

DISPUTE RESOLUTION MATTERS

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As if it wasn't difficult enough.... Holding directors personally liable for reckless conduct

It is a well known principle of company law that the directors of a company cannot be held liable for the debts of the company except in certain limited circumstances. Section 424 of the Companies Act 61 of 1973 (the Act) relates to one of these exceptions and deals with the personal liability of directors who carry on the company's business recklessly or with the intent to defraud creditors.

While the meaning of fraudulent conduct may be relatively apparent, the concept of carrying on a business 'recklessly' and what it entails, is less obvious. The Supreme Court of Appeal (the SCA) held that 'recklessly' entailed that business was carried on with gross negligence and envisaged a situation such as incurring debts when a reasonable businessman would not consider there to be any reasonable prospect of paying creditors when necessary. Although it was held that it was not necessary to prove a causal link between the 'reckless' conduct and any specific debts or liabilities in order for a director to incur personal liability, the SCA emphasised that 'recklessness' would not be lightly found.

However, after the most recent decision in the SCA on the subject, it could be even more difficult to hold directors personally liable for any irresponsible conduct.

In *Saincic and Others v Industro-Clean (Pty) Ltd and Another* 2009 (1) SA 538 (SCA), a parent and subsidiary company instituted

action under section 424 of the Act against the sole director of the subsidiary company, his wife (who was also formerly employed by the subsidiary as a bookkeeper) and a close corporation of which his wife was the sole member, for reckless and fraudulent trading.

Saincic was the managing director of the subsidiary and as such, responsible for its day to day running. Under his direction, the subsidiary company sold goods that it had purchased from the parent company (the parent company was an 80% shareholder in the subsidiary) on credit, almost at cost price to the close corporation to sell the goods at a profit. Saincic benefitted indirectly from these transactions, as at the time his wife, to whom he was married in community of property, was the sole member of the close corporation. The sale of goods by the close corporation was also in direct competition with the subsidiary.

The parent company instituted action under section 424 of the Act and obtained judgment in the High Court for R572 507.98, being the amount by which the debit balance on the subsidiary's trading account with the parent company increased during the period from 1 March 2002 to 19 March 2003, being the period for which the director was the managing director of the subsidiary.

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On appeal, the SCA found that the evidence before the High Court (being the increase in the trading account as the sole measure of the computation of loss) was not sufficient to allow the court to conclude, purely on this basis, that it would be just and equitable for the wrongful parties to be held liable for the net balance. More evidence was required as to how and why the net balance on the trading account increased during the relevant period. Factors such as why and how the increase came about, the trading conditions during that period and other issues which may have contributed to the increase in the trading account had to be taken into account. While proof of a causal link between the relevant conduct and the debts or liabilities for which there is a declaration of personal liability in terms of section 424 would still not be required, the

absence of such a proven link is a factor to be taken into consideration by the court in the exercise of its discretion and in order to decide whether a declaration of personal liability is, in all the circumstances, just and equitable.

The new Companies Act 71 of 2008 (section 22 prohibits reckless trading and section 77 imposes personal liability on directors thereon) is not yet in force. How the new Companies Act, read with the King III guidelines will contribute to the existing body of law relating to declarations of personal liability of directors who trade "recklessly", remains to be seen.

Anja Hofmeyr and Deshni Naidoo

Landlord alert!

A recent Supreme Court of Appeal (SCA) judgment signals an alert for landlords who rent out property that is bonded in favour of a bank or other financial institution.

Almost all bond agreements contain a clause ceding, transferring and assigning the mortgagor's rights to all rentals and other revenues that accrue from the mortgaged property as security for the mortgagor's bond repayments, provided that the cession shall not be acted on by the bank unless the mortgagor is in arrears. This clause is known as a "*cession in securitatem debiti*".

Most commercial property owners understand this clause to mean that they are only deprived of their right to collect rentals from their tenants if they fall into arrears with their bond repayments on the mortgaged property. A recent judgment of the SCA indicates that this is not the case and that an owner of mortgaged property may not institute action against a defaulting tenant for recovery of rentals, even if the owner is not in arrears with its own bond repayments.

In the case of *Picardo Hotels Ltd v Thekwini Property (Pty) Ltd 2009 (1) SA 493 (SCA)*, the landlord instituted action against its tenant, a hotel, for payment of almost a million rand in arrear rentals. When the matter came to trial, the tenant raised the defence that the landlord had divested itself of the right to sue for arrear rentals by virtue of a *cession in securitatem debiti* executed by the

landlord in favour of its bank as security for a mortgage bond. This defence was dismissed by the Durban High Court and the tenant appealed this decision to the SCA.

The SCA found that on a simple interpretation of the cession clause there was a strong indication that an immediate transfer of rights was intended. The cession itself was not suspended; it was only the right to act upon the cession by the bank that was suspended until the mortgagor/landlord was in arrears with bond repayments.

The landlord in this case, being up to date with its bond repayments, was left in the untenable situation where neither it, nor its bank, could sue the defaulting tenant for rentals. Commercial property owners who have, or who intend to, issue summons against tenants should carefully consider the terms of their mortgage bond agreements.

The purpose of a *cession in securitatem debiti* is to provide security to a bank for the loan that it is to advance - the cession provides security to the bank in the event of the mortgagor defaulting with its bond repayment and it also makes the bank a secured creditor in the event of the insolvency of the mortgagor. For these reasons, it is unlikely that banks will agree to exclude cessions from mortgage agreements or to defer the actual operation of the cession until the mortgagor defaults.

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When a tenant fails to pay rental timeously in respect of a bonded property, it is suggested that the most practical solution would be for landlords to get their banks to re-cede the disputed amount

back to the landlord, allowing them to issue summons against the defaulting tenant.

Brigit Rubinstein

Cohabitation and Universal Partnerships: Comfortable Bedfellows?

Marriage is a special, internationally recognised institution, the protection of which is a legitimate concern for the law. The law may in appropriate circumstances accord benefits to married people that it does not accord to unmarried people.¹

Marriage is argued to be a choice. Couples have the choice of either a marriage in terms of the Marriage Act No. 25 of 1961 or the establishment of a domestic partnership. This reasoning has been put forward in support of the premise that the law need not afford the same protection to cohabittees as is provided to their married counterparts. However, within the South African context it may be convincingly argued that ignorance of the law, gender inequality and illiteracy may operate against the existence of a genuine choice whether or not to enter into a marriage contract. The regulation of domestic partnerships is an essential requirement of South African family law. What protection does South African law afford cohabiting couples?

Cohabitation may be defined as a monogamous long-term, intimate relationship between two persons without marrying. This form of relationship is also referred to as a domestic partnership or a permanent life partnership. The only difference between a cohabitative relationship and marriage is that the couple are not legally married to each other.

In South Africa, there is no law of cohabitation governing cohabitation in the same sense as marriage. A widespread misconception is that cohabittees are protected by the so called 'common law marriage.' Despite cohabitation not being a recognised legal relationship, the South African courts have aided such couples by declaring that an express or implied universal partnership exists between the parties. For a universal partnership to exist, four requirements must be established. First, the partnership must aim

to make a profit; secondly, both parties must contribute to the partnership; thirdly, the partnership must operate for the benefit of both parties; and fourthly, the contract between the parties must be legitimate. In the absence of an express agreement for the establishment of a universal partnership, a tacit agreement is acceptable if demonstrated from the conduct of the parties.

The principle of a universal partnership assists cohabittees by according them a right to a share in the property acquired during the relationship, and in certain cases prior to the commencement of the relationship, in the absence of any other legal entitlement. If it is found that the parties created a universal partnership, the property will be owned jointly by the parties in undivided shares, in accordance with the contributions of each of the parties. However, in the absence of the establishment of a universal partnership, the cohabittees will retain all property acquired during and prior to the commencement of the relationship, unless such property is, by agreement, acquired jointly by the parties.

Cohabittees would be well advised to legally regulate their relationship by means of a codified cohabitation contract, expressly stipulating the division of the assets upon termination of the relationship, irrespective of whether or not the relationship is deemed to be a universal partnership. The cohabitation contract may be entered into at any point during the relationship, prior to the termination of the relationship and should govern the division of both movable and immovable property. In addition, a will should be drawn up in order to govern the succession of the parties.

Kaamilah Paulse

¹ A. Cooke 'Choice, heterosexual life partnerships, death and poverty' in 2005 SALJ 122(3) at 544.

Private Arbitration: A victory in the Constitutional Court

Private arbitration continues to become increasingly recognised both domestically and internationally as an important method for resolving commercial disputes. The extensive use of private arbitration may be attributed to a number of factors, including its flexibility, privacy, cost-effectiveness, convenience and speed. In South Africa, these attributes are attractive to commercial parties eager to avoid lengthy court proceedings, which are often rigid, expensive and fraught with delay.

The ability of an aggrieved party to review an arbitrator's award has been the source of vigorous debate in our courts in recent times. In March 2009, the Constitutional Court of South Africa handed down judgment regarding this aspect of private arbitration in *Lufuno Mphaphuli & Associates (Pty) Ltd v Andrews and Another (2009) ZACC 6*.

Mphaphuli was awarded a tender for the electrification of a number of rural villages in Limpopo by Eskom. Mphaphuli subsequently sub-contracted some of its obligations to Bopanang. A dispute arose between the two concerning their indebtedness to each other.

Nigel Andrews was appointed by the parties to resolve the dispute in terms of an arbitration agreement concluded between them. After the conclusion of the arbitration, in favour of Bopanang, the record of the arbitration was made available to the parties. What the record revealed, Mphaphuli alleged, was that Andrews had held a number of 'secret meetings' with Bopanang during the arbitration, and that these meetings had influenced his award.

The Arbitration Act 42 of 1965 governs private arbitrations in South Africa. Section 33(1) of the Act provides narrow grounds on which an arbitrator's award may be reviewed for procedural irregularities. Mphaphuli failed in its attempts to have Andrews' award reviewed and set aside in both the High Court and the Supreme Court of Appeal in terms of s 33(1) of the Act. In its application for leave to appeal to the Constitutional Court, Mphaphuli asked the Court to consider the applicability of section 34 of the Constitution (which enshrines the right to a fair and impartial hearing) to private arbitrations, as well as the extent to which courts are entitled to scrutinise arbitration awards.

After granting Mphaphuli's application for leave to appeal, O'Reagan ADCJ, writing for the majority, held that s 34 does not apply directly to private arbitrations. On the facts, she found that the arbitration had been conducted fairly and that Andrews did not misconduct himself, commit a gross irregularity or exceed his powers.

O'Reagan held that private arbitrations must be distinguished from court proceedings, where s 34 applies, as not only do parties consent to the arbitration, but they agree that the adjudication of their dispute will not be heard in public. O'Reagan was keen to stress that s 34 contemplates proceedings that are provided for by the state and thus those held in public. Private arbitrations, she held, are different creatures, ones that should not be directly regulated by s 34.

Because s 34 does not apply directly to private arbitrations, courts are limited to the grounds set out in s 33(1) of the Arbitration Act when reviewing arbitration awards.

This does not mean that arbitrations should not be conducted fairly; O'Reagan stressed that fairness is one of the core values of our constitutional order. The judgment in Mphaphuli merely means that the standard of fairness required in private arbitrations is not that expected in a court of law. However, if an arbitration agreement contains a provision that is contrary to public policy in the light of the Constitution, that provision will be null and void.

The call by our highest court to our courts to respect findings made by independent arbitrators and not to enlarge their powers of scrutiny beyond s 33(1) of the Arbitration Act, should be seen as an affirmation of private arbitrations and the crucial role they play in expediting commercial dispute resolution.

Marius Potgieter and Callum O'Connor

The Case of the Reluctant Purchaser

It is a common practice, when immovable property is sold by public auction, that so-called "Conditions of Sale" will be circulated by the auctioneer prior to the auction commencing and that have to be signed by the successful bidder at the auction. Usually, these conditions contain a clause to the effect that the successful bidder purchases the property provisionally, subject to acceptance of the offer by the seller within a given period of time after the auction. Successful bidders who sign such conditions of sale are advised to carefully consider and, if necessary, seek legal advice on their legal effect, particularly the question of when and under what circumstances a binding agreement of sale comes into existence.

The recent decision of the Supreme Court of Appeal in the matter of *Withok Small Farms (Pty) Ltd and Others v Amber Sunrise Properties 5 (Pty) Ltd 2009 (2) SA 504 (SCA)* in which the court was called on to decide when a binding agreement of sale had been concluded is a case in point.

The "purchaser" had been the highest bidder for certain immovable property at a public auction, whose bid had been accepted by the auctioneers. On conclusion of the auction, the purchaser had signed the conditions of sale as had the auctioneer's representative.

On a date within seven days of the date of the purchaser's signature, the seller's representative had completed the latter's details on the conditions and had confirmed the sale in writing by signing the conditions of sale as required by clause 1.

The confirmation of the sale was not, however, communicated to the purchaser within the time period contemplated by clause 1 and the purchaser only received notice of the confirmation some time later.

The purchaser subsequently applied to court for an order declaring the agreement to be of no force and effect and for repayment of the deposit that it had paid to the auctioneers, contending that no binding agreement had come into existence.

The Judge hearing the application held that no agreement of sale was concluded at the time of the auction and that the only consequence of the agreement concluded at that stage was to bind the purchaser to its bid for a period of seven days. The Court held that the reference in the conditions of sale to the "confirmation" of the sale had to be construed as a reference to the acceptance of an offer and proceeded to determine whether the provisions of the conditions of sale expressly or impliedly indicated a mode of acceptance other than that required by common law, namely, that it had to be communicated to the offeror. The Court found that there was insufficient evidence to indicate that the common law rule was not to apply and, as the seller's acceptance had not been communicated to the purchaser within the seven day period, the purchaser had to succeed.

On appeal, the Supreme Court of Appeal, while agreeing with the lower court that on a proper construction the reference in the conditions of sale to the confirmation of the sale had to be construed as a reference to the acceptance of the offer, found that in each case it is necessary to consider the terms of the offer to determine the mode of acceptance required. Where the offer takes the form of a written contract signed by the offeror, the inference will more readily arise in the absence of any indication to the contrary that the mode of acceptance required is no more than the offeree's signature and particularly where provision is made in the written contract for the offeree to specify the date on which he or she signs the contract.

The Court held that once completed and signed by the sellers, the document would have served as a recordal of the date and place of the "confirmation".

As the seller had signed the conditions of sale within the seven day period referred to in clause 1, the Court found that a valid agreement of sale had come into existence on that date.

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