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KIETI LAW LLP, KENYA

IN THIS ISSUE

Don't rely on a holding company to unscramble the egg

In law of contract, fraudulent misrepresentation is a false statement of fact made by one party to another party before a contract is concluded. In this instance, the innocent party must be induced to enter into the contract due to the misrepresentation. If the statement is made with the knowledge of the statement's untruthfulness, the statement is then fraudulent.



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Fraudulent misrepresentation renders the contract voidable, meaning that the innocent party has the right to have the contract declared void, and to claim restitution. Restitution entails placing the parties in the same position that they would have been in had the contract not been concluded.

Where the contract involves the sale of an asset by the innocent seller to the fraudulent buyer, restitution would therefore include the return of the asset by the fraudulent buyer to the innocent seller.

In the context of a company, one may ask what happens when the asset is no longer owned by, or in the possession of the fraudulent buyer but is owned by or in the possession of a subsidiary of the fraudulent buyer? No problem, one may surmise, considering that a holding company controls its subsidiary and consequently, should the sale be declared void, the fraudulent buyer could be ordered by a court to ensure that the asset is returned by the subsidiary to the innocent seller.

JUDICIAL APPLICATION: IN THE HIGH COURT

This is what the previous owners of the shares in the popular retail outlet, Tekkie Town (Pty) Ltd, relied on in the case of, *Pepkor Holdings Ltd and Others v Ajvh Holdings (Pty) Ltd and Others* 2021 (5) SA 115 (SCA).

In this case, the previous owners had sold their shares in Tekkie Town to Steinhoff International Holdings NV. Through a series of sequential transactions, the shares in Tekkie Town were transferred to various other companies within the Steinhoff group, with Pepkor Holdings Ltd, a subsidiary of Steinhoff, ultimately holding the shares, and another company in the Steinhoff group ultimately acquiring the business of Tekkie Town.

The previous owners of the shares in Tekkie Town applied to court claiming, amongst other things, a restitution of the shares in Tekkie Town on grounds of the fraudulent misrepresentation of Steinhoff's financial position which had induced them to enter into the contract of sale.

Pending the outcome of these proceedings, the previous owners thought it prudent to ensure that the shares and business of Tekkie Town held by the subsidiaries within the Steinhoff group are preserved in anticipation of a successful restitution claim, which would have resulted in a return of the Tekkie Town shares and business.

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The previous Tekkie Town owners, armed with the notion that Steinhoff controlled its subsidiaries and could therefore be ordered to procure that the Tekkie Town shares and business be preserved, and ultimately returned should a claim for restitution be successful, applied to the Western Cape Division of the High Court, to interdict Steinhoff accordingly.

The interdict was granted in their favour, with the court ordering Steinhoff to, amongst other things, exercise control over Pepkor and its other subsidiaries to preserve the shares and business of Tekkie Town pending the outcome of the restitution claim.

JUDICIAL APPLICATION: IN THE SUPREME COURT OF APPEAL

The granting of this interdict was, however, successfully appealed by the Steinhoff group in the Supreme Court of Appeal on numerous grounds.

One of the grounds for the successful appeal was the assertion that a holding company and its subsidiary are separate legal entities and that the holding company does not control all of its subsidiary's corporate actions.

The appeal court held, amongst other things, that it is an established principle that a company is a legal entity distinct from its shareholders and that property owned by a company is not that of its shareholder/s.

The board of a holding company is thus not able to dictate the decisions of the board of a subsidiary, even if that subsidiary is a direct, wholly owned subsidiary. In terms of section 66(1) of the Companies Act 71 of 2008, the board of a subsidiary must independently manage and direct the business and affairs of the subsidiary company.

Also emanating from this is the principle that the respective boards of directors of a holding company and its subsidiary have discrete obligations and fiduciary duties to the companies on which boards they serve, and that the board of a company must act in the best interests of the company as a separate entity, considering the interests of various stakeholders and not merely those of its shareholders.

CONCLUSION

While this decision is not only thought-provoking from the perspective of the potential inability to claim restitution of assets owned by or in the possession of a subsidiary of a holding company where the latter is a fraudulent buyer under a contract set aside due to fraud, it also highlights, in general, the inability of a holding company to control all the corporate actions of its subsidiary (even in the case of a wholly owned subsidiary).

QUINTIN HONEY AND AKHONA MDUNGE

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BBBEE STATUS: LEVEL ONE CONTRIBUTOR

Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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