# THE CONCEPT OF SEPARATE LEGAL PERSONALITY IN COMPANY LAW AND ITS IMPACT ON THE GOVERNANCE OF COMPANY GROUPS

*by*

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DECLARATION OF ORIGINALITY

I, the undersigned, **2630269** declare that this Research Report is my own unaided work. It is submitted in partial fulfilment of the requirements for the degree of Master of Laws (by Coursework and Research Report) at the University of the Witwatersrand, Johannesburg. It has not been submitted before any degree or examination in this or any other university.

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ABSTRACT

This research focuses on the concept of separate legal personality as it applies to company groups. This research analyses the phenomenon that the separate legal personality of subsidiaries within these company groups enables them to act in breach of good corporate governance norms. This is due to the fact that accountability may be avoided by the holding company in a group through the practice of 'judgement proofing.' This research proposes that a more progressive consideration of the remedy of piercing the corporate veil as well as finding alternatives to veil piercing can be used to ensure that the entity theory does not enable corporate malfeasance (as seen in the case of *Milieudefensie vs Shell Petroleum Development Company of Nigeria Limited*). It is argued that this will promote better corporate governance within company groups.

# I INTRODUCTION

In company law, separate legal personality is a concept that provides that a company is a legal entity, separate from its owners, shareholders and/or directors (broadly, its controllers).[1] The effect of separate legal personality is that the rights and liabilities of the company are separate from the rights and liabilities of its controllers ("the entity theory").[2] This is a concept which has its foundations in the common law[3] and is now entrenched in South African legislation through the Companies Act, 71 of 2008 ("Companies Act").[4]

The effect of the entity theory is that when the company owns assets, sues or is sued and/or enters into contracts, it does so independently from its controllers, who enjoy limited liability.[5] The entity theory, however, poses a number of challenges;[6] it draws a metaphorical veil between the company and its controllers.[7] This opens the door to the possibility that the controllers of a company may avoid liability for the unlawful acts of the company ("corporate misconduct").[8]

Corporate misconduct is a challenge that is more pronounced in company groups.[9] A company group refers to two or more companies that structure their operations using a model based on a holding company and subsidiary company relationship.[10] The company group is recognized in the Companies Act.[11] Section 1 sets out the definition of a *"group of companies"* to be *"a holding company and all of its subsidiaries."*[12] The entity theory applies to company groups.[13] As with the controller of a single company and in light of the

[1] Nicholas James 'Separate Legal Personality; Legal Reality and Metaphor' (1993) 5(2) *Bond Law Review* at 218.
[2] Ibid.
[3] Ibid.
[4] The Companies Act 71 of 2008, s20(9).
[5] James op cit note 1 at 218.
[6] Ibid at 221.
[7] Farouk Cassim, Maleka Cassim, Rehana Cassim et al *Contemporary Company Law* 2 ed (2021) 41. See also James op cit note 1 at 217.
[8] *Airport Cold Storage (Pty) Ltd v Ebrahim & others* 2008 (2) SA 303 (C). See also Cassim et al op cit note 7 at 59. These wrongful acts includes the company conducting itself without keeping proper accounting records, engaging in a form of reckless trading or with no regard to the separate legal personality which exists between a company and its controllers. See also James op cit note 1 at 220. See also Deeksha Bhana 'Should the doctrines of the 'undisclosed principal' or 'piercing the corporate veil' determine the locus standi of a party to sue in terms of a contract? The conundrum of Botha v Giyose t/a Paragon Fisheries' (2010) 5 *South African Law Journal* at 17.
[9] Cassim et al op cit note 7 at 196.
[10] Ibid at 194. See also Martin Petrin and Barnali Choudhury 'Group Company Liability' (2018) 19 *European Business Organization Law Review* at 773.
[11] The Companies Act, s1.
[12] The Companies Act, s1.
[13] Cassim et al op cit note 7 at 196. See also Dario Milo 'The liability of a holding company for the debts of its subsidiary: Is Salomon still alive and well?' (1998) *SALJ* at 318-345.

entity theory, a holding company (being the controller in a company group) can avoid liability for the corporate misconduct of its subsidiaries.[14]

Linked to this is the potential for the entity theory to have a negative consequence in the form of poor corporate governance and reduced accountability within the company group structure.[15] The King IV Report on Corporate Governance in South Africa defines corporate governance as *"the exercise of ethical and effective leadership by the governing body [of the Company] towards the achievement of […] ethical culture, good performance, effective control and legitimacy."*[16] It is essential for the success of company groups to ensure that they adhere to good corporate governance because of the reduced accountability that stems from the impact the entity theory may have on/within company group structures. The judgment in *Milieudefensie vs Shell Petroleum Development Company of Nigeria Limited* ("*Milieudefensie*"),[17] will be considered to illustrate how the entity theory within a company group can result in failures of corporate governance.[18] Although this case was not a South African case, it is instructive in that *Milieudefensie* presents a scenario of how corporate accountability may be avoided by a holding company in a group structure through the practice of 'judgement proofing.'[19] For this research report, judgment proofing refers to the manner in which a company group exploits their limited liability by creating a judgment proof company group structure.[20] Judgment proofing would allow a company group to curtail risk of loss by removing its revenue and assets from a risk-exposed subsidiary company, and moving these to a holding company.[21]

To the extent that a company's controllers abuse their limited liability, our law recognizes the remedy known as piercing the corporate veil ("veil piercing").[22] Veil piercing allows a court to 'see through' the separation between the controllers of the company and the company itself in order to hold the controllers directly liable for corporate misconduct.[23]

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[14] Ibid at 59.
[15] To be discussed under section III.
[16] Institute of Directors Southern Africa 'King IV Report on Corporate Governance for South Africa' Web version (2016), available at *https://cdn.ymaws.com/www.iodsa.co.za/resource/collection/684B68A7-B768-465C-8214-E3A007F15A5A/IoDSA_King_IV_Report_-_WebVersion.pdf* on 25 March 2023 at 11. See also Cassim et al op cit note 7 at 476.
[17] 29 Jan. 2021, ECLI:NL:GHDHA:2021:1825.
[18] To be discussed under section III.
[19] To be discussed under section III.
[20] Phillip Morgan 'Vicarious Liability for Group Companies: the Final Frontier of Vicarious Liability?' (2015) 31 *Professional Negligence* at 280-282. See also Lynn LoPucki "The essential structure of judgment proofing" (1998) 51 *Stanford Law Review* 147 at 151.
[21] Ibid.
[22] The Companies Act, s20(9).
[23] Petrin and Choudhury op cit note 10 at 774. See also the Companies Act, s20(9).

Similarly, in company groups, veil piercing allows courts to see through the separation between the separate companies within the group structure in order to hold the holding company directly liable for the corporate misconduct of its subsidiaries.[24]

This research report argues that the ability of a holding company to avoid liability for the conduct of its subsidiaries can enable and even promote poor corporate governance; it is essential to have greater accountability within group structures in order to hold holding companies liable for the corporate misconduct of their subsidiaries. This is complex as the separate legal identity of each individual company and limited liability is a cornerstone of South African company law and is entrenched in case law.[25] The separate legal identity of the company must be safeguarded as it is the key to entrepreneurial activity as it deflects the risk of the undertaking and encourages innovation. [26] The idea behind the entity theory is to afford protection to business owners, giving them the necessary confidence to conduct business, make decisions and take commercial risks.[27] These factors are necessary for a functional economy.[28]

The key question in this research report is to explore whether a flexible policy around veil piercing can be used as a mechanism to promote better governance within a company group. A specific construction known as equitable veil piercing is proposed as a way to achieve this.[29] The findings in *Milieudefensie,* where a court pierced the corporate veil between companies in a company group to hold the holding company liable for the corporate misconduct of the subsidiary in that case, lends support to this proposition[30] This resulted in the company implementing a mechanism to prevent the corporate misconduct in future, a positive example of the proposed equitable veil piercing construction[31] This research report argues that the court in *Milieudefensie* implicitly used the equitable veil piercing construction, even though it did not identify it as such.[32]

This research report is not intended to be a full and complete assessment of how each corporate governance issue within a company group can be remedied. Instead, this research

[24] Dennis Davis, Walter Geach, Tshepo Mongalo et al *Companies and other Business Structures* 4 ed (2019) 74.
[25] Ibid at 194.
[26] Cassim et al op cit note 7 at 43. Separate legal personality is also susceptible to abuse by company controllers who may avoid any form of accountability for their actions where they abuse the company's separate legal personality.
[27] Ibid. See also *Salomon v A Salomon and Co Ltd* [1897] AC at 52.
[28] Ibid.
[29] Peter Oh 'Veil-Piercing Unbound' (2013) 93 *Boston University Law Review* at 90.
[30] *Milieudefensie* supra note 17 para 3.26.
[31] Ibid.
[32] To be discussed under section III.

report has a narrow focus: It considers the impact of the entity theory on the governance of company groups and investigate whether a more progressive construction of veil piercing within company groups has the ability to encourage better corporate governance. The ancillary questions that are considered in support of this argument include: the development of the entity theory in South Africa; the negative consequences of the entity theory in company groups from the perspective of corporate governance; the manner in which veil piercing can encourage better corporate governance in company groups; and whether a more flexible judicial policy regarding veil piercing by South African courts encourages better corporate governance. I now turn to deal with the development of the entity theory in South Africa.

## II THE DEVELOPMENT OF THE ENTITY THEORY IN SOUTH AFRICA

Company controllers need the confidence to conduct their business, make decisions and take commercial risks – the entity theory gives them this confidence and protection.[33] This informs the underlying historical foundations of the entity theory, which will be elaborated below.

### *(a) Historical foundations of the entity theory*

Limited legal liability, which flows from the entity theory, seeks to protect company owners from the unlimited legal risks associated with carrying out a business. [34] Great personal risk would be a disincentive for robust and active participation in the economy by individuals; such risks were heightened during seismic economic events such as the Great Depression.[35] It is therefore not surprising that limited liability had its genesis then. As a result, a Royal Commission was established in the United Kingdom in 1885 to investigate the Great Depression and its ensuing consequences on businesses at that point in time.[36] The Royal Commission uncovered that the slumps in business activity were as a result of poor profits, which in turn caused the Great Depression.[37] Accordingly, the Royal Commission adopted greater acceptance of limited liability as "*an appropriate legal organizational form for firms*

[33] Cassim et al op cit note 7 at 43. Separate legal personality is also susceptible to abuse by company controllers who may avoid any form of accountability for their actions where they abuse the company's separate legal personality.
[34] Paddy Ireland 'The Rise of the Limited Liability Company' (1984) at 247-249.
[35] Ibid.
[36] Ibid at 249.
[37] Ibid.

*of all economic types."*[38] From this, the Joint Stock Companies Act of 1856 was enacted to include the now common company legal form.[39] This saw heightened economic participation by entrepreneurs who now had an incentive to go into business and form a company – which has the benefit of promoting economic development – while still minimizing the risks and losses to the company controllers.[40] It is clear that limited liability is a cornerstone in English Law: this is important for South Africa as English Law is the foundation of its common law.[41]

The leading common law case of *Salomon v A Salomon and Co Ltd* ("*Salomon*")[42] is frequently relied on as authority for the foundations of the entity theory.[43] One of the most notable remarks in the *Salomon* judgment is that:

> *'The company is at law a different person altogether from the subscribers to its memorandum; and though it may be that, after incorporation, the business is precisely the same as it was before, and the same persons are managers, and the same hands receive the profits, the company is not in law the agent of the subscribers or a trustee for them."*[44] (Own emphasis).

In South Africa, the case of *Dadoo Limited and Others v Krugersdorp Municipal Council* ("*Dadoo*")[45] confirmed that a registered company's legal personality is distinct from the members who own or control it.[46] *Dadoo* further noted that "*[t]his conception of the existence of a company as a separate entity distinct from its shareholders is no merely*

[38] Ibid.
[39] Ibid at 241.
[40] Ibid at 249.
[41] Oliver Schreiner *The Contribution of English Law to South African Law; and the Rule of Law in South Africa* (1967) at 5-9.
[42] *Salomon* supra note 27. *Salomon* confirms that that a company is duly incorporated with liabilities and rights which are independent from the liabilities and rights of its owners or controllers. The case of *Salomon* saw Aron Salomon who was a merchant of leather convert his existing business into the limited company form offered by the Joint Stock Companies Act of 1856 and allotted a certain number of shares to each of his four sons. At no point was anyone else ever intended to form part of the company, however. As a result of the economic slump in early 1893, Salomon proceeded to take out a loan on behalf of the company, and when the company defaulted on the repayment of the loan (which default arose from a default of the repayment of the interest on the debentures which stood security for this loan), the creditor sought payment of the full principal amount owing along with the compulsory winding up of Salomon's company. See also Cassim et al op cit note 7 at 33.
[43] Cassim et al op cit note 7 at 33. See also Mary Arden 'Piercing the Corporate Veil – Old Metaphor, Modern Practice?' (2017) 3 *Journal of Corporate and Commercial Law & Practice* at 3-7.
[44] *Salomon* supra note 27 at 51.
[45] 1920 AD 530. See also *Gumede v Bandhla Vukani Bakithi Ltd* 1950 (4) SA 560 (N) which confirmed and applied the findings in *Dadoo.*
[46] *Dadoo* supra note 45 at 550-1. See also Cassim et al op cit note 7 at 37.

*artificial and technical thing. It is a matter of substance […]"*[47] The entity theory has since been incorporated into the Companies Act, more specifically in section 19, where subsection 1 provides that:

> *'[…] From the date and time that the incorporation of a company is registered, as stated in its registration certificate, the company –*
>
> *(a) is a juristic person, which exists continuously until its name is removed from the companies register in accordance with this Act;*
>
> *(b) has all of the legal powers and capacity of an individual, except to the extent that—*
>
> > *(i) a juristic person is incapable of exercising any such power, or having any such capacity; or*
> > *(ii) the company's Memorandum of Incorporation provides otherwise; […]'*[48]

In addition, subsection (2) provides that:

> *'[…] A person is not, solely by reason of being an incorporator, shareholder or director of a company, liable for any liabilities or obligations of the company, except to the extent that this Act or the company's Memorandum of Incorporation provides otherwise.'*

Yet, even at its inception, the possibility of the abuse of this legal fiction was anticipated as the court in *Salomon* noted that the entity theory can be abused.[49] The court in *Salomon* even suggested that certain checks be put in place to ensure that abuse does not occur therefore

[47] Ibid. The factual background of *Dadoo* involves one Mr Dadoo who established his own company with share capital in the amount of 150 shares. The shares were owned by Mr Dadoo and Mr Dindar who were both considered coloured persons for purposes of South Africa's former apartheid regime. Under the regime, coloured persons were prohibited from owning or acquiring immovable property. Notwithstanding, the company, Dadoo Limited, purchased a property, in terms of which Dadoo was a tenant. The issue that the court was required to answer was whether the fact that the property was owned by the company resulted in said ownership being imputed to Mr Dadoo and Mr Dindar as the company owners, in contravention of the prevailing law of the regime. The court held that a registered company's legal personality is distinct from the members who own or control it. With that said, the court further ruled that a transaction is fraudulent if it has been crafted in a manner to avoid compliance with law – thus piercing the corporate veil between Mr Dadoo and Mr Dindar on one end and Dadoo Limited on the other. What was further noted at page 550 of the *Dadoo* judgment was that *"[…] Cases may arise concerning the existence or attributes which in the nature of things cannot be associated with a purely legal persona. And then it may be necessary to look behind the company and to pay regard to the personality of the shareholders, who compose it."*

[48] The Companies Act, s19(1)(a)-(b).

[49] *Salomon* supra note 27 at 47.

showing that it was foreseen that abuse of the company's separate legal personality could occur and would not be preserved in those circumstances.[50] While a more detailed discussion around the potential for abuse of the entity will be discussed below,[51] it is important to first consider how the entity theory applies to company groups.

*(b) Separate legal personality in company groups*

Company groups emerged almost by 'historical accident', where companies were authorized to acquire and own shares in other companies because of the entity theory but the emergence of the powerful multi-national corporations and the consequences thereof were unanticipated.[52] Company groups have seen accelerated growth and now operate across different jurisdictions.[53] Company groups are recognized in section 1 of the Companies Act as being a holding company and its subsidiaries,[54] a holding company in relation to a subsidiary refers to a juristic person that controls that subsidiary.[55] While this research does not focus on the economic rationale behind why and how a company group structures itself, it is worth noting that the entity theory has in many ways promoted the growth and development of the global economy.[56] A group allows a company to be a diverse and multifaceted business, providing different services through a single entity.[57] Due to the entity theory,[58] a holding company is not usually liable for the corporate misconduct of its subsidiaries.[59]

The entity theory can result in negative consequences for parties affected by the corporate misconduct of a company group because holding companies are able to avoid liability for the actions of their subsidiaries.[60] This links to the fact that company groups have garnered a tremendous amount of economic power that sometimes supersedes that of

[50] Ibid.
[51] To be discussed under section III.
[52] Phillip Blumberg 'Limited Liability and Corporate Groups' (1986) 28 *University of Connecticut School of Law Faculty Articles and Papers* at 605. See also Beth Stephens 'The Amorality of Profit: Transnational Corporations and Human Rights' (2002) 45 *Berkley Journal of International Law* at 56. Blumberg notes that company groups rose to prominence in the state of New Jersey in the United States of America ("USA") in 1889. This was as a result of limited liability being firmly entrenched in the USA legal system.
[53] Stephens op cit note 52 at 56.
[54] The Companies Act, s1.
[55] Davis et al op cit note 24 at 73. See also the Companies Act, s2(2)(a). See also the Companies Act, s3(1)(a).
[56] Petrin and Choudhury op cit note 10 at 780.
[57] Ibid.
[58] Ibid at 74. See also Petrin and Choudhury op cit note 10 at 772.
[59] Ibid. See also Petrin and Choudhury op cit note 10 at 772.
[60] Petrin and Choudhury op cit note 10 at 774. See also *Van Zyl v Kaye* 2014 (4) SA 452.

an actual country.[61] This makes the regulation of company groups all the more difficult, which increases the chances of abuse that in turn results in company groups failing to uphold good corporate governance.[62] To safeguard against this abuse, it is important to create a balance between the function of the entity theory in promoting economic development and the rights of those potentially harmed by this.[63] Accordingly, a court can disregard a company's separate legal personality through veil piercing.[64] This will be discussed along with the negative consequences of separate legal personality in company groups below with reference to *Milieudefensie*.[65]

## III *MILIEUDEFENSIE* AND THE NEGATIVE CONSEQUENCES OF SEPARATE LEGAL PERSONALITY IN COMPANY GROUPS

The Hague Appeal Court handed down a historic judgment in *Milieudefensie*.[66] This judgment is a recent example of how a holding company was held responsible for the corporate misconduct of its subsidiary.[67] It also provides insight into how the court navigated the entity theory within a company group.[68] *Milieudefensie* is relevant to South Africa in that section 5 of the Companies Act encourages courts to interpret the Companies Act by

[61] Stephens op cit note 52 at 56.
[62] Ibid at 56-59.
[63] Ibid at 90.
[64] Helena Stoop 'Lifting or Piercing the Corporate Veil' in *The Law of South Africa* (2022). See also the Companies Act, s20(9). See also the other mechanisms that are external to the company group's corporate governance structure which also have the effect of holding the directors/controllers of the company liable. These mechanisms are split into two broad categories, i.e. director duties and statutory disclosure regimes. Firstly, and in dealing with director duties, these are enshrined in section 76 of the Companies Act and broadly requires that the directors of a company act in good faith; with a proper purpose; in the company's best interests; and with the required degree of skill, care and diligence. Secondly, and in dealing with statutory disclosures, two pieces of legislation are discussed in this regard: the first is the Prevention and Combatting of Corrupt Activities Act 12 of 2004 ("PRECCA"), where section 34 obliges a person in a position of authority within the company group to report offences to the Directorate for Priority Crime Investigation which are in excess of R100 000-00. The second is the Promotion of Access to Information Act 2 of 2000 ("PAIA"), where a requestor can request a company group's information (as a private body) if the information is needed to exercise a right; to the extent that the company group does not have its affairs in order, not only do they have the potential to cause harm, they might also be the subject of a PAIA request where such company's business information will need to be produced.
[65] To be discussed under section III.
[66] *Milieudefensie* supra note 17.
[67] Chiara Macchi and Josephine van Zaben 'Business and human rights implications of climate change litigation: Milieudefensie et al. v Royal Dutch Shell' (2021) *Review of European, Comparative & International Environmental Law* at 414.
[68] Ibid at 412.

considering foreign company law. [69] Additionally, the issues are similar to the questions being grappled with in South Africa.[70]

There were three main parties in this case.[71] The first were Nigerian farmers and a Dutch environmental interest group called Milieudefensie ("the Plaintiffs").[72] The second was Royal Dutch Shell in the Netherlands ("Shell Netherlands"), the first defendant.[73] The third was the Shell Petroleum Development Company of Nigeria Limited ("Shell Nigeria"), the second defendant.[74] Shell Nigeria is a subsidiary of Shell Netherlands, and both form part of an international and multi-jurisdictional company group in the energy, oil and petroleum sector.[75] The Plaintiffs brought an action against Shell Nigeria and Shell Netherlands for damages resulting from an oil spill that occurred in Nigeria, contaminating the land, livelihood and water of the Plaintiffs.[76] The Plaintiffs argued that Shell Nigeria was negligent as they failed to properly maintain and service their oil pipeline infrastructure, resulting in the oil spill.[77] The Plaintiffs also sought to hold Shell Netherlands liable on the basis that it failed to properly oversee Shell Nigeria's operations.[78] The essence of the Plaintiffs' claim rested on how Shell Netherlands applied its group corporate governance policy in a way that damaged the climate, environment and mankind.[79]

The court had to determine whether Shell Netherlands was liable for the conduct of its subsidiary, Shell Nigeria.[80] The court applied the remedy of veil piercing and held that Shell Netherlands owed a duty of care to the Plaintiffs.[81] The court held that the claims against Shell Netherlands are not derived from *direct veil piercing*, which provides that the separate legal personality between a subsidiary company and its holding company is pierced; but rather, *indirect veil piercing* derived from the duty of care in which a holding company is liable for the acts or omissions of its subsidiary against third parties.[82] Put differently, veil

[69] The Companies Act, s5(2). See also the Companies Act, s7(a) which requires the Companies Act to be interpreted in line with the bill of rights. See also the Constitution of the Republic of South Africa, 1996, s39(1)(c) and s39(2) which provide, *inter alia*, that in interpreting the bill of rights, a court may consider foreign law. See also Manson Gwanyanya 'The South African Companies Act and the Realisation of Corporate Human Rights Responsibilities' (2015) 18 *Potchefstroom Electronic Law Journal* at 3107-3109.
[70] See discussion on South African case law under section IV below.
[71] *Milieudefensie* supra note 17 par 1.1a.
[72] Ibid.
[73] Ibid
[74] Ibid.
[75] Ibid. See also Macchi and van Zaben op cit note 67 at 410.
[76] *Milieudefensie* supra note 17 par 2.1.
[77] Ibid.
[78] Ibid par 3.26.
[79] Macchi and van Zaben op cit note 67 at 410.
[80] *Milieudefensie* supra note 17 para 3.26.
[81] *Milieudefensie* supra note 17 para 3.27.
[82] Ibid.

piercing in these circumstances resulted in Shell Netherlands being held liable for the acts and omissions of Shell Nigeria, which stem from Shell Nigeria's delictual breach of its duty of care in the oil extraction activity.[83] The court also held that Shell Netherlands had a sufficient level of influence and control over Shell Nigeria and failed to ensure that Shell Nigeria inflicts no harm on the Plaintiffs.[84] Finally, the court ruled in favour of the Plaintiffs by ordering that the veil between Shell Nigeria and Shell Netherlands be pierced as the group could not rely on their separate legal personality to escape liability from the oil spill.[85] In addition to this ruling, the court ordered Shell Netherlands to install a leak detection system in its oil pipelines to prevent a leak of this nature in future.[86]

This judgment is significant as it held that a holding company located within a specific jurisdiction is accountable for the conduct of its subsidiary company in a different jurisdiction.[87] In reaching its conclusion, the court relied on English law principles.[88] This has particular implications for South Africa, which has a legal system based on the common law, largely derived from English law.[89] South African courts should consider this judgment as a guide in determining the liability of company groups insofar as: they exist in South Africa; they are headquartered elsewhere and have a subsidiary presence in South Africa; and the company group in question abuses its separate legal personality.[90] As noted by Macchi and van Zaben:

> *'The Milieudefensie v RDS judgement seems to confirm a global trend of judicial decisions and emerging due diligence legislations that makes it increasingly difficult for parent*

[83] Ibid para 3.26. See also Macchi and van Zaben op cit note 67 at 412. See also Otto Spijkers 'Friends of the Earth Netherlands (Milieudefensie) v Royal Dutch Shell' (2021) 5 *Chinese Journal of Environmental Law* at 244. See also Wubeshet Tiruneh 'Holding corporations liable for human rights abuses committed in Africa: the need for strengthening domestic remedies' (2022) 6 *African Human Rights Yearbook* at 242.
[84] *Milieudefensie* supra note 17 para 3.27-3.31. See also Macchi and van Zaben op cit note 67 at 411.
[85] Ibid para 3.27.
[86] Ibid para 3.26. The court relied on an English judgment of *Vedanta Resources PLC and another v Lungowe and others* [2019] UKSC 20 ("*Vedanta*"). This case held that a parent company can be held accountable for the conduct of its subsidiary because such parent company "*should know that its subsidiary unlawfully inflicts damage on third parties in an area where the parent company involves itself in the subsidiary"* thereby attributing a duty of care on Shell Netherlands.
[87] Lucas Roorda 'Broken English: a critique of the Dutch Court of Appeal decision in Four Nigerian Farmers and Milieudefensie v Shell' (2021) 12 *Transnational Legal Theory* at 144.
[88] Ibid at 147.
[89] Ibid.
[90] Macchi and van Zaben op cit note 67 at 414.

*companies to hide behind the fictio iuris of the corporate veil and requires them to take responsibility for the social and environmental impacts of their subsidiaries' activities."*[91]

The oil spill in *Milieudefensie* is an example of how company groups raise additional issues and concerns for enforcement agencies and regulators alike.[92] Therefore, company groups need to implement sound corporate governance measures to prevent abuses of the entity theory.[93] Corporate governance becomes more complicated in the case of multinational company groups, as noted by the Organization for Economic Co-operation and Development ("OECD") where:

*'[…] [the] Handling [of] subsidiaries is often made even more difficult by the fact that there may be a great number of subsidiaries, and by the fact that each of these subsidiaries are separate companies with their own governance structure. In many groups subsidiaries are situated in different countries, and therefore the parent company needs to cope with the company laws (and other laws) of different jurisdictions […]'*[94] (Own emphasis).

The essence of the above discussion is that the governance mechanisms of a company group need to be upheld and implemented.[95] From the judgment in *Milieudefensie*, it is clear that the negative consequences of separate legal personality within company groups is that there is the potential for the holding company to evade responsibility for the shortcomings and failures of their subsidiary, abusing its separate legal personality.[96] *Milieudefensie* may have potentially provided an alternative to veil piercing as it is currently understood, for South African courts to consider. As noted by Stevens, a delictual remedy may have a similar effect and can be considered as a way of attributing liability within a company group.[97] This is on the basis of a duty of care which arises from the relationship between a holding company and a subsidiary company.[98] Stevens is, however, wary of applying this in South Africa due to the difficulties in proving the elements of a delict needed to find the holding company liable but this can be seen as a crack in the rather impenetrable armour of the separate legal

[91] Ibid.
[92] Karsten Sorensen 'The governance of company groups' (2021) 22 *OECD Corporate Governance Working Papers* at 6. See also Milo op cit note 13 at 318-345.
[93] Macchi and van Zaben op cit note 67 at 414. A discussion on these sounds corporate governance measures is included under section IV below.
[94] Sorensen op cit note 92 at 7.
[95] Macchi and van Zaben op cit note 67 at 414.
[96] *Milieudefensie* supra note 17 para 3.27.
[97] Richard Stevens 'Circumventing veil piercing: possible delictual liability of a Holding Company to a creditor of its insolvent subsidiary' (2013) 1 *Stellenbosch Law Review* at 106.
[98] Ibid.

entity and as a start to opening the door to considerations of to apply equitable 'veil piercing'.[99]

Importantly, the *Milieudefensie* judgment, like Steven's tentative exploration of a way to keep a holding company accountable, may encourage plaintiffs in South Africa to embark on similar claims against company groups, multinational or otherwise, in order to seek relief for corporate misconduct. This judgment highlights how veil piercing encouraged Shell Netherlands to improve on and better implement its corporate governance policies (for example, a leak detection system was installed pursuant to an order of court to prevent oil spills in future).[100] By implication, this can also encourage South African companies or company groups with links or company networks in South Africa to adopt better policies ensuring good corporate governance and avoid potential liability and reputational damage.[101] The link between governance and veil piercing is discussed in more detail below.

## IV HOW VEIL PIERCING CAN ENCOURAGE BETTER CORPORATE GOVERNANCE IN COMPANY GROUPS

Veil piercing allows a party to seek relief for the corporate misconduct of the company by piercing the veil between a company and its controllers.[102] The specific circumstances where the veil will be pierced differs at common law and at statute. These two positions are discussed below along with how each can encourage good corporate governance in company groups.

### *(a) The common law position on veil piercing*

The courts in South Africa are careful to maintain the balance between the necessity to protect the company as an entity and the advantages that flow from that, as set out in section II above. The courts have traditionally been conservative, leaning towards protecting the entity and courts have also been inconsistent, as will be discussed. [103]

*Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* ("*Cape Pacific*")[104]confirmed that where separate legal personality is abused to commit fraudulent,

[99] Ibid at 98.
[100] Ibid para 3.26.
[101] Macchi and van Zaben op cit note 67 at 414.
[102] The Companies Act, s20(9). See also Oh op cit note 29 at 90.
[103] Davis et al op cit note 24 at 37.
[104] 1995 (4) SA 790 (A) at 810D.

dishonest or improper conduct, such a company's controllers can be held accountable.[105] *Cape Pacific* had to determine whether it was competent to pierce the corporate veil between a holding company and its subsidiary.[106] The court pierced the veil within the company group *in casu*, holding that it is trite law that a court can disregard the separate legal personality within a company group.[107] The court also referred to the test of 'unconscionable injustice' as formulated in *Botha v Van Niekerk and Others*,[108] which is a standard that requires a court to ask whether the company controllers committed improper conduct behind the veil of a company's separate legal personality.[109] This unconscionable injustice is reason enough to pierce the corporate veil.[110]

*Cape Pacific* also emphasized that a court had to balance the rights of a company as a separate legal entity against the rights of the party at the receiving end of the corporate misconduct.[111] In addition, the court in *Airport Cold Storage v Ebrahim & others* confirmed that the protection which separate legal personality affords company controllers is not absolute and that a court can, in exceptional circumstances, pierce the veil to hold company controllers personally liable.[112] Common law veil piercing is held to be a remedy of last resort,[113] as courts are required to consider alternative remedies first.[114] From the perspective of promoting good governance through veil piercing, this may make it difficult for plaintiffs

[105] Ibid at 810D. See also Davis et al op cit note 24 at 37. See also *Knoop NO and Others v Birkenstock Properties (Pty) Ltd and Others* (7095/2008) [2009] ZAFSHC 67 (4 June 2009) par 11. In *Knoop,* it was confirmed that the veil could be pierced where there is proof of fraud, dishonesty or other improper conduct within the company in conducting its affairs. See also *Hülse-Reütter v Godde* 2001 (4) SA 1336 (SCA) at 23. *Hülse-Reütter* confirmed that abuse or misuse refers to the manner in which a company's controllers misuse the company's separate legal personality to obtain an unfair advantage.

[106] *Cape Pacific* supra note 104 at 12. In particular, this case dealt with a company group which had sold certain shares and a loan account from Lubner Controlling Investments (Pty) Ltd ("Lubner") to Cape Pacific Limited ("Cape Pacific"). Lubner conducted its business affairs through a company group known as *the Lubner group of companies,* operated by one Gerald Lubner, who in turn owned and operated Gerald Lubner Investments (Pty) Ltd ("GLI"). The issue in the matter arose when a share sale was to be effected, and Lubner failed to deliver the shares to Cape Pacific and went on to transfer the shares to GLI, while noting that GLI was never joined to the proceedings. Accordingly, Cape Pacific alleged that Gerald Lubner, having knowledge of Cape Pacific's rights to the shares and "in fraud of such rights" transferred the shares from Lubner to GLI.

[107] Ibid at 28.

[108] 1983 (3) SA 513 (W).

[109] Ibid par 524A.

[110] Ibid par 524A.

[111] *Cape Pacific* supra note 104 at 324.

[112] *Airport Cold Storage* supra note 8 par 7. See also Mike Larkin and Farouk Cassim 'Company Law (including Close Corporations)' (2000) 486 *Annual Survey of South African Law* 489-492.

[113] Rehana Cassim 'Piercing the veil under section 20(9) of the Companies Act 71 of 2008: A new direction' (2014) 26 *South African Mercantile Law Journal* at 307. See also *Hülse-Reütter* supra note 105 par 23.

[114] *Hülse-Reütter* supra note 105 par 23.

to rely on veil piercing and in turn, not bring about the governance change required within company groups.

This difficulty is observable in *Adams v Cape Industries PLC* ("*Adams*").[115] The *Adams* case concerned a company group that mined asbestos.[116] It involved four main parties: a South African subsidiary that mined the asbestos;[117] an American subsidiary company that conducting marketing activities;[118] the British holding company;[119] and certain employees of the American subsidiary who contracted asbestosis from exposure to asbestos ("the Plaintiffs").[120] The Plaintiffs sought to pierce the corporate veil between the American subsidiary and the British holding company in order to establish jurisdiction of the court and hold the holding company liable for the loss they suffered.[121] The court considered the extent of control that the British holding company exercised over its American and South African subsidiaries.[122] The court ruled that the holding company did not exercise sufficient control over its subsidiaries and that the corporate veil could not be pierced.[123] The court in *Adams* held that a court would not pierce the veil just because justice dictates that it should:

> *'[...] the court is not free to disregard the principle of Salomon v Salomon, merely because it considers that justice so requires. Our law, for better or worse, recognises the creation of subsidiary companies, which though in one sense the creatures of their parent companies, will nevertheless under the general law fall to be treated as separate legal entities with all the rights and liabilities which would normally attach to separate legal entities.'*[124]

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[115] 1991 1 All ER 929.
[116] Ibid at 2.
[117] Ibid. See also Arden op cit note 43 at 7. Arden notes that the company group in *Adams* was established to reduce its exposure to asbestos claims, an example of a company group judgment proofing its affairs.
[118] Ibid.
[119] Ibid.
[120] Ibid.
[121] Ibid at 7.
[122] Ibid at 7-13. In reaching its decision, the court considered a number of factors: the physical location of the asbestos mine (which was situated in South Africa); the structure of the corporate group in question and the extent of control that the American subsidiary and British holding company had over its subsidiary in South Africa; and whether it actually controlled its commercial activities.
[123] Ibid at 39. *Adams* has since been superseded by the decision in *Vedanta,* which was also applied in *Milieudefensie* to pierce the veil through indirect veil piercing derived from the *duty of care* that a holding company has in respect of its subsidiaries. This is discussed in section III above.
[124] Ibid at 32. See also *Lubbe and Others and Cape Plc. and Related Appeals* [2000] UKHL 41 (20th July, 2000) para 26. See also *Chandler v Cape Plc* [2012] EWCA Civ 525 (25 April 2012) para 79. *Lubbe and Chandler* confirm that a parent company owes a *duty of care* to third parties at the instance of its subsidiaries. This is similar to the approach adopted in *Milieudefensie.*

Where veil piercing is readily applied by courts, this has the ability to encourage better corporate governance in groups. However, the common law is clearly limited in its ability to address governance issues discussed above because veil piercing was seen as a drastic remedy.[125] The statutory position, which was only introduced in the current Companies Act, will now be considered.

*(b) The statutory position on veil piercing*

The Companies Act allows a court to pierce the veil in terms of section 20(9), which provides that:

> *'[…] If, on application by an interested person or in any proceedings in which a company is involved, a court finds that the incorporation of the company, any use of the company, or any act by or on behalf of the company, constitutes an unconscionable abuse of the juristic personality of the company as a separate entity, the court may—*
>
> > *(a) declare that the company is to be deemed not to be a juristic person in respect of any right, obligation or liability of the company or of a shareholder of the company or, in the case of a non-profit company, a member of the company, or of another person specified in the declaration; and*
> >
> > *(b) make any further order the court considers appropriate to give effect to a declaration contemplated in paragraph (a). […]'* (Own emphasis).

Section 20(9) allows a court to disregard a company's separate legal personality where the company controllers commit an unconscionable abuse of the company's juristic personality.[126] Unconscionable abuse is not defined but is argued to be less extreme than what was previously available at common law and diverse enough to cover any type of abuse of the company's separate legal personality.[127]

*Ex Parte: Gore NO* ("*Gore*")[128] applied section 20(9) in a company group and dealt with a request by a liquidator (acting for 41 subsidiary companies) to deal with the assets of the subsidiary companies as if they were the property of the holding company through veil

[125] Ibid. See also Rehana Cassim 'Hiding behind the veil' (2013) 51 *De Rebus.*
[126] Cassim op cit note 113 at 307.
[127] Cassim op cit note 125.
[128] [2013] 2 All SA 437 (WCC) (13 February 2013).

piercing in terms of section 20(9).[129] The court found that the holding company used the subsidiary companies to conduct the business of the holding company to the extent that *"the affairs of [the] group were in material respects conducted in a manner that maintained no distinguishable corporate identity between the various constituent companies in the group"* (Own emphasis).[130] Therefore, it was held that the holding company asserted excessive dominance over its subsidiaries.[131]

The court also looked at the *"dishonest and chaotic"* administration of the business structure in the company group and found that the allocation and distribution of funds within it were at the sole discretion of its management in that there appeared to be a flow of funds which blatantly flew in the face of good company governance and the applicable accounting standards.[132] The court ruled in favour of the liquidator by piercing the veil in terms of section 20(9) in order to treat the holding company as if it was the only company in the group, thereby placing all the assets owned by the subsidiary companies within one company for purposes of the then pending liquidation.[133] In *Gore,* veil piercing was the primary remedy.[134] In addition, the conduct of the management of the companies in *Gore* even attracted an investigation by the Financial Services Board as more shares than what was authorized were issued to shareholders[135] – an abuse of the company group structure.

The difference between veil piercing at common law and veil piercing in terms of the Companies Act is that legislators have cast the wording of section 20(9) in wider terms than what was allowed at common law.[136] According to Cassim, this *"illustrates the width of the powers given to the courts under [the Companies Act]."*[137] These wide powers were applied in *Gore* where section 20(9) was used as a remedy of first instance, and not as a drastic exceptional remedy as at common law.[138] From a corporate governance perspective, *Gore* is a prime example of what can happen when the controllers of a company within a

[129] Ibid para 2. The holding company *in casu* was King Financial Holding Limited (in liquidation). The liquidator's application sought to pierce the veil between the holding company and its subsidiaries in terms of section 20(9) of the Companies Act. The court needed to determine the meaning behind lifting, piercing or looking behind the corporate veil; and how this applies to company groups.
[130] Ibid para 8. Effectively, the company group in *Gore* appeared to have very little regard to the distinction between the separate legal personality of the holding company, and the separate legal personality of the subsidiary companies. See also Natania Locke and Irene-Marie Esser 'Company Law and Stock Exchanges' (2013) 231 *Annual Survey of South African Law* at 242-245.
[131] Ibid para 28.
[132] Ibid para 12.
[133] Ibid para 37.
[134] Ibid para 28. See also Cassim op cit note 125 at 5.
[135] Ibid para 7.
[136] Cassim op cit note 125.
[137] Cassim op cit note 113 at 309-310.
[138] Cassim op cit note 125 at 5.

company group fail to adhere to proper corporate governance, which includes the failure to maintain sufficient accounting records and manage the finances of the company group in line with good practice.[139] Cassim notes the fact that the court having pierced the veil sent a strong message to company groups that the veil can and will be pierced where the company group's separate legal personality is abused.[140] This accords with my argument: that veil piercing in company groups can encourage better corporate governance.

The succinct premise is that the prevailing case law may be considered by company controllers as cautionary tales if they fail to adhere to good corporate governance norms and instead misuse their relationship with the company.[141] The court in *Gore* mentioned that veil piercing is a policy consideration, and that section 20(9) was purposefully couched in wide terms to ensure that the statutory remedy for unconscionable abuse can be applied in different fact complexes and with more flexibility.[142] While *Gore* is an example of the strides made by South African courts to readily apply veil piercing, the remedy is still approached with some restraint.[143] For veil piercing to be successful in deterring the abuse of separate legal personality in company groups (and in turn, encourage better corporate governance), this research report argues that a less stringent judicial policy regarding veil piercing should be considered. I now turn to discuss this below.

### *(c) A less-stringent policy regarding veil piercing by South African courts to encourage better corporate governance*

A company is a separate entity and the abuse of this fiction of law caused harm in the company group in *Milieudefensie* as discussed above.[144] While a form of veil piercing was applied in *Milieudefensie* through the duty of care that the holding company had towards its

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[139] *Gore* supra note 128 para 37.
[140] Cassim op cit note 125 at 5.
[141] Ibid.
[142] *Gore* supra note 128 para 32. See also Cassim op cit note 113 at 335 and Tom Hadden 'The Regulation of Corporate Groups in Australia' (1992) 15 *University of New South Wales Law Journal* at 62. Hadden takes note of the weakness of separate legal personality in groups by noting *'[t]he traditional rules or the duties of the directors and officers of individual companies make little sense within corporate groups. There are no clear rules on the liability of the group for the obligations of its constituent companies. And there is virtually no legal control at all on the complexity of the group structures which may be established with a view to concealing the true state of affairs within a corporate group.'* This statement is indicative of the prevailing contentions around separate legal personality and veil piercing within company groups. See also James op cit note 1 at 217. James refers to the concept of separate legal personality within company group structures as *'weaknesses of the law's commitment to the application of the separate entity metaphor in situations removed from its genesis and justification […]',* in that the concept is applied in company groups without appreciating the more involved practicalities faced within them.
[143] Cassim op cit note 125 at 5.
[144] As discussed under section III.

subsidiary, veil piercing can only be applied as a remedy where the conduct of the company controllers meets certain requirements.[145] South African courts have attempted to streamline the circumstances in which the veil will be pierced, such as when the controllers of a company commit an unconscionable abuse of the company's separate legal personality and the separate identity of the company is disregarded.[146] However, Cassim notes that what constitutes unconscionable abuse is not cast in stone and the effect of this is that its meaning will differ on a case-by-case basis.[147] This issue with veil piercing is noted by Peter Oh who states that:

> *'[…] from its inception, veil-piercing has been an abysmal failure. There is no uniform test for veil-piercing, which typically requires demonstrating that a corporation was an "alter ego" or "instrumentality," controlled or dominated by a shareholder to perpetuate a fraud, wrong, or injustice that proximately caused loss or injury to a plaintiff. […]'*[148]

With this in mind, I propose that a specific construction of veil piercing be applied in South Africa – this is known as the equitable construction of veil piercing, coined by Peter Oh.[149] Oh argues that the equitable nature of veil piercing has been eroded with time in attempts to find clear and objective markers such as an 'unconscionable abuse' of the company's separate legal personality.[150] The knock on effect of this is that corporate governance within company groups will, in the absence of the company's internal corporate governance mechanisms, continue to go unchecked, bringing about some of the issues as seen in *Milieudefensie, Gore* and/or *Cape Pacific* from a company group governance perspective.

For veil piercing to truly promote good corporate governance, it would need to be interpreted more progressively and through the equitable construction referred to above. Even though this construction is not explicitly applied in South Africa, it can provide an overarching 'bright line' for the court to ask when considering the common law or s20(9)- namely, whether the conduct of the company's controllers warrants equitable relief.[151] This equitable relief casts sufficient light on the defendants' enrichment, and the plaintiffs'

[145] As discussed under section IV.
[146] The Companies Act, s20(9).
[147] Cassim op cit note 125 at 5.
[148] Oh op cit note 29 at 90.
[149] Ibid at 113.
[150] Ibid at 95.
[151] Ibid at 117.

impoverishment and/or harm, through their conduct.[152] This equitable construction of veil piercing is in line with the broader purpose of veil piercing as noted by South African lawmakers who contributed to South Africa's company law reform that took place in anticipation of the promulgation of the 2008 Companies Act.[153]

Geach remarked on the position of South Africa's company law regime prior to the promulgation of the 2008 Companies Act where he noted that, '*complete codification cannot accommodate an environment that keeps on changing as would a statutory scheme that is based on broader principles.*'[154] I argue that this is evidence of the flexibility of the Companies Act's provisions. In further support of this notion, a law reform report by the Department of Trade and Industry ("DTI") confirmed and noted the following:

> *'[c]ompany law should therefore contain a minimum of mandatory rules and clear enforceable prohibitions, limited to those aspects of corporate structure, governance, administration and management […]'*[155]

This law reform report by the DTI further held the view that the proposed changes to the company law regime, must be in a position to provide for the maximum possible flexibility in the interpretation of the company law provisions.[156] This research report argues that this sets out the framework in which the equitable construction of veil piercing can be applied.

When considering the law makers' intention to allow the provisions of the Companies Act to have the ability to adapt and find more flexible application in a fast paced and changing world of commerce and business, this necessitates the provisions set out in section 20(9) and further accommodates a more progressive interpretation of the same in line with the equitable construction of veil piercing. I also argue that veil piercing through

[152] Ibid at 117. I accept that the proposed equitable construction to veil piercing will need further consideration by our courts in order to see what this looks like practically, but it is certainly proposed as one possible test for veil piercing in pursuit of better corporate governance in company groups.
[153] Walter Geach, 'Statutory, Common Law and other Duties of Directors' (2009) *Paper for CIS Corporate Governance Conference* at 9
[154] Ibid.
[155] GN 1183 'Company Law for the 21st Century' (2004) *Guidelines for Corporate Law Reform* at 30.
[156] Ibid. See also Geach op cit note 154 at 12. In South Africa, courts require the aggrieved party to bring the veil piercing application in terms of section 20(9) of the Companies Act. On a reading of section 20(9) and the commentary of the Companies Act, it is trite that statutory veil piercing should still be considered along with its common law counterpart. I argue that this is what South African law makers sought to do with the enactment of section 20(9) i.e. couching its terms in far broader terms than what was permitted at common law to expand the circumstances in which a court would consider piercing the corporate veil. See also Gwanyanya op cit note 71 at 3119-3121.

the equitable construction will achieve the objectives that South African law makers intended section 20(9) to achieve.

When one considers what is evidenced in practice and throughout the decisions made by our courts, a rather conservative approach has been adopted in deciding whether to pierce the corporate veil or not.[157] In determining whether a case exists for a less conservative judicial policy surrounding veil piercing, as is argued in this research report, the South African company law regime and its foundations at legislative level must be considered in the interpretation of any provision of the Companies Act or even a corresponding common law principle.[158] It can therefore be argued that particularly when it comes to veil piercing within company groups, there is a case for a less conservative judicial policy and that courts should be alive to the fact that company groups in their intricate networks and structures need to be encouraged to engage in business practices that align with good corporate governance.

It is nevertheless important to recognize the complexity of veil piercing and ensure that it does not disrupt the very foundations of corporate activities - the company as a separate legal entity. For this reason the caution displayed by the Courts to not wantonly disregard a company's separate legal personality too easily, is still well placed and will not be swept of the away by the judicious balancing of the competing interests referred to in this research report.[159] This is highlighted by Cassim who notes that:

> *'Simply put, the court stated that in determining whether to pierce the corporate veil, one must weigh up or balance the importance of giving effect to the separate legal personality of a company against the adverse moral and economic effects of tolerating an unconscionable abuse of the juristic personality of the company.'*[160]

Cassim additionally remarks on the fact that the law is not settled when it comes to veil piercing.[161] The lack of solidified principles that set out the precise circumstances under which the veil can be pierced can serve as an opportunity for further development in our law and in the interpretation of section 20(9) of the Companies Act.[162] This can be built on the

[157] Cassim op cit note 125 at 5.
[158] The Companies Act, ss5 & 7.
[159] Cassim op cit note 113 at 308.
[160] Ibid at 324.
[161] Ibid at 330. See also Mike Larkin and Farouk Cassim 'Company Law (including Close Corporations)' (2003) 549 *Annual Survey of South African Law* at 571.
[162] Ibid. See also Oh op cit note 29 at 90.

broad principles that have already been established by the courts.[163] It is trite that the nature of corporate activity has evolved since the development of the separate corporate entity doctrine in the late 1800's. However, the courts have been resistant to disrupt this and this research report has argued that an innovative approach to this can lead to greater accountability and governance within company groups. This is considered in more detail below.

*(d) Veil piercing which encourages good corporate governance in company groups*

In *Milieudefensie* the Hague Appeal Court pierced the veil between the holding company and subsidiary company.[164] The court in *Milieudefensie* ordered the installation of a leak detection system to prevent future damage.[165] *Gore* involved a ruling by the court that pierced the veil in a largely disorganized and chaotic company group.[166] The defendants' conduct in *Gore* also resulted in a follow up investigation from the Financial Services Board.[167] *Cape Pacific* involved a ruling by the court that pierced the corporate veil in a company group and is a culmination of how veil piercing was treated prior to the enactment of section 20(9) of the Companies Act.[168] In all the three cases discussed above, the threshold which the plaintiffs had to achieve was quite onerous and the courts had to consider a number of different factors before it ruled in favour of veil piercing. But the principle that companies in groups will not be permitted to the corporate veil has clearly been established rate.[169] Courts are certainly empowered to pierce the veil in these circumstances. If company controllers fail to properly implement their corporate governance mechanisms, the threat of legal proceedings in which holding companies can be held accountable for the corporate misconduct of their subsidiaries should deter them from this failure to begin with. If courts adopt a less conservative judicial policy around veil piercing and perhaps adopt the equitable construction referred to above, improved corporate governance in company groups can become a reality. This will serve as a cautionary tale against company controllers conducting themselves in ways that causes harm to others.

[163] *Gore* supra note 128. See also *Cape Pacific* supra note 104.
[164] *Milieudefensie* supra note 17 para 3.27.
[165] Ibid.
[166] *Gore* supra note 128 para 7.
[167] Ibid.
[168] *Cape Pacific* supra note 104 at 12.
[169] See discussion under section II above.

However, the drawbacks in applying veil piercing in company groups as a tool to promote good corporate governance must be acknowledged. These are elaborated below.

*(e) Drawbacks to the equitable construction of veil piercing*

Veil piercing has the potential to disrupt the business operations of company groups as a result of heightened scrutiny from courts and regulators alike, protracted litigation and, where applicable, unwanted media attention which can cause great reputational harm to the company group in question.[170].

Second, the hallmark of separate legal personality is premised upon allowing company controllers to take business decisions and necessary commercial risks without fear of direct loss to the controller's themselves.[171] With the threat of heightened litigation and scrutiny surrounding veil piercing in the company group context, this might deter company controller's from taking necessary and crucial business risks even where there is a valid commercial rationale which underpins this business risk. This might also deter future external investment and funding opportunities within the company group for lack of business creativity.[172]

Third, I accept that veil piercing might not serve as a catch all remedy for deeply entrenched and complex corporate governance issues in company groups. These include matters relating to gaps in the accountability, authority and delegation frameworks; a company environment which chastises whistleblowing and reporting within the company; and/or a company environment which lacks basic reporting and governance infrastructure. Fourth, and as evident from the case law discussions above, I recognize that the veil piercing remedy can have varying results owing to the fact that the law which surrounds it is not settled.[173] In addition, the guidelines can become too unclear which can disturb the balance between the company, the controllers and the society that has been developed over a number of years. This is a sentiment neatly articulated by Macey and Mitts who remark as follows:

> *'The doctrine of piercing the corporate veil is shrouded in misperception and confusion. On the one hand, courts understand the fact that the corporate form is supposed to be a juridical entity with the characteristic of legal "personhood." As such, courts acknowledge that their*

[170] Ibid.
[171] Robert Thompson 'Piercing the Corporate Veil: An Empirical Study' (1991) 76 *Cornell Law Review* at 1039.
[172] See discussion on company groups and their economic rationale under section II.
[173] Cassim op cit note 113 at 330. See also Jonathan Macey and Joshua Mitts 'Finding Order in the Morass: The Three Real Justifications for Piercing the Corporate Veil' (2014) 100 *Cornell Law Review* at 100.

> *equitable authority to pierce the corporate veil is to be exercised "reluctantly" and "cautiously." Similarly, courts also recognize that it is perfectly legitimate to create a corporation or other form of limited liability business organization such as an LLC "for the very purpose of escaping personal liability" for debts incurred by the enterprise.'*[174]

This discussion does not detract from what I ultimately propose, which is to encourage further thought and consideration around the equitable construction of veil piercing. If applied properly, equitable veil piercing has the potential to produce equitable results. In my view, this eclipses the negative consequences of veil piercing set out above.

### *(f) The future: an equitable construction of veil piercing*

The equitable construction referred to above is not in stark contrast to the approach that South African courts have historically adopted around veil piercing; it is rather the next progressive step. The equitable construction is simple, as it asks fundamental questions such as: whether the company's separate legal personality is abused; whether the company controller's benefitted from this abuse; and whether a party suffered harm and/or loss as a result of the company controller's abuse. These sentiments are best summarized by Peter Oh, who notes that:

> *'Lady Justice has waited long enough for her integrity to be restored. Courts already possess and routinely exercise […] equitable discretion […]. By balancing the interests of claimants, corporations, shareholders, and third parties, courts finally can produce efficient and equitable results in one of the most dysfunctional and important areas of corporate law.'*[175]

## V SUMMARY AND CONCLUSION

I have set out a comprehensive discussion regarding separate legal personality and veil piercing in company groups. I proposed that veil piercing in company groups will encourage better corporate governance. This proposal depends on whether South African courts are willing to adopt a less conservative judicial policy in this regard. In particular, I propose that South African courts adopt an equitable construction to veil piercing, believing that its proposed application in South Africa is in line with our law maker's intention prior to the promulgation of section 20(9) of the Companies Act. Section 20(9) must be approached with

[174] Macey and Mitts op cit 173 at 100.
[175] Oh op cit note 29 at 137.

more flexibility than  was allowed at common law. Accordingly, I posit that the proposed application of the equitable construction of veil piercing will still need to be tested in the courtroom against facts which favour the piercing of the corporate veil. The arguments advanced are not necessarily a full assessment of all the mechanisms which may improve corporate governance within company groups – nor do they attempt to be. Notwithstanding, the precedent set by the courts and the scholarly discourse referred to is indicative of the fact that South Africa might already be predisposed to an equitable and/or less conservative judicial policy surrounding veil piercing and more particularly, veil piercing within company groups, thus bringing about and encouraging better corporate governance within company group structures.

Word count: **10475.**

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