IN TRUSTS WE TRUST

As parties to litigation, creditors often find themselves in a predicament where the individual they have a claim against has assets of insignificant value. The same individual may, however, be a trustee of a discretionary trust owning substantial assets. Faced with this difficulty, creditors are left with little choice but to ask a court to ‘go behind the trust’ in an attempt to find assets to execute judgment against.

Allegations of a trust being a debtor’s ‘alter ego’ or ‘a sham’ often find their way into pleadings and the terms are frequently used interchangeably.

To date, our courts have mostly shied away from declaring assets registered in a trust to be regarded as assets falling within the personal estate of one of the trust’s trustees. The recent judgment of *Van Zyl and Another Nno V Kaye No and Others 2014 (4) Sa 452 (WCC)* confirms this reluctance.

In the *Van Zyl* case, Binns-Ward J had to determine whether two immovable properties, one registered in the name of a trust and the other in the name of a company, should be treated as assets in the insolvent estate of the debtor, Mr Kaye.

Kaye, his wife and an attorney were the trustees of a family trust. The trust owned a property which was used by Kaye and his family as their home. The beneficiaries of the trust were Kaye, his wife and their descendants. Evidence was also led - in a separate enquiry relating to the company Kaye was associated with - which suggested that financial transactions were recorded in the books of various entities over which Kaye exercised control in a manner that did not accurately represent the flow of funds.

The court clarified the difference between finding that a trust is a sham and going behind a trust. To hold that the trust was a sham, in other words non-existent, is a finding of fact, among other things, on the basis that the requirements for the establishment of the trust were not met, in which event the ‘trustees’ of the trust acted as agents of Kaye when acquiring the property.

The court found that even a delinquent discharge by trustees of their responsibilities, resulting in only one trustee exercising unfettered *de facto* control over the trust assets or the maladministration of an asset of the trust is not enough to justify a finding that a trust is a sham; in other words, a finding that renders the trust non-existent and the asset no longer vesting in the trust. All that this type of conduct does is call into question the fitness of the trustees to hold office.

Going behind the trust, on the other hand, entails accepting the trust’s existence, but disregarding for given purposes the ordinary consequences of its existence. The court found that this may entail holding the trustees personally liable for an obligation undertaken in their capacity as trustees. Conversely, going behind the trust may require holding the trust bound to transactions seemingly undertaken by the trustees acting outside the limits of their authority or legal capacity; or in cases where the trustees treat the property of the trust as if it were their personal property and use the trust essentially as their alter ego. This equitable remedy will generally be given when the trust is used in a dishonest or unconscionable manner to evade a liability or avoid an obligation, rather than in a situation where a creditor seeks relief against a debtor who is a trustee of a trust.

The court pronounced that there is nothing untoward in trusts being established for the purposes of holding family homes separately. Similarly, there is nothing sinister about a trustee personally paying the mortgage bond and maintenance expenses in respect of such a property.
The court went on to find that even if it were accepted that Kaye administered the trust without proper regard to his fiduciary duties and, in a sense, treated the trust as his ‘alter ego’, that does not, in itself, make the trust a sham, nor does it vest ownership of the trust’s assets in the trustees of Kaye’s insolvent estate.

This judgment appears to be another nail in the coffin of creditors who attempt to recover debts from debtors who registered all ‘their’ assets in trusts.

As this avenue of relief narrows, it is important that transacting parties ensure they have sufficient security in respect of debts due to them, in the form of suretyships or security bonds.

Lucinde Rhoodie

THE TERMINATION OF A CONTRACT ON REASONABLE NOTICE

Difficulties often arise under circumstances where an agreement, governing the commercial relationship between two parties, is silent on either party's right to terminate that agreement.

It is sometimes contended that an agreement, which makes no provision for a right of termination by either party is, as a consequence, indefinite or ‘evergreen’.

A court ought not lightly to infer, from the absence of specific provisions relevant to the termination of an agreement, that the same is one intended to operate in perpetuity. Notwithstanding this fact, a decision delivered in the North Gauteng High Court, Pretoria, found that a written agreement concluded between Nippon Africa Chemicals and a local distributor of its products, was not capable of termination on reasonable notice. That decision was challenged before the Supreme Court of Appeal in the matter of Plaaskem vs Nippon Africa Chemicals 2014 (5) SA 287 SCA.

Thankfully, the Supreme Court of Appeal (SCA) adopted a more commercially realistic attitude to the issue as to whether or not the agreement was in fact capable of termination, on reasonable notice, by either party.

The SCA emphasised that the first question is one of construction, and that it was therefore necessary to have regard to the language used by the parties in the contract. Having considered the terms of the agreement, the SCA found that there was no express term dealing with the agreement’s duration, and also that there was no indication that the parties intended to be bound in perpetuity. The second investigation necessary, concerns the intention of the parties, having regard to the nature of the relationship between them, as well as the surrounding circumstances. The court held that where an agreement required the parties to form and maintain a close working relationship, with regular contact and interaction between them, it was reasonable to assume that the nature of the relationship may change from time to time. That commercial reality strongly suggests an intention by the parties not to be bound in perpetuity.

Having applied these tests, and after taking into account the surrounding circumstances and the fact that the contract was silent as to its duration, the SCA held that it was necessary that a tacit term be imported into the agreement to the effect that the contract could be terminated by either party on reasonable notice.

This approach is to be welcomed, as it recognises the commercial realities at play in business relationships.

Jonathan Witts-Hewinson

A TENDER ISSUE: PERSONAL LIABILITY FOR TENDER OFFICIALS

On 19 November 2014, in the decision Mogale City Municipality v Fidelity Security Services (Pty) Ltd (572/2013) [2014] ZASCA 172, the Supreme Court of Appeal (SCA) held that a tender awarded by the Mogale City Municipality (Municipality) had been correctly set aside due to procedural irregularities. The SCA also warned that in the future, officials who failed to carry out their duties with appropriate diligence when awarding tenders may be held personally liable for their actions.

In issuing the warning, the SCA referred to the recent decision, Gauteng Gambling Board and Another v MEC for Economic Development, Gauteng 2013 (60 SA 24 (SCA) paragraph 54, in which the Court stated: "It is time for courts to seriously consider holding officials who behave in the high-handed manner described above, personally liable for costs incurred. This might have a sobering effect on truant public office bearers."

continue
During the initial proceedings in the court a quo, a series of irregularities in the tender process were exposed, including the following:

- one of the bidders was erroneously disqualified during the tender process;
- the successful tenderer had initially scored such a low mark in the functionality component of the bid that they should have been disqualified, however, their score was re-evaluated and a new qualifying score was allocated to them;
- one of the bidders was involved in dubious activities which included giving gifts to officials of the Municipality involved in evaluating the tender; this bidder somehow remained in the running for the tender; and
- one of the unsuccessful bidders launched a review application but withdrew the application after the successful bidder agreed to share the tender award. This agreement was seemingly endorsed by the Municipality despite there being no provision for this occurrence in the tender.

The SCA held that the exclusion of the disqualified bidder had been wrong and reviewable because the disqualified bidder’s error was unintentional and unavoidable. Clarifying this point, the Court stated that “a bar on awarding a tender does not mean that a possible obstacle to the award of the tender cannot be removed before the decision on the tender is made”. In this instance, the obstacle was removed after the submission of the tender but prior to the consideration of the tender.

With the advent of ‘tenderpreneurs’, and funds advanced to successful bidders frequently running into millions of rands, the equitability of the tender process is vitally important. Transparency is an essential ingredient in securing public and commercial faith in the legitimacy of tender proceedings.

The SCA’s looming warning of potential personal liability being levied against tender officials who negligently carry out their functions, will hopefully create more accountable government tenders going forward.

Burton Meyer and Faye Hoch

INTERPRETATION OF ON DEMAND GUARANTEES

In the past, our courts have called payment guarantees issued by banks in commercial deals ‘the life blood of commerce’ which should not lightly be subjected to judicial interference. The Supreme Court of Appeal recently confirmed this principle in the case of the State Bank of India and Another v Denel SOC Limited and Others (947/13) [2014] ZASCA 212 but also emphasised that a demand made pursuant to a payment guarantee (which is independent of the underlying contract and is similar to an irrevocable letter of credit), must comply strictly with the terms and requirements set out in such guarantee.

In the case, the Supreme Court of Appeal was asked to set aside an interdict granted by the South Gauteng High Court prohibiting Absa Bank from honouring its undertaking to pay on eight counter guarantees issued by Absa Bank in favour of the State Bank of India and the Bank of Baroda (Indian Banks).

The facts were briefly as follows: Denel contracted with the Union of India (UOI) to supply it with defence equipment. As security for its contractual obligations, Denel was obliged to furnish UOI with counter guarantees. The counter payment guarantees contained irrevocable and unconditional undertakings by Absa Bank to pay the Indian Banks on receipt of a demand that the Indian Banks had been called upon to make payment in terms of the principal guarantee. The principal guarantees contained undertakings by the Indian Banks to pay the UOI in the event that the President of India declares “that the goods have not been supplied according to the warranty obligations under the contract”.

A dispute arose between the parties and the UOI issued a demand to the Indian Banks on the basis that the goods had not been supplied ‘according to the contractual obligations’ of Denel. On the strength of this demand, the Indian Banks paid UOI and issued a demand to Absa Bank which simply repeated the demands made upon the Indian Banks by the UOI.

The Supreme Court of Appeal held that the terms of the demands made under the counter guarantees didn’t comply with the terms of the respective counter guarantees in that they referred to Denel’s ‘contractual obligations’ as opposed to its ‘warranty obligations’. Accordingly, ABSA Bank was not obliged to make payment in terms of the counter guarantees.

In light of this decision, beneficiaries of payment guarantees should ensure strict compliance with the exact terms of a payment guarantee when making a demand for payment.

Brigit Rubinstein

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Very often, deregistration in the above circumstances results from administrative negligence on the part of the company rather than the company having ceased its corporate activities. The question that arises is what the effect of reinstatement to the register is? More particularly, are the acts performed by the company during the period of deregistration validated? This was the issue brought before the Western Cape High Court in the recent matter of Peninsula Eye Clinic (Pty) Ltd v Newlands Surgical Clinic and others.

The previous Companies Act, No 61 of 1973 contained an express provision that, upon restoration of a company’s registration, all corporate activity which occurred during its period of deregistration was validated retrospectively. These express provisions were repealed by the current Act.

The facts of the Peninsula Eye Clinic case are briefly as follows: Newlands Surgical Clinic (Respondent) failed to submit its annual returns and was subsequently deregistered by CIPC. During this period of deregistration, the Respondent actively defended and subsequently lost arbitration proceedings against Peninsula Eye Clinic (Applicant). An arbitration award was made against the Respondent ordering the company to pay the Applicant a substantial sum.

The Respondent refused to pay the amount awarded, contending that the arbitration award had no bearing since the company had no legal status at the time and could not have had the authority to participate in the arbitration.

The Judge stated that the automatically retrospective provisions of the old Companies Act had potentially prejudicial consequences for third parties and that where a company’s acts are to be retrospectively validated, a judicial process, which affords affected third parties the right to be heard, was far preferential to an automatic administrative one.

The court accordingly held that administrative reinstatement of a company’s registration would automatically restore its corporate personality and title to its assets, but would not validate its corporate activity during the period that it was deregistered. A reregistered company or interested party would have to apply to court for an order to that effect.

In the particular circumstances of this case, the court found that it would be just and equitable for the arbitration proceedings to be declared valid and accordingly for the respondent to be bound by the terms of the arbitration award.

Brigit Rubinstein

POST-DEREGISTRATION CORPORATE ACTIVITY: VALID OR VOID?

The Companies Act, No 71 of 2008 (Act) provides that the Companies and Intellectual Property Commission (CIPC) may deregister a company where it fails to file annual returns for two or more years in succession and doesn’t provide adequate reasons for the failure. The Act also provides that, where CIPC deregisters a company on these grounds, an interested party may apply to reinstate the registration of the company.
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