸ MOKHUTAMANE KENNETH MAAKE AND OTHERS // CHEMFIT FINECHEMICAL (PTY) LTD CASE NO. 5772/2016 para 35.

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