THE SUPREME COURT OF APPEAL OF SOUTH AFRICA

JUDGMENT

Case no**: 173/12**

Reportable

In the matter between:

Robert Cheng-Li Tsung **First Appellant**

Robert Hsu-Nan Tsung **Second Appellant**

and

Industrial Development Corporation of South Africa Limited **First Respondent**

Findevco (Proprietary) Limited **Second Respondent**

Neutral citation: ***Tsung v IDC*** **(173/2012) [2013] ZASCA 26 (25 March 2013)**

Coram: Lewis, Cachalia, Theron JJA and Schoeman and Van der Merwe AJJA

Heard: **20 February 2013**

Delivered: **25 March 2013**

Summary: Directors of a company held liable under s 424(1) of the Companies Act 61 of 1973 for conducting the business of the company at a time when it was insolvent, and knowing that the company would not be able to pay its creditors, by concluding transactions for their own gain.

ORDER

On appeal from: Western Cape High Court, Cape Town (Davis J sitting as court of first instance)

The appeal is dismissed with costs including those of two counsel.

JUDGMENT

LEWIS JA (CACHALIA AND THERON JJA AND SCHOEMAN AND VAN DER MERWE AJJA concurring)

[1] The appellants, father and son, Robert Cheng-Li Tsung and Robert Hsu-Nan Tsung, were the directors of Dynasty Textiles (Pty) Ltd (Textiles) which ran a textile factory in Atlantis, Cape Town. The respondents, the Industrial Development Corporation of South Africa Ltd (the IDC) and its financial arm, a wholly owned subsidiary, Findevco (Pty) Ltd (Findevco), instituted action against both appellants in the Western Cape High Court, claiming some R35 million (rounded off) in terms of s 424 of the Companies Act 61 of 1973, on the basis that the business of Textiles had been carried on by them recklessly or with the intention to defraud creditors of Textiles, in particular the IDC and Findevco. The action succeeded, Davis J declaring that the Tsungs' conduct fell within the ambit of s 424(1) and that they were personally liable for an amount agreed (during the course of the trial) to be the quantum of their liability, R32 340 346. Leave to appeal against that decision was given by this court.

[2] Section 424(1) reads:

'When it appears, whether it be in a winding-up, judicial management or otherwise, that any *business of the company was or is being carried on recklessly or with intent to defraud creditors of the company or creditors of any other person or for any fraudulent purpose*, the Court may, on the application of the Master, the liquidator, the judicial manager, any creditor or member or contributory of the company, declare that any person who was knowingly a party to the carrying on of the business in the manner

aforesaid, shall 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.' (My emphasis.)

(The other subsections of s 424 deal with the kinds of order that a court may make when a person is found to be liable for the reckless or fraudulent conduct of the business of a company, and with criminal liability. When I refer to s 424 alone it should generally be read to mean s 424(1).) Davis J found that the Tsungs had, on the probabilities, concluded three transactions that brought their conduct within the ambit of s 424. He declared them jointly and severally liable to Findevco for the sum agreed – R32 340 346. I shall deal with each of the three transactions in turn. But first the factual background must be explained: the context within which the Tsungs conducted the business of Textiles is all-important.

[3] Tsung senior (to whom I shall refer as Robert) established a textile factory in the former 'homeland' Ciskei in the early eighties. He wished to take advantage of the tax incentives offered to businesses which were set up in the area. For this purpose he formed a company, Dynasty Garments (Pty) Ltd (Garments), which manufactured woven shirts and exported them, mainly to America. The business flourished and by 1985 employed some 850 people. But sanctions against South Africa, instituted in 1986, had a seriously adverse effect on the business and Garments changed its market and began to manufacture knitwear for the domestic market, selling to the South African clothing retailers.

[4] The factory was located in an area that was in economic and political turmoil, and so the Tsungs decided to reduce their reliance on the local labour force and to produce cotton yarn instead. Garments ceased effectively to be operational by 1990 and Textiles was established to produce the yarn. The sole shareholder in Textiles was Lio Ho International Co Ltd (Lio Ho), a company incorporated in Hong Kong. The Tsungs were both directors of Textiles. (I shall refer to Dynasty Textiles as Textiles so as to distinguish it from Dynasty Garments. In passages quoted later in this judgment reference is made simply to Dynasty. It is the same

entity as Textiles.) The shareholders in Lio Ho were the Tsungs and Robert's wife, Lucy Tsung.

[5] The production of yarn required major capital expenditure for plant and equipment, and the Tsungs (Tsung junior, to whom I shall refer as Bobby, having joined his father Robert in the Ciskei) decided to purchase the building in which the factory was operated. In order to fund this Textiles borrowed funds (about R5 million) from the IDC, and repaid it by 1998.

[6] In that year too a bill – the African Growth and Opportunity Bill – was passed in the United States Senate to promote exports to America by African countries. The Tsungs wished to take advantage of the proposed benefits that the legislation (which did not ever materialize) would have. Textiles needed easy access to a large international port for that purpose and the Tsungs decided to relocate the factory to Atlantis in Cape Town.

[7] In order to set up the factory in Atlantis, Lio Ho lent some R80 million to Textiles. Textiles approached the IDC for further funding, this time for R40 million. It was IDC's requirement that the ratio between what Lio Ho invested in the company, and what it would invest, would be 2:1. Findevco then purchased plant and equipment from Lio Ho and sold it on to Textiles. The agreement was dated April 1997. It was labelled a 'suspensive sale agreement', although I fail to see what was suspensive about it. It was a sale with a reservation of ownership until the full purchase price and interest had been paid by Textiles to Findevco. The invoice from Lio Ho to Findevco in respect of the plant and machinery purchased was for US$7.84 million. The invoice was dated 30 November 1996. Lio Ho apparently left this sum in South Africa, on loan account, as working capital for Textiles. Findevco advanced R25.9 million to Textiles in respect of the machinery reflected on the invoice.

[8] The Tsungs arranged for Tung Hung International Trading Company Ltd (Tung Hung) to transport the machinery from Hong Kong and to commission it in Atlantis. Tung Hung was not only a broker in this type of machinery but also a mover and installer of such plant and machinery. Its director, Mr Stephen Yang, himself visited the factory in Atlantis in 2000 and provided a valuation of it then of $10 million. (A great deal of the evidence led at the trial related to this valuation. I shall not deal with it for reasons that I shall explain.) The invoice in respect of the plant and machinery, as I have said, was some $7.84 million.

[9] In November 1997 more equipment was purchased by Findevco and sold in turn to Textiles under a second 'suspensive sale agreement'. The purchase price was R5.9 million. And as security for Textiles' indebtedness to Findevco, Textiles registered a collateral mortgage bond over immovable property owned by it in Dimbaza in the Eastern Cape in favour of Findevco, and a notarial covering bond over its movable property – the machinery.

[10] Textiles did well financially in 1998 and 1999. But in 2000 it started to struggle financially and did not meet all its payment obligations to Findevco. It was affected by the downturn in the global economic markets and by the crisis in the Asian economies in particular. Accordingly, when payments were not made to Findevco timeously, or at all, Textiles' account was handed over to Mr Christo Fourie who headed the restructuring department of the IDC. Bobby testified that as early as 2000 he and Fourie had discussed the possibility of a debt-equity swap, but that Fourie had not been interested in it at that stage. However, in an effort to resolve the issue of non-payment, the IDC and Findevco concluded a debenture deed with Lio Ho in late 2000. What Bobby had had in mind instead was that Lio Ho would swap its equity in Textiles in reduction of its debt to Findevco, as the IDC had done with a competitor of Textiles, Prilla 2000 (Pty) Ltd (Prilla), to which the IDC had also lent money.

[11] Bobby testified that although Textiles had still been profitable in 2000, the payments of interest to Findevco made it unable to meet its repayment of capital. Thus throughout 2001, 2002 and most of 2003 he had continued to negotiate with Fourie about a debt-equity swap. His view was that Prilla was able to compete against Textiles because the IDC had acquired, first, 70 per cent of Prilla's equity, and subsequently all the shares in the company. Prilla's interest obligations were thus reduced and then disappeared which meant that it could undercut Textiles' prices.

[12] Eventually, in August 2003, Fourie agreed that Findevco would swap Textiles' debt to it for 80 per cent of the equity in Textiles, Lio Ho retaining the balance of 20 per cent. A draft agreement reflecting this was prepared in October or November of 2003, and a copy sent to Bobby for his comment. The proposed agreement was never concluded. But in anticipation of it Bobby agreed that the IDC, acting for Findevco, could perfect its notarial bond over the plant and machinery (by taking possession of it) which it did in November 2003. Bobby considered that the agreement was in effect concluded. And that appeared to be the view also of the Executive Policy Committee of the IDC which met on 6 November 2003. The minutes of the meeting record the following:

'IDC is already effectively acting as a shareholder of Dynasty [Textiles] as it has not taken any legal action against Dynasty in spite of its non-payment, as Dynasty always kept IDC up to date with the status of the business and IDC's recovery in a forced sale situation would be very low. However, IDC is not currently receiving any benefit for acting as a shareholder and it does not have any control over Dynasty's operations. Converting IDC's debt to equity will provide IDC with control over the business and the ability to determine decision-making and the future direction of the company. The existing shareholder [Lio Ho] is willing to give IDC management control of Dynasty, if required.'

[13] In the same report the IDC referred to the various factors that had led to Textiles' inability to meet its commitments to Findevco – the collapse of the Asian economy, illegal importation of cheap textiles and clothing from East Asia, high local interest rates and the

appreciation of the Rand in early 2003. It referred also to the retrenchment of half the workforce of Textiles in that year, and a scaling down of production. The report stated also that should Textiles not survive, the IDC would lose approximately R30 million. To avoid this, it would explore the possibility of a merger between Prilla and Textiles.

[14] Once the IDC had perfected its notarial bond over the machinery of Textiles, it sold it to Prilla for R19 075 million. It is noteworthy that the machinery had been valued for substantially more than that by Yang in 2001, at R79 494 287, and that was reflected in the financial statements of Textiles.

[15] In fact Bobby left South Africa with his family in December 2003. He advised Fourie at a meeting shortly before he left that he was going to live in Australia and that Robert would attend to the formalities for the debt-equity swap to be concluded. The events leading to their departure will be discussed later as the IDC argued that the Tsungs had an 'exit strategy', intending to strip Textiles of its funds, divert them to repay the Lio Ho loans, and then leave the country and the shell of the company behind.

[16] Mr Jorge Maia, an economist employed by the IDC, was seconded to Textiles in January 2004 to facilitate the handover of the management of the company to the IDC and to prepare for the proposed merger between Textiles and Prilla. The former financial officer of Textiles, Mr Donald Campbell, left the company and went to work for Prilla in January 2004.

[17] On 2 February 2004 Maia and Ms Angela Mhlanga, the financial manager of Textiles seconded by the IDC, wrote an 'interim status report' on the operations of Textiles and its financial status. For the sake of convenience I shall refer only to Maia when dealing with the

report. Maia made some damning comments about the quality of the yarn produced, and the financial position of Textiles. He said, apropos shareholders' loans:

'These comprised ordinary shareholders loans and a loan from the Bank of Taiwan to Mr RCL Tsung and secured by family members, on behalf of Dynasty. Quoting from a statement made by Mr Donald Campbell on 23 January 200[4]: "from around March to May last year, Bobby Tsung realised that the business was going nowhere and decided to cash in." What followed reflected a deliberate attempt by the shareholders assisted by the former management to repay shareholders' loans and reduce their exposure to company risk by various means.

Shareholders' loans were repaid to the tune of R7,6 million over the ten-month period ending 31 December 2003. These repayments were effected through:

- cash payments made to Mr Tsung or Lio Ho . . . including an amount of R1.6 million in May 2003 (pushing the FNB and Bank of Taiwan overdraft facilities towards significantly higher negative balances) as well as a total of R908 000, mostly in cash, paid during the last quarter of calendar 2003 . . .
- recurring monthly payments, either through debit orders or direct settlement of personal liabilities; and
- the outstanding balance on Mr RCL Tsung's loan facility with the Bank of Taiwan (on behalf of Dynasty), but secured by personal unlimited guarantees and stand-by letters of credit opened by the Tsung family), was reduced by R3 million to R1 million during the course of December 2003. The overdraft facility had been stable throughout the previous nine months at a level of R4 million. This payment was made possible by significant receipts from debtors during the month of December.'

Maia continued:

'In the opinion of the new management . . . no further repayments of shareholders loans should be effected until the company is in a position to do so.'

[18] Most damning of all is the following narration in the report: after being requested by Campbell on behalf of Robert to transfer some R200 000 overseas through Textiles' bank

account, and being told that such transactions had been done in the past, Maia investigated such previous transactions. He stated:

'It became evident that one such transaction was effected through Dynasty's FNB banking account towards end-December 2003 for the purpose of transferring USD 1 500 000 (R10 373 500) to the account of Lio Ho . . . at the Hong Kong and Shanghai Banking Corporation in Hong Kong.'

Maia noted that the following movements were recorded in the bank account: Two deposits on 23 December 2003 of R4 million each; a deposit on 24 December of R2.5 million; a withdrawal on 29 December 2003 of R3 412 500 and another the following day of R6 969 000. The sum withdrawn was paid to Lio Ho in Hong Kong.

[19] This was the most controversial of the acts complained of by the IDC and I shall return to the evidence of Maia, Bobby and Campbell in this regard when considering whether the payment out of Textiles' account constituted conduct falling within the ambit of s 424. For now, it is sufficient to note how Maia understood the transaction based on what Campbell had told him. He noted that the deposits emanated from the proceeds of the sale of properties by the Tsung family. The funds were channelled through the Textiles bank account, and the document presented to the bank (FNB) to support the transfer of what amounted to $1.5 million was an invoice from Lio Ho reflecting the sale of second-hand spinning mill machinery and equipment to Textiles in December 1996. The invoice had been stamped for exchange control approval of payment in 1997. The payment to Lio Ho, said Maia, resulted in a reduction in the shareholders' loans by R10 372 500, and a corresponding credit to Garments for R10 500 000 (the amount of the deposit). The foreign liability was thus converted to a domestic liability. The inference that Maia drew in this regard was from entries in Textiles' books of account which reflected that the deposits were made by Garments, and the credit was reflected against a Garments shareholder's loan account.

[20] Maia referred also to the overvaluation of the machinery by Yang which resulted in an inflation of the value of Dynasty's assets. He concluded that the conduct of the Tsungs (to

whom he referred as shareholders) reflected a ‘clear exit strategy’. This was evidenced by the following conduct (I do not refer to all the acts complained of): they had deliberately wound down the company’s operations; accelerated repayment of their shareholders’ loans; and used the company’s bank account for sending money overseas under false pretexts. Both Tsungs had left the country, Robert going to Hong Kong and Bobby to Australia.

[21] The report referred further to a legal opinion that had been written at Maia’s request by the IDC’s attorney on the legality of the payment of R10.3 million to Lio Ho as well as to a pending forensic audit. He recommended that the signing of the debt-equity swap agreement be delayed and possibly reconsidered. Acting on his advice the IDC did not sign the debt-equity swap agreement and eventually instituted action under s 424 of the Act against the Tsungs.

[22] I do not propose to traverse the evidence of the expert accountants who testified for both parties about the financial health of Textiles in the years leading to 2003 and in that year in particular. It is not disputed, at this stage, that Textiles was both factually and commercially insolvent by the end of 2003: its liabilities exceeded its assets by some R5.9 million at the beginning of the year, and it was unable to pay its creditors, principally Findevco, for most of that year. Many of Textiles’ employees had been retrenched during the course of the year, and by the end of it only a small part of the factory was operative. About ten workers were still employed. It had ceased trading in the ordinary course; it was in fact insolvent and it could not pay its creditors. On 17 December 2003, Fourie wrote to Campbell instructing that no payments should be made to Lio Ho or to the directors – the Tsungs. The payment of R10.3 million to Lio Ho was thus directly contrary to Fourie’s instruction.

The reach of s 424(1)

[23] The purpose of the section is to prevent the business of a company from being carried on in a reckless or fraudulent manner. The complaint of the IDC and Findevco (I shall refer mainly to the IDC, but such references, where appropriate, include Findevco as well) was, in essence, that the Tsungs had deliberately and fraudulently embarked on a strategy to ensure that they were able to take as much money as possible from Textiles when they left the country. They did this at a time when the company was unable to meet its financial commitments and did not advise the IDC of the transactions complained of, which were contrary not only to the instruction from Fourie on 17 December 2003, but also in breach of the suspensive sale agreements. The Tsungs denied any deliberate or reckless wrongdoing, but also argued that there was no causal link between the acts in issue and the inability of the company to pay its debts.

Causation

[24] Until recently it was clear from a series of decisions in this court that a plaintiff need not prove that the defendant's conduct was the cause of the company's inability to pay its creditors. This was affirmed in *Howard v Herrigel and another NNO*[1] and *Philotex (Pty) Ltd v Snyman*.[2] But in *L & P Plant Hire BK v Bosch*,[3] Brand AJA pointed out that if a company was able to pay its debts, even if there was reckless conduct on the part of a person conducting the company's business, the intention of the section (in fact the equivalent section dealing with close corporations)[4] was not to create a joint and several liability with the company.

[25] That statement was interpreted to mean, in *Saincic v Industro-Clean (Pty) Ltd*,[5] that causation was a requirement to found liability under s 424. That would have been a deviation

[1] *Howard v Herrigel and another NNO* 1991 (2) SA 660 (A) at 672C-E.
[2] *Philotex (Pty) Ltd v Snyman* 1998 (2) SA 138 (SCA) at142G-I.
[3] *L & P Plant Hire BK v Bosch* 2002 (2) SA 662 (SCA).
[4] Section 64 of the Close Corporations Act 69 of 1984.
[5] *Saincic v Industro-Clean (Pty) Ltd* 2009 (1) SA 528 (SCA).

from *Howard* and from *Philotex*. However, Brand JA has recently explained what he intended in *L & P Plant Hire*. In *Fourie v Firstrand Bank Ltd*[6] Brand JA said that he had not suggested that a causal requirement be introduced to found liability under the section: he had said, in the context of the *L & P Plant Hire* case, where the close corporation was able to pay its debts, that the reckless actors were not jointly and severally liable. If the company or close corporation were able to pay then no prejudice would be suffered by creditors.

[26] In a case where a company was 'hopelessly insolvent', as was the case in *Fourie*, a causal link between the fraudulent or reckless conduct, and the company's inability to pay its debt, does not have to be established. Counsel for the Tsungs argued that this court in *Fourie* nonetheless approved the judgments in *Saincic* to the effect that although causation as it is understood as a requirement for delictual liability is not required for liability under s 424, a causal link is somehow required as in the example given by Harms JA in that case in his separate concurring judgment. Harms JA suggested that where the reckless or fraudulent conduct occurs at a time when company A owes a debt to B, which does not affect A's solvency at the time, but subsequently A incurs a debt to C when the affairs of A are being properly conducted, and A, for some reason, cannot then pay its debt, C would not be able to rely on s 424. The example, he said, illustrated that there must be some causation in order to found liability under s 424.

[27] However, the passage does not suggest that there must be a causal link between the improper conduct and the inability of the company to pay its debt. It seems to me to hold no more than that there must be some link or connection *in time* between the conduct complained of and the company's inability to pay. Brand JA went on to say, in *Fourie,*[7] that *Saincic* recognized 'an exception to this general principle where the converse had been positively established, namely that there was plainly no causal connection between the relevant conduct and the debt', as in the example given by Harms JA. But, he said, even if the company's

[6] *Fourie v Firstrand Bank Ltd* 2013 (1) SA 204 (SCA) paras 27, 28 and 29.
[7] Para 31.

financial downfall resulted from the behaviour of other parties, if that was facilitated by the reckless or fraudulent conduct of the defendant, the latter would be liable under s 424, as Fourie was held to be.

[28] Moreover, this court was careful to point out in *Fourie* that *L & P Plant Hire* had not changed the law. After citing the passage from Harms JA's judgment[8] Brand JA said[9] that *L & P Plant Hire* was not authority for the proposition that where a company is insolvent 'the plaintiff-creditor is required to establish a causal link between the fraudulent or reckless conduct relied upon and the company's inability to pay its debt. On the contrary, *L & P Plant Hire* was never intended to deviate from those decisions of this court . . . [such as *Howard* and *Philotex*] which expressly laid down the general principle that s 424 does not require proof of a causal link between the relevant conduct and the company's inability to pay the debt.'

Disregard of the corporate identity

[29] Another important consideration in determining whether conduct falls within the ambit of s 424 is the separate legal identity of a corporate entity. In dealing with a close corporation, Cameron JA said this in *Ebrahim v Airport Cold Storage (Pty) Ltd*:[10]

'It need hardly be added that the function of the statutory provision also shapes its application. Although juristic persons are recognised by the Bill of Rights – they may be bound by its provisions, and may even receive its benefits – it is an apposite truism that close corporations and companies are imbued with identity only by virtue of statute. In this sense their separate existence remains a figment of law, liable to be curtailed or withdrawn when the objects of their creation are abused or thwarted. The section retracts the fundamental attribute of corporate personality, namely separate legal existence, with its corollary of autonomous and independent liability for debts, when the level of mismanagement of the corporation's affairs exceeds the merely inept or incompetent and becomes heedlessly gross or

[8] Para 29 in *Saincic* quoted in para 27 of *Fourie*.
[9] Para 30.
[10] *Ebrahim v Airport Cold Storage (Pty) Ltd* 2008 (6) SA 585 (SCA) para 15, dealing with s 64(1) of the Close Corporations Act 69 of 1984. Footnotes are omitted.

dishonest. The provision in effect exacts a quid pro quo: for the benefit of immunity from liability for its debts, those running the corporation may not use its formal identity to incur obligations recklessly, grossly negligently or fraudulently. If they do, they risk being made personally liable.'

[30] In that case, a shelf close corporation was used in order to provide the delinquent member's (A) creditor (B) with a VAT number. B had for some time supplied A with 'comestibles' (poultry, fish and the like) through a different entity, C. A transferred the entire debt owed by C to B to the new close corporation. It received no consideration for taking over the debt. A regarded the transfer as a formality. Cameron JA found that A had 'no conception of, nor respect for, the fact that the CC was a distinct legal entity with a separate legal existence; that to sustain its separateness the law exacts compliances and formalities; and that it could not be used at will as the receptacle of another entity's accumulated debts'.[11] The section (64(1)) 'targets just such heedlessness of corporate autonomy and form', where the transfer of the debt showed reckless disregard for the solvency of the CC.[12] This court upheld the finding of Griesel J in the Western Cape High Court that the Ebrahims had used the corporate entities concerned to pursue their own interests, having 'scant regard' for the separate identities of the various corporate entities and thus acting recklessly. Various acts, Griesel J found, formed 'part of one composite complaint of abuse of the separate juristic personality' of the close corporation.[13]

[31] It is clear, then, that if the IDC can show (and of course it bears the burden of proof) on the probabilities that the Tsungs acted recklessly or fraudulently in conducting the business of Textiles, and that Textiles was unable to pay its debts, they would be liable to it under s 424. *Henochsberg on the Companies Act*[14] states that the carrying on of the business of a company recklessly means 'carrying it on by conduct which evinces a lack of any genuine concern for its prosperity'. A fortiori if one deliberately depletes the company's assets, or misuses its

[11] Para 17.
[12] See also *Fourie v Newton* [2011] 2 All SA 265 SCA.
[13] Para 4 of the SCA judgment.
[14] Edited by J A Kunst et al, service issue 33, 916(1), approved in *Ebrahim* para 18.

corporate form for one's own purposes, then that conduct will fall within the ambit of s 424. *Henochsberg* states also:[15]

'Ordinarily, if a company while carrying on its business incurs debts at a time when to the knowledge of its directors there is no reasonable prospect of the creditors' ever receiving payment, there is a carrying on of its business with intent to defraud those creditors.'

Textiles' inability to pay its debts

[32] I turn then to the question whether the Tsungs knew that Textiles could not pay its debts and knowingly concluded transactions that exacerbated its inability to meet its obligations. I have already said that by the end of 2003 Textiles had retrenched all but ten of its staff and was operating only a very small part of its former business. Indeed, Bobby said, in his affidavit in support of an application for the liquidation of Textiles, deposed to in July 2006, that Textiles in 2003 was unable to pay its debts, was dormant and not trading. When testifying he insisted that he did not know what 'dormant' meant: that the company had indeed been carrying on business. But the fact is that the reason for the attempts to conclude the debt-equity swap agreement was precisely because Textiles could not pay the IDC what it owed. And Campbell confirmed that by November 2003 only a handful of staff were still employed and there was limited production. The expert witnesses for the Tsungs and the IDC considered that the company was factually and commercially insolvent.

The fraudulent conduct of the Tsungs

[33] As indicated earlier the IDC and Findevco relied upon several transactions in which they alleged that the Tsungs had acted recklessly or fraudulently. I shall deal only with those in respect of which Davis J in the high court made findings.

[15] At 916(2) -916(3).

Payment of R10.372 million to Lio Ho

[34] I shall first discuss the payment into the Textiles bank account, and then the almost immediate transfer out to Lio Ho. I have already referred to the payment into the account of Textiles and the way in which it was reflected in the books. The assumption made by Maia, on which the IDC relied when it instituted action under s 424, was that the source of the payment to Textiles was Garments: that there had been a sale of property by a Tsung company, and that by paying into the account of Textiles the loan account of Garments to Textiles was extinguished (so it ceased to be a debtor and instead Textiles became Garments' debtor). But Bobby testified that the payment was made not by Garments to Textiles but by another entity. In fact, Robert's bank records reflect that he made the payment to Textiles from his personal account.The source of the funds, Bobby testified, was compensation for the expropriation of a golf course in the Eastern Cape. Since the owner of the golf course, Alexander Properties (Pty) Ltd (usually referred to as Xander Properties), had no bank account, and neither did Garments, it was channelled to Lio Ho through the Textiles account. On the Tsungs' argument that account was used as a 'conduit'.

[35] The fact of Xander Properties' ownership was not put to Maia when he was cross-examined. And his testimony that Campbell told him that he was instructed by the Tsungs to enter the transaction as a credit to Garments' account was not challenged. But there is no evidence of any particular loan by Textiles to Garments and the entries in the books of account of Textiles are not supported by any documentation. Bobby's evidence was of no help. He agreed that the payment was credited to Garments' loan account.

[36] The IDC argued that correspondence between Fourie and Bobby reflected that Bobby saw the transaction as one where Garments was repaying a loan to Textiles. In a memorandum to Bobby dated 12 February 2004, Fourie asked Bobby to respond to a number of queries, but in particular, for present purposes, to the comment that Textiles bank account was being used 'for the transfer of funds of "affiliated" companies overseas, with such

companies having no relation to Dynasty Textiles. The funds were channelled overseas utilising import documentation of Dynasty Textiles for exchange control purposes'. Bobby's response, written on 15 February 2004, was that:

'The affiliated companies repay the loan from Dynasty Textiles or lend to Dynasty Textiles to repay LIO HO. The net shareholder's loan has not changed. This has been common practice throughout the years between 1990 and 2003. The IDC is aware of all these types of transactions in the past and had not found them to be improper.'

[37] This showed, argued the IDC, that the payment into Textiles was regarded as repayment of a loan to Textiles, but because it was in excess of what was apparently owed to Textiles, Garments became a creditor and Textiles a debtor, thus reducing its ability to pay its debt to the IDC. It is, however, hard to see how this construction is supported by the evidence, given that there is nothing to tell us what Garments in fact owed Textiles, if anything, and given also that we do not know on what basis the funds had become those of Garments.

[38] The high court concluded that because of the payment of the funds into Textiles' account, the 'funds became the property of Dynasty Textiles', converting Garments to a creditor. Textiles' property was thus used to repay a shareholder's loan 'at the time when Dynasty Textiles was factually and commercially insolvent and in flagrant breach of contractual obligations, which defendants owed to plaintiffs in respect of payments for example, to Lio Ho'.

[39] I do not accept the finding that the R10.3 million became the property of Textiles (although technically the money was owned by the bank, which had a contractual obligation to pay Textiles if required to do so).[16] The indiciae are that the compensation for expropriation

[16] See in this regard *First National Bank of Southern Africa Ltd v Perry NO* 2001 (3) SA 960 (SCA), confirming what has long been trite.

was paid to Robert, who used the Textiles bank account as a conduit to send money to Lio Ho in Hong Kong. But that is not the end of the matter.

[40] The next question is whether the Tsungs fraudulently (or recklessly) used the document issued to Textiles in 1997, reflecting the sale of equipment by Lio Ho to Textiles, and in respect of which exchange control approval for payment was granted. Clearly the payment was made contrary to the instruction of Fourie to which I have referred.

[41] Much was made in argument before us of the misuse of the invoice from Lio Ho issued in 1996 for equipment that had been sold to Findevco. The invoice was issued by Lio Ho to Textiles on 30 November 1996. It was in respect of machinery, the price being $7 844 million. Treasury approval for payment was given in May 1997. When Campbell, acting for Textiles and on the instructions of the Tsungs, remitted R10.3 million to Lio Ho in Hong Kong in December 2003, this elderly invoice with its foreign exchange approval was used to facilitate that payment. The invoice was stamped by 'FNB Forex' on 2 January 2004.

[42] When Maia discovered this he consulted the IDC's attorney, Mr David Anderson, about potential liability for exchange control contravention. Maia informed Anderson that the payment into Textiles' bank account was repayment of a loan by Garments. The advice sought was whether IDC had an obligation to disclose to the Reserve Bank that the payment to Lio Ho was 'ostensibly' made in relation to exchange control approval granted for imports in 1997. Anderson advised that the regulations did not require a creditor to advise the Reserve Bank of a contravention by a debtor. He said in an email following a consultation that:

'Textiles obtained exchange control approval for the repayment of the debt owing by Textiles to Lio Ho in relation to the Imports. Any payment made by Textiles in December 2003 to Lio as repayment of the Imports is legitimate and not contrary to the Regulations. The fact that the funds were raised by means of a loan from Garments . . . is generally not problematic . . . .'

[43] Reliance on this advice by the Tsungs, in arguing that the IDC's attorney had considered the transaction as one that was not in contravention of exchange control regulations, is misplaced. The opinion was based on the information that Garments had repaid a loan to Textiles, which the Tsungs now argue was not the case. If the Tsungs' argument that the Textiles bank account was used as a conduit is correct, then clearly there was a misuse of authority given to Textiles some years previously. Indeed, Bobby stated that when the IDC advanced funding to Textiles it was advised that there would be 'channelling through Dynasty Textiles and its invoices through the approved exchange controlled invoices back into Lio Ho International over to overseas'.

[44] The gravamen of Bobby's evidence in this regard was that IDC was not deceived. Fourie knew that money was channelled 'in and out, sometimes not for the purpose of Dynasty Textiles'. When cross-examined he said that 'I knew the money that did not belong to Dynasty Textiles was being put into Dynasty Textiles and will eventually exit via Dynasty Textiles. I was aware of that, yes.' He conceded also that the payment to Lio Ho in December 2003 in reliance on the 1996 invoice and 1997 Treasury approval actually had nothing to do with Textiles itself. He testified that the process, and previous use of the account as a channel, had been approved by the company auditors. But he could not name the auditor who had given such approval and it is improbable that any auditor would have sanctioned the misuse of exchange control approvals in this way.

[45] In my view the Textiles account was indeed used as a conduit: but in making use of the account in that way the Tsungs were, at the least, recklessly carrying on the business of the company by using its bank account as a channel for payments and making false entries in the books of account. More significantly they were dishonestly using foreign exchange approval given to Textiles in remitting funds, unrelated in any way to Textiles, to Lio Ho. They were deliberately using documents of Textiles for a purpose that was not intended. While Textiles

may not have suffered any actual loss as a result of this transaction (no causal connection is required), it in fact could not pay its debts in December 2003 and the Tsungs knew this full well.

[46] The payment to Lio Ho did not cause the company to fail. But at a time when it had failed they falsely used an invoice provided to Textiles, and Treasury approval given to Textiles, to remit what was, on their version, Robert's money to Lio Ho. They put Textiles at risk of prosecution. In my view, their conduct showed not just a reckless, but a deliberate, disregard for the prosperity of Textiles. The Tsungs treated Textiles' bank account as their own, ignoring the corporate entity and making themselves vulnerable to having the benefit of immunity from its liabilities removed. The statements from Cameron JA's judgment in *Ebrahim* cited above are particularly apposite here.

[47] I consider that the Tsungs used a Textiles document and bank account for a fraudulent purpose and brought themselves within the ambit of s 424. The inference is inescapable that they were using the Textiles account as a conduit – part of their strategy to get money (in this case, on their version, compensation for the expropriation of a golf course) out of the country falsely using Textiles' invoice for plant and equipment bought from Lio Ho. I shall return to this conclusion after examining the other transactions for they all show a pattern of conduct.

The Bank of Taiwan repayments

[48] One of the matters on which Maia reported in February 2004 was the payment by Textiles to the Bank of Taiwan of some R3 million over the period from 3 to 17 December 2003. At the time Textiles' account with FNB was overdrawn. The payments were made into Bobby's account with the Bank of Taiwan, and had the effect of reducing the overdraft in that account from R4 million to R1 million, that is, by R3 million. The reason advanced by Bobby for the payment was so that combing machines in the Atlantis factory could be released from the

security held by the Bank of Taiwan over the machines in order to facilitate the debt-equity swap. However, when Textiles purchased the combing machines they had been specifically excluded from the embrace of the general notarial bond in favour of Findevco or the Bank of Taiwan would not have agreed to advance funds to Textiles.

[49] Fourie of the IDC did not know of the payments made in December 2003, and had in fact prohibited payments to the shareholders and directors of Textiles on 17 December 2003, as has been discussed. Indeed a year before then, on 13 November 2002, Fourie had written to Bobby saying that during 'a period that a company is facing financial difficulty and especially when a company is not able to honour its commitments to its lenders one would expect the company's shareholders to inject additional funding and to restrict their withdrawals and therefore not to repay shareholders' loans before honouring commitments to its lenders'.

[50] Indeed it was a term of the suspensive sale agreement that Textiles would not repay any shareholders' loans or make payments to its directors without the written consent of Findevco. However, the prohibitions were subject to thresholds and it was not proved that those threshholds were reached. So it is not entirely clear that these payments were made in breach of contract.

[51] However, the effect of these payments was to reduce Bobby's liability to the Bank of Taiwan and to reduce the assets of Textiles. The payments were made when the Tsungs knew that Textiles was insolvent and when both were planning to leave South Africa. The Tsungs also knew that the payments were made contrary to Fourie's instruction. While Bobby testified that Fourie had known about these payments, this is contrary to the written comment of Fourie and to his instruction, and it was never put to him that he had known of, let alone authorized, these payments. Again, the inference is inescapable that the Tsungs deliberately diminished Textiles' ability to repay its debts, thus bringing their conduct within the ambit of s 424. It is no

defence to say, as counsel for the Tsungs did, that the payments were made to a legitimate creditor of Textiles and that they were thus neutral. The payments had the effect of reducing the Tsungs' personal liability, and aggravating Textiles' inability to pay its creditors.

[52] While I accept that the preference of one creditor over another does not in itself amount to reckless or fraudulent carrying on of a business, I consider that this conduct, examined in context, and coloured by the exit strategy, was a deliberate means of reducing the Tsungs' personal liability at the expense of Textiles' creditors.

Payment of the Tsungs' personal expenses

[53] Garments did not have a bank account. But it did have a Diners Club credit card. Textiles paid the credit card account. The Tsungs paid for their very lavish lifestyle on the Diners Card. The statements from the bank reflect vast sums spent on clothing, golf courses and restaurants, among other things. None of this is disputed. Nor is it disputed that in 2003, the year of Bobby's departure from South Africa, he bought a new vehicle in Australia, paid emigration consultants and a furniture removal company and bought air tickets for himself and his family to leave for Australia, all on the Diners Club card.

[54] The Tsungs contended that since the inception of Textiles their expenses had been paid in this way: it was in lieu of payment as directors, had been sanctioned by their auditor, and was in the normal course set off against their shareholders' loans at the end of every financial year. Campbell said that this was the procedure followed, and that the IDC conducted internal audits. He testified that there was a clause in the IDC agreements that limited what the Tsungs 'could draw out' each year.

[55] It would have been apparent from a glance at the Diners Club statements that the card was used for personal purposes, given the nature of the expenditure. Thus the IDC must have sanctioned payment by Textiles of the account, it was argued. Moreover, the contention went, the amounts were nominal. However, the total expenditure on what were clearly lifestyle expenses in 2003 exceeded R1 million. In addition, school fees for one of Bobby's children had been paid out of the Textiles account.

[56] Moreover, Lio Ho had ceded (in February 1997) to the IDC, as security for the performance of its obligations under the suspensive sale agreement, its right to all amounts standing to the credit of its loan account in Textiles. And Bobby could not say which auditor had sanctioned such book entries. Although the practice may have been to debit the shareholder's loan account at the end of each financial year to offset these personal expenses, in fact for the 2003 year no such transaction was effected. Textiles' insolvency was exacerbated.

[57] As argued by the IDC, payment by a company of a director's personal costs is a breach of a fiduciary duty, and is unlawful. In *S v De Jager*[17] this court held that De Jager was guilty of theft because he had paid personal expenses from a company's account. The defence that his conduct was justified because his loan account was in credit was rejected on the facts. In that case too the director charged with theft argued that his conduct was not unlawful because the company's shareholders (of whom he was one) had agreed that the company's funds be used to pay his debts. Holmes JA held that this contention could not succeed: it entailed the consequence that a shareholder could agree to the company being 'despoiled' by a director, and offended also against the basic principle of limited liability.

[17] *S v De Jager* 1965 (2) SA 616 (A) at 624H-625A.

[58] Counsel for the Tsungs argued that *De Jager* is distinguishable because there the accused's loan account was not in credit. I see no distinction. And even if the Tsungs' conduct in this regard did not amount to theft (on which I make no finding) it certainly amounted to the dishonest use of Textiles' funds at a time when Textiles was unable to pay its debts – not only to the IDC but to other creditors as well. This conduct too falls within the ambit of s 424.

The exit strategy

[59] I have found that each of the three transactions or courses of conduct which the high court considered gave rise to s 424 liability was in itself sufficient to warrant that the Tsungs be held liable under the section. It is important, however, additionally to place their conduct in context to show that they did not intend to rescue Textiles by concluding the debt-equity swap: they knew that the equity would be substantially diminished when they left the country. They deceived the IDC.

[60] I have already referred to Maia's description of their conduct as an 'exit strategy'. He said in evidence that while the Tsungs had appeared to be working with the IDC to conclude the debt-equity swap agreement, such that the IDC (Findevco) would acquire 80 per cent of Textiles, they had at the same time planned their emigration, and to take with them as much money from Textiles as they could. The IDC had negotiated in good faith, assuming that the Tsungs also wished to save Textiles, when in fact they were 'doing exactly the opposite'.

[61] In his affidavit in support of an application to attach the Tsungs' property in 2004, Maia referred to Bobby's admission to him early in December 2003 that he was emigrating to Australia. Robert told him in January 2004 that he too was leaving, going to Hong Kong. During the course of 2003 Bobby had (with the Garments Diners Club credit card) paid for flights to and from Australia, paid school fees in Australia, bought a car, paid emigration consultants, and the furniture removal company. Indeed it is probable that he had planned the

move in the previous year: the Diners Club statements for 2002 reflected payments for flights and expenses in Australia. And in evidence Bobby acknowledged that he had bought a house in Australia in 2002.

[62] In the face of all this, Bobby maintained when testifying that he made the decision to emigrate only in December 2003. He waited, he said, until the debt-equity swap was finalized and only then did he decide to leave. His evidence was rightly disbelieved by Davis J.

[63] The Tsungs did not advise the IDC of their intention to leave South Africa while they negotiated the transfer of their equity to it. Despite meetings with IDC staff and Fourie in the course of the year they made no mention of their plan. Only in December 2003, when transactions that fell foul of s 424 had already been concluded, did Bobby advise the IDC that he was going. And after he went Robert paid the R10.3 million into Textiles and Campbell was instructed to pay that sum to Lio Ho, using an old invoice and old Treasury approval to remit the funds.

[64] If one has regard to these facts it is plain that the payments made to Lio Ho, to the Bank of Taiwan and in respect of the Tsungs' personal expenses, were for their personal gain and not for the benefit of Textiles or its creditors. They deliberately eviscerated the company. They used the corporate shell not for its prosperity but to recover their personal investment.

[65] As I have said, when instituting action and running the trial the IDC relied on several additional acts to show that the Tsungs should be held personally liable for Textiles' debt. I have dealt with only three, as did Davis J in the high court. In view of the conclusion to which I have come, I consider that there is no need to consider the other conduct.

Costs of postponement

[66] At the end of the trial the Tsungs asked for the costs of a postponement requested by the IDC and Findevco. The parties had agreed that the question of those costs would stand over for determination when judgment was given. But the high court made no mention of these costs 'seemingly per incuriam', according to counsel for the Tsungs. The reason for the postponement was that the IDC and Findevco made discovery of an additional 600 pages of documents shortly before the trial was due to commence. They had also filed an expert report out of time. The Tsungs required time to consider the documents and report. They argued that the wasted costs occasioned by the postponement should be borne by the IDC and Findevco.

[67] The response of the IDC and Findevco is that the documents and the report related to the extent of the liability, and had become irrelevant once the parties had agreed on quantum. The report was itself a response to the Tsungs' expert's report, and the late filing had caused no prejudice. I consider that the claim for wasted costs is accordingly not founded.

Order

[68] In the result, the appeal is dismissed with costs including those of two counsel.

C H Lewis

Judge of Appeal

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