REPUBLIC OF SOUTH AFRICA

Reportable

THE LABOUR COURT OF SOUTH AFRICA, DURBAN

JUDGMENT

Case no: D 393/11

In the matter between:

GOLDFINCH GARMENTS CC **First Applicant**

JCR CLOTHING CC **Second Applicant**

and

THE SHERIFF OF THE COURT - NEWCASTLE **First Respondent**

THE NATIONAL BARGAINING COUNCIL FOR THE CLOTHING MANUFACTURING INDUSTRY (KZN REGION) **Second Respondent**

Heard: **15, 16 and 17 October 2012**

Delivered: 5 July 2013

Summary: Interpleader: applicant's claim dismissed: **Lifting the corporate veil justified**.

JUDGMENT

GUSH J

[1] This matter basically involves an interpleader claim by the applicants who initially applied for an order in the following terms:

1. that the first respondent is ordered to restore to the applicants forthwith possession of the factory premises situated 41 yellow speak, Newcastle, KwaZulu Natal;

2. that the attachment and seizure of all the property belonging to the first applicant be and is hereby set aside;

3. that the first respondent is ordered to restore to the first applicant forthwith, possession of all property belonging to the first applicant.

[2] The application was launched as a result of the first respondent having attached the property listed in the inventory attached to pleadings pursuant to a writ of execution having been issued in respect of a consent arbitration award in favour of the second respondent. The award was issued by consent against the second applicant and ordered the second applicant to pay to the second respondent an amount of R3,972,974 which amount the second respondent had failed to pay.

[3] The applicants originally launched their application as an urgent application. It was subsequently agreed by the parties that the matter should proceed as an interpleader claim. The first applicant subsequently elected to file particulars of claim in which the first applicant seeks an order:

1. declaring the property attached by the first respondent listed in the inventory on the notice of a judgment dated 11 May 2011 is not the property of the second applicant;

2. releasing the aforesaid property from attachment.

[4] The first applicant in its particulars of claim records that the second respondent is the judgment creditor under reference number U/6/534/9/09 in the sum of R3,972,974 and that the second applicant is the judgment debtor. The second applicant further avers that at the time of the attachment the property on the inventory described as raw material, work in progress or completed garments was the property of third parties, (persons who had ordered the making of the garments) and the other items on the inventory are owned by the first applicant.

[5] The consent arose in the following circumstances. On 24 February 2010, pursuant to a claim by the second respondent that the second applicant had failed to register as an employer, failed to register its employees and fulfil its obligations as an employer in terms of the second respondent's main agreement, an arbitration was convened under the auspices of the second respondent, reference number U/6/534/9/09, before an arbitrator Mr R Ramsumer. The arbitration award issued on 24 February 2010 records that the second applicant consented to an order that is recorded in the following terms 'the parties agree as a settlement of this dispute that the [second applicant] shall pay R3,972,974 which is inclusive of the underpayment assessment, levies, fine and the cost within 14 days of this award.' [1]

[6] Prior to the trial commencing, the parties entered into a pre-trial minute in which the common cause facts as per the pleadings are recorded as *inter alia*:

(a) it is admitted on the pleadings that the second applicant carries on business manufacturing and distributing clothing, garments and related merchandise;

(b) the second respondent is the judgment creditor in respect of the arbitration award reference number U/6/534/9/09 and that the second applicant is the judgment debtor;

(c) the first applicant was registered as a close Corporation on 29 October 2003;

(d) the second applicant was registered as a close Corporation on 24 March 2009.

[7] The facts in dispute were recorded as follows:

(a) that the first applicant carries on business hiring machinery and equipment;

(b) that all the property in the Sheriff's inventory which can be described as raw material, work in progress or completed garments, was the property of third parties namely persons who ordered the making of garments;

[1] Arbitration award pleadings pages 64 - 65

(c) that all the other items listed on the inventory were owned by the first applicant;

(d) that none of the property attached by the first respondent is owned by the second applicant;

(e) that the creation of the second applicant as legal entity distinct from the first applicant was a scheme designed to assist the business operated by the first and/or second applicants to evade its legal obligations towards its employees and the second respondent, *in fraudem legis.*

[8] In its opposition to the first applicant's claim, the second respondent averred:

(a) firstly that the items on the inventory are owned by the second applicant and were probably attached in execution of the writ:

Alternatively and in the event that the first applicant is able to establish a proprietary interest in the goods under attachment

(b) that the clothing manufacturing business currently operated by the second applicant was previously owned and operated by the first applicant;

(c) the first and second applicants are owned, respectively, by one Zhiliang Han and/or members of his immediate family;

(d) the creation of the second applicant as a legal entity distinct from the first applicant was a scheme designed to assist the business operated by the first and/or second applicant to evade its legal obligations towards its employees and to the second respondent, *in fraudem legis.;*

(e) In the circumstances that the court should pierce the corporate veil and hold that the first and second applicants are one and the same entity for the purposes of the execution of the writ; and or

(f) hold that they are jointly and severally liable for the due performance of the obligations contained in the arbitration award and writ of execution.[2]

[9] The applicants commenced by leading the evidence of Zhiliang Han.

[2] Second respondent's statement of defence: pleadings pages 168 -9.

[10] Han's evidence was that he was a businessman living in Newcastle. He had first come to South Africa in 2002 for a textile factory in Isithebe before leaving in May 2003 to start his own clothing factory. In July 2003, he had started a clothing factory with friends and shortly thereafter started his own factory. He had engaged the services of an accountant, who registered the first applicant CC for him in 2003.

[11] According to Han, he was and is the sole member of the first applicant and the operations manager. The factory was engaged in the CMT business (cut, make and trim) a process whereby the factory is engaged to cut, sew and complete garments.

[12] On 24 March 2009, Han caused to be registered a second Close Corporation (the 2nd applicant) which according to the certificate of registration commenced business on the same day. His evidence was that he had registered and set up the second applicant in order to prepare his son, who was 19 years old at the time, to inherit the business. The second applicant was according to Han, exclusively owned by his son. His son had however quit the business five months later and left South Africa to study in the United States, in August or September 2009. Han's evidence was that his son was the only member of the second applicant and that in terms of "mostly oral agreements" the second applicant would perform the CMT operation and the first applicant would contact the suppliers. Han also gave evidence that he was the second applicant's operations manager. Han junior did not give evidence.

[13] Despite the pleadings and the pre-trial minute wherein it was admitted that the second respondent was the judgment creditor in respect of the consent arbitration award, Han variously gave evidence that he was unaware of the award, and did not know who had represented the second applicant at the arbitration on 24 February 2010 or who had consented to or signed the award. Han's evidence was however that he employed a Labour consultant, one Jacques de Necker who handled all his labour issues.

[14] Han denied that the second applicant had been set up to avoid liability due to second respondent and averred that it was intended that the second applicant

would pay the debts. Neither he nor his son, according to his evidence, was aware of the amount due to the second respondent.

[15] During cross-examination *inter alia* the following evidence was elicited:

(a) where dates on which affidavits were signed did not coincide with his evidence Han's explanation was that the affidavit had been prepared by his erstwhile attorneys. He could not explain how his son who had not been in the country at the time had signed an affidavit in support of the original application;

(b) When questioned why he had created the second applicant so as to allow his son to inherit as opposed to preparing it will his evidence was that "Chinese people don't do it that way";

(c) in response to the question as to why the second applicant had been set up so that its only indebtedness was intended to be to the second respondent and the employees Han's reply was that he had "not thought about it that way" (sic);

(d) Han was unable to explain why the so-called "Agreement of Hire" was undated he could not explain this and blamed his accountant;

(e) when questioned on the financial statements, the contents of which raised serious doubts as to the veracity of Han's evidence regarding the structure of the "family business", Han ultimately resorted to giving evidence to the effect that he did not understand any of the financial statements and all he looked at and was concerned about was to see that he had money in the bank.

[16] Han somewhat plaintively endeavoured to explain that the items attached which appear on the infantry were either goods belonging to third parties or equipment belonging to the first applicant. His evidence regarding these issues suffered from the same lack of credibility as did his evidence regarding the rationale behind the supposedly separate entities comprising the first and second applicants and his explanation why he had established the second applicant.

[17] I do not intend to summarise in detail the cross-examination of Han, but suffice to say that at best in answering the questions he was evasive, obtuse and he gave the distinct impression of being extremely economical with the truth. In essence what Han endeavoured to portray was an ignorant simple businessperson who had no idea whatsoever what was taking place in his business except that he he had simply sought to provide for his son's inheritance when registering the second applicant. Han persistently denied any knowledge of the second respondent's requirements or its functions.

[18] In response to questions where he was unable to provide an answer he either blamed his advisers, the Labour consultant or his accountant, or pleaded ignorance. An example of this was when questioned about the contents of the founding affidavit Han's response was that "I simply sign what Jacques tells me"

[19] The second witness who gave evidence for the applicants was a Mr Louis Kruger. Kruger is a chartered accountant and has known Han since 2003. Kruger had registered both the first and second applicants.

[20] Kruger confirmed that he had prepared the financial statements contained in the bundle of documents. Unsurprisingly he confirmed further that the information and financial details contained therein was provided to him by the first applicants' Han.

[21] Han's evidence regarding the averment that the first and second applicants were separate trading entities lacked credibility and did not accord with his evidence or the pleadings. One example relates to his suggestion in evidence in chief that the reason for having established the second applicant was in order to provide for his son's inheritance. This explanation stands in stark contrast to, and must be considered and weighed up against, the averments he made in his founding affidavit in the original application:

> 5. My **family business**:
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> 5.1 has invested approximately 1.5 million Rand of capital in the economy of South Africa in terms of the costs of:
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> a. **setting up the infrastructure clothing manufacturing factory; and**

b. acquiring the necessary machinery and equipment;

c. the payroll of approximately 400 full-time and part-time workers;

6 **in the interests of business risk management, which is vital for the continued viability of any business operation,** I separated my family business assets from its business operations with the result that the business has two separate divisions. One division procures clothing manufacturing job orders, and owns and maintains the assets, whilst the other division conducts the actual clothing manufacturing business operations using the assets in terms of a high agreement. (my emphasis)

[22] This averment in the applicants' founding affidavit directly contradicts the evidence in chief given by Han. Despite Han blaming his erstwhile attorney for the contents of any affidavit which did not coincide with his oral evidence he also somewhat startlingly suggested that he had simply signed the affidavits and that his attorneys had not explained the contents to him. His excuses lacked veracity as did his answers to the questions put to him in cross-examination. His evidence on the whole can best be described as glib, disingenuous and largely fictional.

[23] In response to the applicant's case the second respondent called the second respondent's compliance manager and legal counsel, Deepnath Seocharan, and Mndeni Mhlango an inspector for the second respondent. Seocharan was the official who had launched and attended the arbitration that led to the consent award being made by the arbitrator. His evidence was that de Necker the Labour consultant who represented the applicants was present at the arbitration and consented to the award on the second applicant's behalf. Needless to say de Necker was not called to give evidence by the applicants.

[24] Both Seocharan and Mhlongo explained the background to the dispute which led to the arbitration award and the extensive efforts the second respondent had made to persuade the applicants to register the employees and to ensure that the employees were paid the correct wages. The second respondent's produced substantial documentation in support of their evidence. Both

witnesses were patently honest. The clear picture which emerged from their evidence was that they had been continually frustrated in their attempts to secure compliance from the applicants and thereof.

[25] Mhlongo in particular described in his evidence how he had been continually frustrated in his attempts to ensure compliance with the second respondent's agreements. He had explained to Han what was required to register the employees and on one occasion had at Han's request assisted him in the completion of the requisite forms. He had communicated with Han in English which Han had understood. His evidence was that Han' attitude was that he did not believe that the second respondent could force him to do anything.

[26] The distinct impression Mhlongo's evidence left was that the second respondent efforts to ensure compliance with the second respondent's agreements had for some years been frustrated at every turn by the applicants. Mhlongo's evidence that he had explained in detail to Han the second respondent's requirements and that he had served compliance orders on him and that he was aware of the arbitration award was not seriously challenged in cross-examination. Suffice to say that in all respects where they differ the evidence of Mhlongo must be preferred to that of Han.

[27] At the conclusion of the evidence it was argued by both parties that two issues need to be determined. The first issue regarded the determination of the ownership of the goods attached as set out in the inventory and the second whether the registration of the second respondent was merely a scheme and whether the court should "pierce the corporate veil" and disregard the separate existence of the second applicant. The second respondent argued that the court should find that the first applicant was the true employer.

[28] Piercing the corporate veil does not only apply in circumstances where the members of a close Corporation are held to be personally liable for the debts and liabilities of the close Corporation, it also applies in circumstances such as this matter when the second respondent urges the court to treat the applicants as a single entity and ignore the separate existence of the two Close Corporations.

[29] The background to piercing the corporate veil was considered in the matter of *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd and Others.*[3]

> 'The principle of a company's separate juristic personality was first asserted in the House of Lords in *Aron Salomon v A Salomon and Co Ltd* [1897] AC 22. There already it appears to have been recognised that proof of fraud or dishonesty might justify the separate corporate personality of a company being disregarded. (See, in this regard, the speeches of Lord Halsbury at 33 and Lord Macnaghten at 52-3.) And over the years it has come to be accepted that fraud, dishonesty or improper conduct could provide grounds for piercing the corporate veil. Recently this was confirmed in *The Shipping Corporation of India Ltd v Evdomon Corporation and Another* 1994 (1) SA 550 (A) where Corbett CJ expressed himself as follows at 566C-F:
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> "'It seems to me that, generally, it is of cardinal importance to keep distinct the property rights of a company and those of its shareholders, even where the latter is a single entity, and that the only permissible deviation from this rule known to our law occurs in those (in practice) rare cases where the circumstances justify "piercing" or "lifting" the corporate veil. And in this regard it should not make any difference whether the shares be held by a holding company or by a Government. I do not find it necessary to consider, or attempt to define, the circumstances under which the Court will pierce the corporate veil. Suffice it to say that they would generally have to include an element of fraud or other improper conduct in the establishment or use of the company or the conduct of its affairs. In this connection the words "device", "stratagem", "cloak" and "sham" have been used..."
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> Two matters arising from the quoted passage merit further comment. First, reference is made to 'those (in practice) rare cases where the circumstances justify "piercing" or "lifting" the corporate veil'. It is undoubtedly a salutary principle that our Courts should not lightly disregard a company's separate personality, but should strive to give effect to and uphold it. To do otherwise would negate or undermine the policy and principles that underpin the concept of separate corporate personality and the legal consequences that attach to it. But where fraud, dishonesty or other improper conduct (and I confine myself to such situations) is found to be present, other considerations will come into play. The need to preserve the separate corporate identity would in such circumstances have to be balanced against policy considerations which arise in favour of piercing the corporate veil (cf

[3] 1995 (4) SA 790 (A) at 803C-.804D.

Domanski 'Piercing the Corporate Veil-A New Direction' (1986) 103 *SALJ* 224). And a court would then be entitled to look to substance rather than form in order to arrive at the true facts, and if there has been a misuse of corporate personality, to disregard it and attribute liability where it should rightly lie. Each case would obviously have to be considered on its own merits.

The second is the reference to the inclusion of 'an element of fraud or other improper conduct in the establishment or use of the company or the conduct of its affairs'. (My emphasis) It is not necessary that a company should have been conceived and founded in deceit, and never have been intended to function genuinely as a company, before its corporate personality can be disregarded (as appears in some respects to have been the view of the trial Judge - see the judgment at 821G-J). As Gower (op cit) states (at 133):

"It also seems clear that a company can be a facade even though it was not originally incorporated with any deceptive intention; what counts is whether it is being used as a facade at the time of the relevant transactions."

Thus if a company, otherwise legitimately established and operated, is misused in a particular instance to perpetrate a fraud, or for a dishonest or improper purpose, there is no reason in principle or logic why its separate personality cannot be disregarded in relation to the transaction in question (in order to fix the individual or individuals responsible with personal liability) while giving full effect to it in other respects. In other words, there is no reason why what amounts to a piercing of the veil *pro hac vice* should not be permitted.

[30] In the matter of *Airport Cold Storage (Pty) Ltd V Ebrahim and Others,*[4] the court considered the principles applicable to piercing the corporate veil and held the following:

'9. Whatever form it takes, veil piercing is an 'exceptional procedure',

and, as pointed out by Scott JA in Hülse-Reutter and Others v Gödde, 6 a court has no general discretion simply to disregard the existence of a separate corporate identity whenever it considers it just or convenient to do so. However, the circumstances in which a court will disregard the distinction between a corporate entity and those who control it are 'far from settled':

[4] 2008 (2) SA 303 (C).

"Much will depend on a close analysis of the facts of each case, considerations of policy and judicial judgment. Nonetheless what is, I think, clear is that as a matter of principle in a case such as the present there must at least be some misuse or abuse of the distinction between the corporate entity and those who control it which results in an unfair advantage being afforded to the latter." (My emphasis.)

10 In *The Shipping Corporation of India Ltd v Evdomon Corporation and Another* Corbett CJ required proof of 'an element of fraud or other improper conduct in the establishment or use of the company or the conduct of its affairs' before a court can pierce the corporate veil.

11 This requirement of fraud or other improper conduct finds resonance in the provisions of s 65 of the Act, 9 where the legislature, with regard to close corporations, has created a statutory remedy 'which is equivalent to (the court's) jurisdiction at common law to ''pierce the corporate veil'' in relation to a company'. Liability under this section depends on a finding of 'gross abuse of the juristic personality of the corporation as a separate entity'. However, no attempt has been made in the section to indicate the facts or circumstances that would qualify as a gross abuse of the juristic personality of the corporation as a separate entity. The courts are required, in other words, to give content to the open-ended concept of 'gross abuse', based on the facts of each particular case. This exercise does not take place in a vacuum, however, and it is axiomatic that the principles and categories developed with regard to piercing the corporate veil in the context of company law will serve as useful guidelines in this context.

12 The starting point is that veil piercing will be employed 'only where special circumstances exist indicating that it [ie the company or close corporation] is a mere façade concealing the true facts'. Fraud will obviously be such a special circumstance, but it is not essential. In certain circumstances the corporate veil will also be pierced 'where the controlling shareholders do not treat the company as a separate entity, but instead treat it as their ''alter ego'' or ''instrumentality'' to promote their private, extra-corporate interests':

Although the form is that of a separate entity carrying on business to promote its stated objects, in truth the company is a mere instrumentality or business conduit for promoting, not its own business or affairs, but those of its controlling shareholders. For all practical purposes the two concerns are in truth one. In these cases there is usually no intention to defraud although there is always abuse of the company's

separate existence (an attempt to obtain the advantages of the separate personality of the company without in fact treating it as a separate entity).

13 Against this background, I turn to consider whether the plaintiff has established that the defendants have in fact abused the separate juristic personality of the close corporation in question.'[5]

[31] I have no doubt that the applicants in this matter, as was held by Griesel J in *Airport Cold Storage (Pty) Ltd v Ebrahim and Others* 'attempted to obtain the advantages of the separate identity of the corporation[s]' and 'When it suited them, to ignore the separate juristic identity of the [corporations]. In these circumstances, the [applicants'] cannot now choose to take refuge behind the corporate veil'[6]

[32] Applying the principles set out above and taking into account the evidence of Han and the second respondent, I am persuaded that the creation of the second applicant as a legal entity distinct from the first applicant was no more than "a scheme designed to assist the business operated by the first and or second applicants to avoid its legal obligations towards its employees and the second respondent, *in fraudem legis"* and that lifting the corporate veil is justified.

[33] In the circumstances, the first and second applicants are one and the same entity for the purposes of the execution of the writ and they are accordingly jointly and severally liable for the due performance of the obligations contained in the arbitration award and writ of execution.

[34] Although it is not necessary, for the purposes of disposing of this matter, I am satisfied that to all intents and purposes the first and second applicants are jointly and severally liable as the employers of the employees employed by both entities and for the purposes of complying with the second respondent's agreements.

[35] As regards the determination of the ownership of the goods attached as set out in the first respondent's inventory of the goods that the applicants aver belong to third parties; I am not persuaded that the applicants have succeeded in proving that. Han's evidence in all respects lacks sufficient

[5] At pages 307 -308; paragraphs 9 – 13.
[6] *Airport Cold Storage (Pty) Ltd v Ebrahim and Others* at para 52.

credibility to sustain such a claim. Regarding the balance of the items attached of the goods attached, I am satisfied that the first and second applicants are jointly and severally liable for the due performance of the obligations contained in the consent order (arbitration award) in respect of which the writ of execution was issued.

[36] As regards costs, I am satisfied that it is appropriate and fair that an order of costs be made against the applicants and that such order be punitive.

[37] In the circumstances, I make the following order:

(a) The applicants' claim is dismissed;

(b) The property attached by the first respondent as listed in the inventory and notice of attachment is properly attached and the process of execution may proceed;

(c) The applicants are ordered to pay the second respondent's costs on an attorney and client scale.

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D H Gush

Judge

APPEARANCES

FOR THE APPLICANTS:	Adv M Bingham Instructed by Tomlinson Mnguni James Inc
FOR THE SECOND RESPONDENT:	Adv P Schumann Instructed by Shepstone and Wylie