payment mechanism used, but also because the creditor (lessor) had accepted (by agreement) to bear the risk of late payment as a result of an delay inherent in the system. It is, of course, also possible to argue that the insurer, by not objecting to payment by stop order, agrees by implication to accept the risks inherent in the stop-order system. Where the stop- or debit-order system of payment has been preferred by the insured, or insisted on by him, any risk inherent in the payment system should lie with him. But each case must be considered in the light of its own circumstances. The agreement (or its absence) between the parties in respect of the type of payment mechanism to be used, is of vital importance to establish the incidence of the risk of late payment.

It would appear, therefore, that the last word on the payment of debts by stop or debit order has not yet been spoken. One could but hope that *Penderis and Gutman* will not be followed blindly by our courts. The payment of debts by way of stop order or debit order deserves further careful judicial scrutiny.

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Creditors, Directors and Personal Liability under Section 424 of the Companies Act

MICHELE HAVENGA
University of South Africa

1 Introduction

Various rules and statutory provisions attempt to protect the interests of company creditors. The rules concerned with the maintenance of capital, for example, are based on the assumption that the creditors of a company rely on the paid-up share capital remaining undiminished by any expenditure outside the limits of the authorized objects, or by the return of any part of it to the shareholders (see *In re Dronfield Silkstone Coal Company* (1881) 17 ChD 76; *Trevor v Whitworth* (1887) 12 App Cas 409). These common-law rules are often backed by statute (in respect of the maintenance of capital, see, inter alia, s 38 of the Companies Act 61 of 1973), but they are not always enforceable by creditors. (For example: although the ultra vires doctrine exists at least partly for the benefit of creditors, it was held in *Lawrence v West Somerset Mineral Railway Company* [1918] 2 Ch 250 that a creditor has no standing to sue for a declaration to prevent the company from concluding an ultra vires transaction.) There is some controversy as to whether the fiduciary duties owed by directors to the company can be extended to creditors (see *In re Dronfield Silkstone*...

2 Section 424

Where it appears, whether in the winding-up or judicial management of a company, or otherwise, that any business of the company concerned was or is being carried on recklessly or with the intent to defraud creditors of the company or any other person, or for any fraudulent purpose, the court may, on application, declare that any person who was knowingly a party to the carrying on of the business in such manner 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 (s 424(1)). The application may be made by the Master, the liquidator, the judicial manager, or any creditor, member or contributory of the company.
Every person who was knowingly a party to the conduct of the company's business in the manner set out in s 424(1) commits an offence (s 424(3)). The enactment of this criminal sanction does not prejudice any other criminal liability such person may incur. (See, generally, FHI Cassim 'Fraudulent or "Reckless" Trading and Section 424 of the Companies Act' (1981) 98 SALJ 162; HS Cilliers & ML Benade (eds), DH Botha, MJ Oosthuizen & EM de la Rey Corporate Law (1987) 487; Hahlo op cit at 739 742–743; Eleanor G Hambidge & Stephanie M Luiz 'Compromise and Personal Liability under Section 424 of the Companies Act: Two Judicial Approaches' (1991) 3 SA Merc LJ 123; Philip M Meskin (gen ed) Henochsberg on the Companies Act vol II 4 ed (1985) 745–750; A Hyman 'Director's Liability for Company's Debts' (1980) South African Company LJ E1; Stephanie Luiz 'Extending the Liability of Directors' (1988) 105 SALJ 788.)

Section 424 differs from the corresponding, but now repealed, English s 332 of the Companies Act 1948 (11 & 12 Geo 6, c 38) and s 630 of the Companies Act 1985 (c 6) in a material respect. English law restricted the sanction to fraudulent trading. The recommendation made in the Report of the Company Law Committee (the Jenkins Report) Cmnd 1749 (1962) para 503(b), that the civil sanction be extended to apply to reckless trading, was not implemented in subsequent English company legislation. Under South African law, the civil sanction applies to both fraudulent and reckless carrying on of the business of the company. (On the meaning of 'recklessness' in s 424, see Dorklerk Investments (Pty) Ltd v Bhyat 1980 (1) SA 443 (W); S v Parsons en 'n ander 1980 (2) SA 397 (D); Fisheries Development Corporation of SA Ltd v Jorgensen & another 1980 (4) SA 156 (W) at 169–170; Hyman op cit at E4; RC Williams 'Liability for Reckless Trading by Companies: The South African Experience' (1984) 33 International and Comparative Law Quarterly 684. On the meaning of 'carried on', see Gordon NO and Rennie NO v Standard Merchant Bank Ltd and Others 1984 (2) SA 515 (T) at 525–527. See also Ex parte Lebowa Development Corporation Ltd 1989 (3) SA 71 (T) at 101–111 for a detailed analysis of fraud and recklessness in the interpretation of s 424.)

Du Plessis regards s 424(1) as one of the most powerful instruments in the hands of creditors (Jean Jacques du Plessis Maatskappyregtelike Grondslike van die Regposisie van Direkteure en Besturende Direkteure (unpublished LLD thesis, University of the Orange Free State 1990) 126; see also JSA Fourie (1980) 43 THRHR 328). But its effectiveness will depend largely on cost implications and the likelihood that the particular creditor's claim against the company will be settled if her application under the section is successful.
3 Form of Proceedings

It is now accepted that the applicant may elect to proceed by ordinary action or by way of motion (see *Joh-Air (Pty) Ltd v Rudman* 1980 (2) SA 420 (T) (discussed by Henochsberg op cit at 748) where this question was left unanswered; *Food & Nutritional Products (Pty) Ltd v Neumann* 1986 (3) SA 464 (W); *Howard v Herrigel & another* 1991 (2) SA 660 (A)). Where the applicant has reason to believe that facts which are essential to her claim will probably be disputed, but she still elects to proceed by way of motion, she runs the risk that the application may be dismissed. In the exercise of its discretion, the court may decide not to refer the matter for trial, nor to order oral evidence on the factual dispute to be placed before it, but rather to dismiss the application (*Room Hire Co (Pty) Ltd v Jeppe Street Mansions (Pty) Ltd* 1949 (3) SA 1155 (T); *Tamarillo (Pty) Ltd v BN Aitken (Pty) Ltd* 1982 (1) SA 398 (A) at 430G–H). If, notwithstanding the existence of disputed facts on the papers before the court, it is satisfied that, on the facts stated by the respondent together with the admitted facts in the applicant’s affidavits, the applicant is entitled to relief, it will make an order to give effect to such finding, coupled with an appropriate order as to costs (*Tamarillo* at 430H–431A). In *Howard* the appellate division recently confirmed that where the applicant has elected to proceed by way of application and to have the matter determined on the affidavits, she runs the risk of being non-suited by obliging the court, as it were, to accept the version of the director at face value (at 679A).

4 Delinquent Directors

The order made under s 424 may be directed against any person who was knowingly a party to the carrying on of the business in the ways envisaged by the section. As a separate juristic entity, a company must of necessity have organs to act on its behalf. One of these, the board of directors, is elected by the general meeting. It is normally entrusted with the management of the company (Hahlo op cit at 446). Directors are, therefore, obviously included in the classification of people who may incur liability under s 424.

In *Fisheries Development v Jorgensen* (supra) Margo J indicated that a director who exercises reasonable care would be entitled to rely on information and advice. But she would have to give such information and advice due consideration, and exercise her own judgment. She may not be indifferent or a mere dummy — there is no difference between the duties of ‘puppet’ and ordinary directors (see, generally, *S v De Jager* 1965 (2) SA 612 (A); *Selangor United Rubber Estates Ltd v Cradock (No 3)* [1968] 1 WLR 1555, [1968] 2 All ER 1073; *S v Hepker & another* 1973 (1) SA 472 (W); *Wallersteiner v Moir* [1974] 1 WLR 991, [1974] 3 All ER 217 (CA); Michael Larkin ‘The
Fiduciary Duties of the Company Director' 1979 *South African Company LJ* E-8; JS McLennan 'Directors' Duties and the Misapplications of Company Funds' (1982) 99 *SALJ* 394 at 400ff). Nor may she shelter behind ignorance or failure to understand the company's affairs (*Fisheries Development v Jorgensen* at 166D–E). A director thus has a positive duty to safeguard and protect the affairs of the company (see also *Howard* supra at 674). Failure to do so may constitute a breach of the fiduciary duties owed by her to her company. It may also render her a 'party' to reckless or fraudulent conduct as envisaged in s 424. This would be the case even in the absence of positive steps taken by her in the carrying on of the company's business. Whether or not such inference can be drawn, will depend upon the facts and circumstances of each particular case.

In *Howard* (supra) the application under s 424 was against one of the 'non-executive' directors of the company (on the distinction between 'non-executive' and 'executive' directors, see Hahlo op cit at 327; Michele Havenga 'Directors' Secret Profit — Accounting to the Company' (1991) 3 *SA Merc LJ* 95). Goldstone JA regarded it as unhelpful, and even misleading, to use this classification to ascertain the duties of directors to the company or when any specific or positive action is required from them (at 678A). The court thought it a factor to be considered in the assessment of the director's liability that she is not involved in the management of the company on a full-time basis (see also *Fisheries Development v Jorgensen* supra at 166ff). The fact that she is a 'non-executive' director does not, however, generally indicate that she has less onerous duties than would otherwise have been the case. Prospective directors should therefore be aware that even if they will have only non-executive duties, they may still incur liability under s 424 (see also *Cronjé NO v Stone en 'n ander* 1985 (3) *SA 597* (T)).

5 The Court Order

Should the court find the delinquent personally responsible for any or all of the debts or liabilities of the company, it has to order their payment. The question then arises to whom such payment should be effected. If payment is ordered to the company, it would have to be effected to the company for the benefit of creditors generally. It has been indicated under English law that monies recovered by a liquidator under the corresponding s 275 of the Companies Act 1929 (19 & 20 Geo 5, c 23) fall into the general assets of the company and should be applied accordingly (see *In re William C Leitch Brothers, Limited* (2) [1933] 1 Ch 261). The defrauded creditor would, therefore, have no preferential rights. But there have also been indications to the contrary. In *In re Cyona Distributors Ltd* ([1967] 1 Ch 889 (CA), [1967] 1 All ER 281 (Ch)) an application was brought
under the now-repealed s 332 of the Companies Act 1948 (11 & 12 Geo 6, c 38). Denning MR and Danckwerts LJ indicated that where the application was made by a defrauded creditor, such application was made on his own account and not as trustee for the general body of creditors. Danckwerts LJ also pointed to the wide discretion that the court has under s 332. Payment could thus be ordered to any particular creditor, or to a particular class of creditors, or to the liquidator in order that it falls into the general assets of the company. In *Re Gerald Cooper Chemicals Ltd* ([1978] 2 All ER 49 (CA)) Templeman J indicated that the court could order payment directly to the applicant creditor. But it was considered essential that the liquidator be advised of the proceedings, since the respondents should not be placed in double jeopardy by the possibility of further proceedings once payment has been ordered to the creditor. It would appear that the balance of English authority favoured the approach that the court has the power to order payment to a particular creditor (see Williams op cit at 698).

An order in favour of a particular creditor cannot, however, be made under the present English legislation. Contributions in respect of fraudulent and wrongful trading must be ordered to constitute general assets of the company (see s 213 (1) and (2) and s 214 of the Insolvency Act 1986 (c 45)). The application may be made only by the liquidator of the company.

Under South African law it is accepted that s 424 confers a wide discretion on the court (see *Dorklerk v Bhyat* supra at 447E). In this regard, s 424 (2) provides that the court may make whatever direction it thinks proper for the purpose of giving effect to its declaration. The intention appears to be that the court should make a declaration in respect of a particular debt (or debts) or all the debts, and not in respect of a particular amount (see Henochsberg op cit at 749).

The provisions of s 424 are intended to provide a meaningful remedy against the abuse contemplated by the legislature (see *Gordon v Rennie* supra at 527E). The court should, therefore, give the words of the section their full breadth (see also *In re Cyona Distributors Ltd* [1967] 1 All ER 281 (Ch) at 284). The application may be made by a creditor of the company or, where the company is in winding-up or under judicial management, by its liquidator or judicial manager. It is submitted that creditors are unlikely to make use of s 424 if payment, in the event of a successful application, is to be ordered to the company. There would then be uncertainty whether they will actually receive payment, and they may have to contribute towards the costs of the application, or even possibly furnish security for such costs (*Kelly & Hingle v Cohen* 1923 WLD 140 at 145). Accordingly, it is submitted that the court should be able to order payment directly to them (see Cassim op cit at 164; Henochsberg op cit at 749). Where the company is in winding-up or under judicial
management, payment will usually be directed to the liquidator or judicial manager in order to protect all interested parties. In appropriate circumstances the rights of preferent creditors will have to be considered. If the payment by the delinquent is insufficient to cover all the debts, a direction may be sought from the court as to how the distribution is to proceed (see ss 387(3), 388 and 439 in respect of applications for directions by the court). It is submitted that certainty in respect of the order for payment will be achieved only by the amendment of s 424, and that the section will only then become a truly effective remedy in the hands of company creditors.

6 Conclusion

The wider ambit of s 424, when compared with its English counterparts, as well as the application of the section to circumstances other than those where the company is in the process of being wound up, are indicative that it is intended to provide a meaningful remedy. Amongst others, creditors should be adequately protected against misuse of their powers by company controllers. In view of the uncertainty whether fiduciary duties owed by directors to the company can be extended to creditors, they may well have to rely on s 424 in this regard. They are unlikely to do so if there is uncertainty whether they will actually receive payment in the event of a successful application. Such uncertainty arises because it is not clear to whom the court may order the payment envisaged by the section. It is, therefore, submitted that the section should be interpreted or amended to permit payment directly to the applicant creditor if it would not prejudice other parties. The applicant may select the form the proceedings should take, but runs the risk of being non-suited if she elects to proceed by way of application. The decision in Howard v Herrigel (supra) is a welcome addition to the case law in respect of s 424, as it clearly indicates that where the defendant is a director it will not necessarily be a sound defense that her functions are non-executive.

An Updated Bibliographical Guide to South African Shipping Legislation

JP VAN NIEKERK
University of South Africa

Introduction

There has been a great deal of legislative activity in the field of shipping law since the publication of an earlier guide to its legislation