LAW LETTER

Contracts.Companies.Commerce

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Your strategic partner at law

Rugby injuries, soccer stadiums, the taxman, debtors, creditors, directors and shareholders, local authorities and trade marks all feature in this early Summer edition of Law Letter. Please remember that the contents of Law Letter do not constitute legal advice. For specific professional assistance, always ensure that you consult your attorney. We welcome your comments and suggestions.

RECENT JUDGMENTS

Company Law

■ *Shareholders Rule*

MORE THAN a century and a half ago it was held in the English case of *Royal British Bank v. Turquand* that a person dealing with a company in good faith is entitled to assume that the company has complied with its internal procedures and formalities. This is known as the "Turquand rule" and has been accepted as part of South African law at least since 1948. The effect of the rule precludes a company from relying upon the absence of some internal management requirement or procedure in order to avoid a contract concluded with an outsider who is acting in good faith.

The question that has come before the Supreme Court of Appeal is whether the Turquand rule applies to Section 228 of the Companies Act. This section provides that the directors of a company do not have the power to dispose of the whole or the greater part of the company's undertaking or its assets save by a special resolution of its members.

A company, Bubesi Investments 196 (Pty) Ltd, purported to sell a property owned by it to a purchaser referred to in the judgment as "Stand 242". Two directors of Bubesi, Göbel and Wilken, furnished Stand 242 with a document certifying that the sale had been approved of by the shareholders of Bubesi in terms of Section 228 and that the property did not constitute the whole or the greater part of Bubesi's assets. These statements were false. The property was in fact Bubesi's sole asset and most of the shareholders were unaware of the sale. The shareholders were two trusts, namely the Göbel Trust (one of whose trustees was Göbel himself) and the other, the Deutra Trust (one of whose trustees was the wife of Wilken).

Bubesi was, at the time of the sale, in financial difficulty. Shortly after the sale, it let the property to a third party for a period of three years intending to use the lease as an alternative source of finance. Stand 242 brought an urgent application to the Johannesburg High Court to prevent Bubesi from dealing with the property pending the institution of an action to enforce the sale. Bubesi opposed the application on the basis that Section 228 had not been complied with. The remaining trustees of the two trusts (three in each case) claimed not to have been aware of the sale or of Stand 242's application until it was granted an interim order. In seeking to confirm the interim order, Stand 242 relied on the Turquand rule but the court held that the rule did not apply in the case of Section 228.

An appeal to the Supreme Court of Appeal followed in which Appeal Judge Carole Lewis concluded:

> *"In my view, the clear meaning of Section 228 is that the shareholders must give their consent to, or ratify, the disposal of the sole asset, or the major assets, of a company. If the purpose of Section 228 is the protection of the shareholders, then the application of the Turquand rule would deprive them of that protection. The section would then serve no purpose. It would be cold comfort to a shareholder, when the company loses its substratum, to be told to sue the directors who have acted without approval."*

The sale agreement was declared to be not in compliance with Section 228.

Stand 242 Hendrik Potgieter Road Ruimsig (Pty) Ltd v. Göbel NO & Others 2011 (5) SA 1 (SCA).

Tax Law

■ *Payback Time*

"The taking of a bribe or gratuity, should be punished with as severe penalties as the defrauding of the State."
– William Penn (1644 - 1718)

THE SUPREME Court of Appeal (SCA) has recently given judgment in a criminal appeal relating to VAT fraud. The appeal was brought by Izak Engelbrecht against his conviction and sentence on 157 counts of fraud and one of corruption.

Engelbrecht's offences all related to a scheme in which sales of cars were zero-rated for VAT purposes, by fraudulently stating that they were being exported from South Africa. The sales actually took place within South Africa and should have been subject to VAT at the standard rate of 14%. SARS was defrauded of about R1.6m.

The scheme was an elaborate one, involving stolen customs documents and forged stamps. Three individuals were initially charged. Two of them pleaded guilty, entered into plea-bargain arrangements for lesser sentences and gave evidence against Engelbrecht. The Regional Court in Bellville sentenced Engelbrecht to an effective seven year prison term. That term comprised a six year sentence with two years suspended, in respect of the fraud convictions and then a three year sentence for the corruption conviction. Engelbrecht appealed unsuccessfully to the High Court. He was then denied leave to appeal further, but successfully petitioned the SCA in order to be able to bring his appeal.

The SCA confirmed the convictions. It was satisfied that Engelbrecht was a willing participant in a clearly fraudulent scheme. He had benefitted from the scheme through commissions that he was paid by one of the other participants. Engelbrecht did not himself directly benefit from the non-payment of VAT.

The SCA then considered the sentencing issue. Engelbrecht argued that his sentences and those of the two individuals who entered into plea-bargains was startlingly disparate. The SCA disagreed. The other two individuals pleaded guilty and received the benefit of being able to enter into plea bargains. Engelbrecht pleaded not guilty and so chose to go to trial. That trial gave the court the opportunity to hear evidence as to the extent of the scheme and Engelbrecht's involvement in it. The SCA said that, even if the others sentences were unduly lenient, there was no reason why Engelbrecht should also benefit. The need for strong deterrent sentences in fraud cases was confirmed.

The SCA did, however, find that the cumulative effect of the sentences had not been properly considered. It therefore ruled that the fraud and corruption sentences should run concurrently – resulting in an effective four year sentence.

Engelbrecht v. The State [2011] ZASCA 068.

■ *Power of the Purse*

"The avoidance of taxes is the only pursuit that still carries any reward."
– John Maynard Keynes (1883 - 1946)

A NUMBER OF court cases has looked at the limits of SARS collection powers.

The South African Revenue Service (SARS) has extensive powers in relation to the collection of tax. These are set out in various provisions of the tax legislation and are intended to facilitate the prompt collection of tax that is due.

The Western Cape High Court recently handed down judgment in a case dealing with SARS collections powers. The case related to a judgment obtained by SARS against Fastmould Specialist CC in respect of VAT and employees' tax. The VAT Act and the Income Tax Act both contain provisions allowing SARS to obtain judgments against taxpayers, by filing a statement with the clerk or registrar of any competent court. The taxpayer is not afforded an opportunity to oppose the granting of the judgment.

Fastmould made application to the Goodwood Magistrates Court for the rescission of a judgment in favour of SARS against it. That application was successful and SARS appealed to the Western Cape High Court.

This court identified two issues that it needed to consider. These were:

- whether there was a dispute about the amount of tax payable by Fastmould; and
- whether SARS was obliged to raise an assessment before obtaining its judgment.

It was found firstly, that there was not a dispute about the amount of tax payable by Fastmould. This finding was based on the fact that the VAT and employees' tax systems effectively require self-assessment. Fastmould had submitted the necessary returns, but had not made the corresponding payments. It was therefore difficult for it to contend that it disputed the amounts reflected in its own returns. There was also found to be no dispute as to the calculation of penalties and interest levied.

It was also decided that SARS was not obliged to raise an assessment before obtaining its judgment. The legislation contains provisions allowing SARS to raise assessments in certain circumstances. But SARS need not do so where the relevant amounts accord with returns submitted by the taxpayer itself. The penalty and interest calculations were found to be simple enough as to not require an assessment to be raised.

SARS' appeal succeeded. The rescission of the judgment was set aside.

SARS v. Fastmould Specialist CC (unreported case of the Western Cape High Court. Case No A642/2010).

Insolvency

■ *Broke & Bankrupt*

A DEBTOR WHO gives his creditor notice in writing that he is unable to pay any of his debts commits an act of insolvency which entitles the creditor to apply for the sequestration of the debtor's estate. In this matter the debtor advised his creditor that he had applied for debt review under the **National Credit Act**, 2005, and intended to repay his debts in accordance with a debt rearrangement order in terms of Section 87 of the Act. Notwithstanding the debtor's intention to repay his creditors pursuant to whatever rearrangement was determined, Judge Wallis in the Durban High Court determined that the debtor's notification conveyed to his creditor that he was not in a position at that time to pay his debts on the terms upon which they had been incurred. The debtor had accordingly committed an act of insolvency.

Furthermore, Section 88(3) of the Act does not preclude a credit provider from bringing an application for the sequestration of the debtor's estate. That section provides, in essence, that unless the debtor defaults on any obligation under a debt rearrangement, the creditor may not enforce by litigation or other judicial process any right or security under the credit agreement. Following an earlier decision in the Supreme Court of Appeal, Judge Wallis pointed out that sequestration proceedings are not legal proceedings to enforce the credit agreement.

A provisional order of sequestration was granted against the debtor.

Firstrand Bank Ltd v. Evans 2011(4) SA 597 (KZD).

Defamation

■ *Mayoral Chains*

INDIVIDUALS WHO are defamed may sue for damages; in certain limited circumstances companies may also do so. But the question in this case was whether a municipality has the right to claim for alleged damage to its reputation.

The dispute arose out of an affidavit filed by the Bitou Municipality in previous court proceedings between the parties. Booysen (a defendant in the defamation action) had obtained a judgment against Bitou which had applied to court to have the judgment set aside. In opposing that application Booysen had alleged in her opposing affidavit that Bitou had deliberately attempted to deceive the court by making statements which it knew to be untrue or misleading and had made reckless and irresponsible allegations which bordered on fraud and perjury. It was not disputed that these allegations were defamatory.

In 1946 our Appeal Court had ruled that the Crown (now, of course, the State) could not sue for defamation. *"Any subject,"* held Judge Schreiner, *"is free to express his opinion upon the management of the country's affairs without fear of legal consequences."* Bitou's counsel argued, however, that different considerations applied in regard to municipalities. In dealing with what she referred to as counsel's "interesting and innovative argument", Deputy Judge President Jeanette Traverso in the Cape Town High Court found, firstly, that a municipality is part of the State or government for purposes of the common law of defamation. Secondly, in the absence of any South African case directly in point, she cited overseas cases which concluded that it would be contrary to public policy or public interest for organs of government, whether central or local, to have the right to sue for defamation. Quoting the words of Lord Kinkel in the House of Lords in 1993 in a matter concerning the Derbyshire Country Council, she said:

> *"It is of the highest public importance that a democratically elected government body, or indeed any government body, should be open to public criticism."*

Contending that there was a difference between central and provincial government on the one hand and local government on the other, Bitou's counsel tried to persuade the court to develop the common law to extend the right to sue for defamation to municipalities. Judge Traverso decided, however, that none of the considerations advanced in argument affected the underlying reason for retaining the rule against municipalities having the right to sue for defamation, namely that any citizen must be entitled to express his opinion about the management of local affairs without fear of legal consequences.

Bitou Municipality & Another v. Booysen & Another 2011 (5) SA 31 (WCC).

Damages

■ *Crouch, Touch, Pause, Enrage*

"Serious sport has nothing to do with fair play."
– George Orwell (1903 - 1950)

"RUGBY IS a high-speed contact sport, so there will always be the risk of injury. The participants in a rugby game can expect to sustain injuries, even serious injuries, in the normal course of a game."

So said Judge Burton Fourie in deciding that damages be awarded to Ryand Hattingh, whose neck was seriously injured

while he was playing hooker for his school rugby team from Labori High against Stellenbosch High School. Although the principle that the voluntary assumption of risk will usually preclude any claim for damages by a participant in a sport that is inherently risky, Ryand's case was based upon the allegation that his opposing hooker, Alex Roux, had deliberately performed an illegal and highly dangerous manoeuvre which had led to the injury.

In his judgment Judge Fourie referred to the applicable laws of the game relating to scrums, explained in detail how the scrum must be formed and its players positioned and how the opposing players must be faced and engaged. A sentence from Law 20.1 (f) and (g) provides that: "The front rows must interlock so that no player's head is next to the head of a team-mate."

Ryand's evidence was that at the last instant before the forwards engaged in the scrum, Alex moved his head which forced Ryand's head into the wrong channel or gap between the opposing heads in the front row of the scrum. This enabled Alex's head to impact directly on to Ryand's neck and so fracture his neck.

In considering whether a legal wrong had been committed which entitled Ryand to claim damages for his injury, the court pointed out that despite the accepted inherent risk of injury, it would be legally offensive to deny an injured player a remedy in appropriate circumstances. It found that an injured player should not, by virtue of his participation in the sport, be regarded as having consented to a risk of being injured as a result of serious aggressions which are not normally associated with the game of rugby.

Applying the usual tests to determine whether an unlawful act had been committed Judge Fourie considered whether the act complained of had been wrongful and, if so, whether it had been done intentionally or negligently. After carefully considering all the evidence, which included that of experts in the game, a number of photographs and the testimony of Ryand, Alex and other players in the scrum, Judge Fourie preferred the evidence given by Ryand and his witnesses and found also that the probabilities favoured him. On that basis he concluded that the dangerous nature of the manoeuvre deliberately executed by Alex did not constitute conduct which rugby players would accept as part of the normal risks inherent in a game of rugby. The conduct was legally unlawful and Alex was liable in delict for the injury sustained by Ryand.

Leave to appeal has been granted.

Hattingh v. Roux NO & Others 2011 (5) SA 135 (WCC).

Intellectual Property

■ *Asset Management*

IN 1933 at the height of the Great Depression, the Currency and Exchanges Act was passed by the South African Parliament. Much of the Act has since been repealed but Section 9 remains. It empowers the head of State to make regulations "in regard to any matter directly or indirectly relating to or affecting or having any bearing upon currency, banking or exchanges". Pursuant to that power the Exchange Control Regulations have been promulgated. Regulation 10(1)(c) provides that no person shall, except with permission granted by the Treasury and in accordance with such conditions as the Treasury may impose, enter into any transaction whereby capital or any right to capital is directly or indirectly exported from the Republic.

In this case, Oilwell applied to set aside the assignment in 1998 of a trade mark, "Protec", to Protec International Ltd in the United Kingdom on the basis that such assignment was in contravention of Regulation 10(1)(c). The issue to be decided by the Supreme Court of Appeal was whether a trade mark constituted "capital" as envisaged in the regulation. Upholding a decision of the Pretoria High Court, the Supreme Court of Appeal confirmed that a trade mark is not capital.

Oilwell (Pty) Ltd v. Protec International Ltd and Others 2011 (4) SA 294 (SCA).

■ *Penalty Spot*

"A self-made man may prefer a self-made name."
– Learned Hand (1872 - 1961)

SINCE THE advertising value of naming a sports stadium after a well-known commercial enterprise has been realised, most of the large stadia in South Africa have been re-named after whatever company has, in consideration for financial or other assistance rendered to the owners of the stadium concerned, obtained the "naming rights" to it. In 1988, First National Bank provided the loan to finance the erection of a football stadium in Soweto. The contract for the loan provided that the stadium would be known as "First National Bank Stadium" or by such other name as might be chosen by the Bank from time to time. Prior to the FIFA Football World Cup in 2010 it was called "FNB Stadium".

In anticipation of the World Cup and because the stadium had to be rebuilt it became necessary to rearrange the relationship

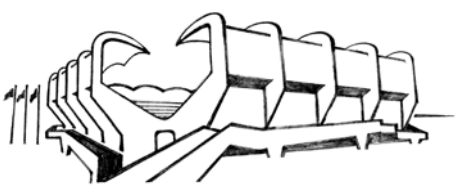
between the parties with an interest in the stadium. The reconstruction of the stadium required extensive funding from the government and the City of Johannesburg. Furthermore, to enable FIFA to enjoy exclusive merchandising rights for the event, the Bank had to temporarily relinquish its naming rights in favour of FIFA for a period preceding and during the event. During that time it was called "Soccer City". After the World Cup a dispute arose between the Bank and the City and its appointed stadium manager who adopted the view that the right to name the stadium no longer vested in the Bank and that they had the right to name the stadium or to sell the naming rights to third parties.

The Bank contended that the name of the stadium should revert to "FNB Stadium". An application to the Johannesburg High Court by the Bank for an interdict to restrain the stadium manager from referring to the stadium by any other name and for a declaratory order declaring that the Bank had the sole right to name the stadium was successful but the dispute was taken to the Supreme Court of Appeal.

In his judgment, the Deputy President of the SCA, Judge Louis Harms, pointed out that the naming rights attached to a sporting stadium are exceptionally valuable. When the property was transferred to the Government in 2008, it registered a "personal servitude" for "naming right purposes" in favour of the Bank. As Judge Harms explained, a servitude is a limited real right in respect of the property of another. He did not accept the City's argument that naming rights can only arise by virtue of contract and that the servitude was of no force and effect. The right to name a building or structure vests in the owner by reason of its control over it and a servitude is valid if it carves out a portion or takes away something of that ownership and transfers it to the servitude holder. This was the effect of the arrangement between the parties here.

The Bank's continued entitlement to the naming rights of the FNB Stadium was upheld.

National Stadium SA (Pty) Ltd and Others v. Firstrand Bank Ltd [2011] 3 All SA 29 (SCA).



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