REPUBLIC OF SOUTH AFRICA

IN THE HIGH COURT OF SOUTH AFRICA
(NORTH GAUTENG, PRETORIA)

CASE NO:21263/2012
DATE HEARD:18-27 March 2014

(1) REPORTABLE: YES / NO
(2) OF INTEREST TO OTHER JUDGES: YES/NO
(3) REVISED.

....
DATE SIGNATURE

In the matter between:

PIETER HENDRIK STRYDOM N.O.	1st Plaintiff
JOHN RODERICK GRAEME POLSON N.O.	2nd Plaintiff
LOUIS STRYDOM N.O.	3rd Plaintiff
DEON MARIUS BOTHA N.O.	4th Plaintiff
TIRHANI SITOS DE SITOS MATHEBULA N.O.	5th Plaintiff
SEAN CHRISTENSEN N.O.	6th Plaintiff
GAIL LLYN WARRICKER N.O.	7th Plaintiff
ALTRON GROUP PENSION FUND	8th Plaintiff

and

JOHAN HENDRIK BAKKES	1st Defendant
LOUIS KOTZE VENTER	2nd Defendant
LIESL MARÉ	3rd Defendant

BHEKAMA SWAZI MSHIZOBOMVU	4th Defendant
GERHARDUS JOHANNES VAN ZYL	5th Defendant
HANS JURGENS BRITS	6th Defendant
JOHANNES GERHARDUS DU TOIT	7th Defendant
DERREK JOHN ELLERBECK	8th Defendant
SIYABONGA GQOLI	9th Defendant
FREDERICK VERMAAK	10th Defendant
LUCAS WILLEM VILJOEN	11th Defendant
DESRÉ PATON	12th Defendant
ANNA JACOBA VAN HEERDEN	13th Defendant
MARK DAVID ARENDSE	14th Defendant
RYAN MARK BOTHA	15th Defendant
DAVID THOMAS OOSTHUIZEN	16th Defendant
VINCENT REVOR SMITH	17th Defendant
ERNEST PHILIPPUS SEVENSTER	18th Defendant
NSALO FINANCIAL SERVICES (PTY) LTD	19th Defendant
MARTINA CORNELIUS BAKKES	20th Defendant
MARICIA BAKKES	21st Defendant
REZANNE BAKKES	22nd Defendant

JUDGMENT

MURPHY J

1. The eight plaintiffs initially instituted action against twenty two defendants for various orders in terms of section 424 of the Companies

Act 61 of 1973 ("the old Companies Act") and/or section 218 of the Companies Act, 71 of 2008 ("the new Companies Act") and for judgment against those defendants personally for the debts of Corporate Money Managers (Pty) Ltd ("CMM") and ten other entities who were associated or connected with CMM in a collective investment scheme and securitisation arrangements which have failed and brought about substantial losses for the investors in the scheme.

2. On 3 April 2009, the collective investment scheme, CMM Cash Management Fund ("CMF") was closed by its manager, Ayanda Collective Investment Solutions Ltd ("Ayanda") and pursuant to an investigation conducted by the Financial Services Board ("FSB"), the financial services regulator, CMM, CMF and their associated companies were placed under provisional curatorship by an order of this court on 28 April 2009. The order was confirmed and made final on 18 June 2009. On account of CMM having been the provider of funds to the Allegro group of companies (consisting of Allegro Bridging (Pty) Ltd ("Allegro Bridging"), Allegro Holdings (Pty) Ltd, Allegro Bridging House (Pty) Ltd and Allegro Group Investments (Pty) Ltd) a close relationship existed between CMM and Allegro. As will be explained more fully in due course, Allegro Bridging appears in many instances to have been the originator of assets in the property development sector in which CMM invested on behalf of its clients. On 15 October 2009 the order of curatorship was extended to include the Allegro group of companies under the curatorship of the companies.

3. At the date of the curatorship, 28 April 2009, CMM's liability to investors stood at approximately R1,152 billion. Cash and cash equivalents under control of CMM at that date amounted to approximately R100 million. Many of the investors have lost their life savings as a result of the failure of the scheme. The curators have since their appointment been engaged in the recovery of the investors' funds. They anticipate that the ultimate recovery on behalf of the investors will in all probability amount to no more than 25% of the capital invested.

4. Section 424(1) of the old Companies Act provides:

> "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."

5. Section 218(2) of the new Companies Act provides:

> "Any person who contravenes any provision of this Act is liable to any other person for any loss or damage suffered by that person as a result of that contravention.

6. The first, second and third plaintiffs are the curators of the whole of the business of providing financial services and of managing a portfolio of assets of the CMM, its associated entities and the Allegro group of companies. The fourth and fifth plaintiffs are the joint liquidators of Dunrose Trading 160 (Pty) Ltd, ("Dunrose") a company which in broad terms was involved in certain investments made by CMM and Allegro. The sixth and seventh plaintiffs are the joint liquidators of Amalgum Investments 102 (Pty) Ltd ("Amalgum"), a shareholder in Dunrose. The eight plaintiff is Altron Group Pension Fund, an investor in CMF.

7. The trial of the action has been set down before me from 17 March 2014 until 23 May 2014. At the commencement of the proceedings I was informed by counsel for the plaintiffs, Mr Terblanche SC, that the plaintiffs had been able either to settle the action or have withdrawn it against most of the defendants, while other have consented to judgment. These defendants were directors and shareholders in various companies in the CMM and Allegro group of companies. Only four defendants are continuing to defend the action. They are: Mr Johan Bakkes, ("Bakkes") the first defendant, the managing director of CMM and a director of various of the other companies, who allegedly either controlled those companies or at least participated in the carrying on of their business; Nzalo Financial Services (Pty) Ltd, ("Nzalo") the nineteenth defendant, the majority shareholder of CMM, the shares in which were beneficially held and controlled by Bakkes and his wife through the Betterknow Trust, and the ultimate holding

company of various entities associated with CMM; Mrs Maritha Bakkes, the twentieth defendant, the wife of Bakkes, a trustee of the Betterknow Trust and a director of Nzalo; and Mr Vincent Smith, the seventeenth defendant, a director of CMM Corporate Finance (Pty) Ltd ("Corpfin"), a company associated with CMM of which Bakkes was a co-director.

The application for separation in terms of rule 33(4)

8. After counsel had presented his opening address at the commencement of the trial, the plaintiffs made application in terms of rule 33(4) for an order that certain questions be decided separately from the other issues of the trial. As part of their case against the defendants that the business of the various companies was carried on recklessly or with the intent to defraud the creditors or for a fraudulent purpose, the plaintiffs allege that certain conduct of the defendants in the scheme of investment devised and pursued by them involved contraventions of provisions of the legislation forming part of the regulatory framework. Various companies in the CMM group issued promissory notes over a three to four year period in an aggregate amount of approximately R1 billion, with the consequence that substantial funds of the CMF, the collective investment scheme managed by CMM, were invested in such promissory notes. The four questions the plaintiff wishes to be decided separately relate to the legality of those investments.

9. The first question is whether the promissory notes issued by the entities referred to in the paragraph 1.1 of the unamended notice of motion of the application in terms of rule 33(4) were legal commercial paper. The entities referred to are six private limited companies falling within the CMM group and Thunderstruck Investments 15 (Pty) Ltd. The six companies in the CMM group are: Miro Capital (Pty) Ltd, Four Rivers Trading 307 (Pty) Ltd, Regent Group Capital (Pty) Ltd, Escascape Investments (Pty) Ltd, CMM Corporate Finance (Pty) Ltd and CMM Finpro (Pty) Ltd. For reasons which I will elucidate later I granted an amendment with agreement of the parties deleting paragraph 1.1.5 of the notice of motion with the result that the plaintiffs no longer seek determination of the questions in relation Corpfin at this stage of the proceedings.

10. The second question is whether the issue of the promissory notes by these entities against the acceptance of money from the general public constituted “the business of a bank” in contravention of the Banks Act.

11. The third question is if in the event of the court finding that the promissory notes were issued in contravention of the Banks Act, whether the promissory notes qualified as “approved assets” under GN 1503 of 2005 as determined and promulgated by the Registrar of Collective Investment Schemes under sections 40 and 46 of the Collective Investment Schemes Control Act 45 of 2002. These provisions permit the Registrar to determine securities or classes of

securities that may be included in a portfolio of collective investment schemes as well as the manner in which and the limits and conditions subject to which securities or classes of securities may be included in a portfolio of a collective investment scheme.

12. The fourth question which the plaintiffs want separately decided is whether the investments by the CMF and the clients of CMM in the promissory notes were authorized by or were in breach of the approved mandate or any variation thereof. CMM was granted authorisation by the Registrar of Financial Service Providers under section 8 of the Financial Advisory and Intermediary Services Act 37 of 2002 ("FAIS") to render financial services as, *inter alia*, a Category II financial service provider, specifically to provide services in terms of a mandate granting it discretion regarding the choice of financial products. In terms of the provisions of the Notice on Codes of Conduct for Administrative and Discretionary Financial Service Providers of 2003, promulgated in terms of the Act, a discretionary financial service provider must obtain a signed mandate from a client. The content of the mandate and approval thereof is prescribed by the Code. The mandate must initially be approved by the Registrar, and the financial service provider may not amend the approved mandate substantially without the prior written approval of the Registrar.

13. In their plea the defendants plead that the promissory notes were legal commercial paper, that they were approved assets and complied with GN1503.

14. The plaintiffs contend that the named entities were not permitted legally to issue promissory notes or to receive deposits in contravention of the Banks Act, read with the so-called Commercial Paper Notice GN2172 of 14 December 1994 and the Exemption Notices GNR681 of 4 June 2004 and GN2 of 1 January 2008 promulgated in terms of the Banks Act. These statutory instruments designate certain activity as not falling within the meaning of the "business of a bank" in the Banks Act and stipulate the legal conditions relating to the issue of commercial paper in general and by special-purpose institutions for the purpose of a securitisation scheme.

15. The plaintiffs submit that if it is found that the promissory notes were not legal paper, were not approved assets and were issued in contravention of the Banks Act and in breach of the mandate, such conduct would at the very least establish that the business of the various companies was carried out recklessly as contemplated in section 424 of the old Companies Act. There is obvious merit in that submission. The purpose of the statutory instruments making up the regulatory framework governing commercial paper is to provide safeguards and protection to investors. The investment in commercial paper that is not legal, or not subject to regulatory protection,

invariably will disclose a choice by those responsible to ignore prudential safeguards.

16. Moreover, if the questions are decided against the defendants it will mean that certain of the defendants were involved, as managers and shareholders, in the unlawful issue by the entities of promissory notes to CMM, the manager of the collective investment scheme. Such conduct would be in contravention of section 4 of the Collective Investment Schemes Control Act 2002 which provides that the manager of a collective investment scheme must avoid conflict between the interests of the manager and the interests of an investor. If the issuing of the promissory notes was illegal, the conflict of interests would be exacerbated in that the defendants would be shown to have participated in illegal activity to their own advantage to the disadvantage of the investors. This too, it is argued, would amount to the reckless carrying on of the business of CMM. Again, the submission has merit.

17. On this basis, the plaintiffs submitted that the separate determination of the four questions could be decisive of the whole case. At the very least, a separate determination of these issues, should they be decided in favour of the plaintiffs, will have a material bearing on the nature and extent of the evidence to be adduced by the plaintiffs and will significantly shorten the proceedings.

18. At the end of the day, the defendants did not vigorously oppose the application for separation. The advantages of separately determining the four questions are self-evident, for the reasons stated by the plaintiffs. They are in the main legal issues based on a limited factual foundation which can be conveniently decided before other evidence is led. Their determination will assist the parties in their choices regarding the nature and ambit of the other evidence which they may wish to lead. Accordingly, I granted an order in terms of prayers 1 and 2 of the application for separation that the four questions be decided separately before any other evidence be led. The plaintiffs closed their case on the separated questions without leading any evidence. The defendants led the evidence of Bakkes who was cross-examined over four court days.

The background: the CMF collective investment scheme and investment in securitisation

19. Before dealing with the four separated questions, it will be useful to sketch the background and to refer to certain aspects of the investment and securitisation schemes involved. The evidence in this regard is incomplete and has not been presented in a comprehensive fashion. The intention of the plaintiffs is to present expert testimony in this regard during the main trial. It is nonetheless possible to provide a broad outline by drawing on the evidence of Bakkes, documentary evidence admitted during his testimony and the common cause facts.

20. CMM was an authorized financial service provider ("FSP") in terms of FAIS. It was controlled by Bakkes, Louis Venter (the erstwhile second defendant), Liesl Mare (the erstwhile third defendant) and Nzalo. FAIS regulates the business of rendering financial advice and intermediary services to clients in respect of a wide range of financial products by financial firms. It covers the activities of investment managers, investment advisors, insurance brokers, financial planners and financial advisors. These providers are referred to in the Act collectively as "financial service providers". FAIS enacts a comprehensive regulatory framework applying to FSPs, including the grant of authorisation to act as an FSP, the duties of FSPs and codes of conduct. CMM was registered as an FSP by the Registrar of FSPs with effect from 30 September 2004 and was granted authority to render financial services as a Category I, Category II and Category III FSP. Category I FSPs are financial advisers and intermediaries who may not use discretion in the rendering of financial services. Category II FSPs are those who may render intermediary services in terms of a mandate granting to the FSP discretion regarding the choice of financial products. Category III FSPs are investment administrators specialising mainly in bulking collective investments on behalf of clients.

21. CMM was involved in the establishment of CMF, a collective investment scheme regulated by the Collective Investment Schemes Control Act, 45 of 2002 ("CISCA"), in 2003 and 2004. A collective

investment scheme is a scheme in pursuance of which members of the public are invited or permitted to invest money or other assets in a portfolio and having done so hold a participatory interest in a portfolio of the scheme through shares, units or any other form of participatory interest. The investors in the scheme share the risk and the benefit of investment in proportion to their participatory interest in a portfolio. In other words, funds from various investors are pooled for investment purposes with each investor sharing proportionally in the benefits and risks attached to the underlying assets.

22. CMF was a collective investment scheme in securities as defined in section 39 of CISCA, being "a scheme the portfolio of which consists, subject to this Act, mainly of securities". CISCA does not define the term "securities", but such are commonly understood to include shares, preference shares, bonds, debentures, futures, options, warrants and various money market instruments.

23. Section 40 of CISCA provides that the Registrar may determine securities or classes of securities that may be included in a portfolio of a collective investment scheme in securities. In terms of section 46, the Registrar may determine the manner in which and the limits and conditions subject to which securities or classes of securities may be included in a portfolio as well as different manners, limits and conditions for different securities or classes of securities or different portfolios of a collective investment scheme in securities. Section 41(1)

provides that no person other than a company which has been registered as a manager and its authorised agent may administer any collective investment scheme in securities. And section 85(1) provides that a manager may not sell or offer for sale any participatory interest in a portfolio of a collective investment scheme unless at the time of such offer the portfolio included assets in the manner, within the limits or on the conditions determined by the Registrar. Non-compliance with section 85(1) is an offence in terms of section 115(b) of CISCA. In addition, in terms of section 109(1)(a), any person who contravenes or fails to comply with any provision of CISCA is liable to any other person for any loss or damage suffered by that person as a result of such contravention or failure.

24. On 4 December 2005 the Registrar caused to be promulgated GN1503, which is the determination of securities, classes of securities, assets or classes of assets that may be included in a portfolio of a collective investment scheme in securities and the manner in which and limits and conditions subject to which securities or assets may be so included. It will be recalled that the third question to be determined is whether the promissory notes qualified as approved assets in terms of GN1503.

25. Section 68 of CISCA requires the manager of a collective investment scheme to appoint either a trustee or a custodian for its collective investment scheme, which will typically be a bank or a long-term

insurance company. That appointment is made in terms of a "deed" defined in section 1 of CISCA to mean "the agreement between a manager and a trustee or custodian, or the document of incorporation whereby a collective investment scheme is established and in terms of which it is administered …." The trustee has a plethora of duties imposed upon it by section 70 of CISCA. They include ensuring that the transacting in and pricing of participatory interests are in accordance with CISCA and that the dealings and administration of the scheme are in accordance with acceptable market practice, the law, the deed and appropriate auditing and accounting practice. It has a duty to report non-compliance to the Registrar. Section 71 provides that for the purposes of CISCA any money or other assets received from an investor and an asset of a portfolio are regarded as being trust property for the purposes of the Financial Institutions (Protection of Funds) Act 28 of 2001, and a manager, its authorised agent, trustee or custodian must deal with such money or other assets in terms of CISCA and the deed and in the best interests of investors.

26. The circumstances in which CMF came into existence were described by counsel in his opening statement. There is a measure of complexity to the contractual arrangements which will no doubt be elucidated in expert testimony. Suffice it to say that CMF appears to have been born out of the mCubed Unit Trust Scheme established by mCubed Unit Trust Management Company Ltd ("mCubed"), acting as manager, and ABSA Bank Limited ("ABSA") appointed as trustee and custodian. That

deed provided that the scheme may consist of one or more portfolios established by a supplemental deed. ABSA was empowered to refuse to accept as part of the assets of a portfolio any asset which did not comply with the requirements of the deed or a supplemental deed. On 16 April 2004, mCubed entered into a contract with CMM as the portfolio manager which permitted CMM to manage portfolios under the supervision of mCubed. A few days before this agreement, ABSA and mCubed entered into a supplemental deed for the purpose of establishing a portfolio to be known as CMM Cash Management Fund, that is CMF. The Registrar approved the supplemental deed on 28 April 2004. In 2006 mCubed became Ayanda, which remained the manager of CMF, while CMM continued as the portfolio manager.

27. The supplemental deed describes CMF as a specialist portfolio with an investment policy which seeks to provide investors with a level of income in excess of that offered by money market portfolios, while maintaining a high degree of liquidity and capital preservation. Counsel's opening address quotes the following extract from the supplemental deed:

> "To achieve this objective, the securities to be included in the CMF portfolio will comprise a combination of assets in liquid form and securities of an interest bearing nature, including loan stock, debentures, debenture stock, debenture bonds, unsecured notes, preference shares, financial instruments and any other non-equity securities which are considered consistent with the portfolio's primary objective and that the CISCA Act or the Registrar may from time to time allow, all

to be acquired at fair market value. Any fixed income security to be included in the portfolio will typically have a maximum term to maturity of three years and a weighted average term to maturity of 180 days."

28. In mandates approved by the Registrar and concluded between CMM and its clients, being investors in CMF, CMF is described as a "low risk South African cash management fund". It is also stated that the CMF aims to outperform the relevant money market benchmark over the medium term at low levels of risk within the money market asset class. Exhibit X1-22 is the investment management agreement between CMM and Teba Bank, one of its investors. The annexed mandate (Exhibit X13) includes the following statement of investment policy:

"All investments shall be restricted to interest rate instruments including:

2.1 Fixed interest rate instruments;
2.2 Variable interest rate instruments;
2.3 Commercial paper;
2.4 Preference shares;
2.5 Convertible debentures;

provided that where any investment is made in commercial paper, preference shares or convertible debentures, the prior written consent of Teba Bank is required."

Moreover, it is common cause that in terms of the trust deed and the supplemental trust deed CMF is a "non-equity securities" portfolio as contemplated in Chapter VII of GN1503 and consequently is subject to

the investment limits and conditions determined by the Registrar in that chapter.

29. CMM from time to time distributed marketing material to potential and existing investors soliciting investment in CMF. In general terms the material aimed at creating the impression that CMF was a unit trust fund with the same benefits of a call account. Investors were told that they could earn fixed deposit rates while the money was available on call. The investment was described as low risk and regulated by CISCA, the FSB and ABSA, and would be made strictly in accordance with a standardized mandate approved by the FSB and in accordance with GN1503.

30. CMM attracted large and numerous investments from investors as a result of the attractive interest rates, the immediate availability of funds and the supposedly regulated environment. As mentioned, by the time CMM was placed under curatorship the amount invested in CMF was approximately R1,152 billion. It is common cause that at the time of the closure of the fund the majority of the money invested via CMM was not actually pooled and held in CMF but had been disaggregated and was held in “segregated portfolios” on behalf of individual clients, the legality of which is questionable. Many of the funds invested in both CMF and in the segregated portfolios were invested in promissory notes issued by special purpose vehicles, securitisation institutions, which were established by CMM. It is these investments which are the

subject matter of the inquiry mandated by the four questions separated in terms of rule 33(4).

31. CMM's move into the securitisation business related principally to two categories of underlying transactions: property development and factoring. To this end it set up so-called "special purpose vehicles" - SPVs. The SPVs are the companies referred to in paragraph 1.1 of the notice of motion in terms of rule 33(4). Miro Capital (Pty) Ltd ("Miro Capital") and Four Rivers Trading 307 (Pty) Ltd ("Four Rivers") issued promissory notes in relation to bridging loans for property development. Regent Group Capital (Pty) Ltd ("Regent"), which was previously Two Ships 427 (Pty) Ltd ("Two Ships"), issued promissory notes in relation to the provision of financing for factoring and trade finance by Regent Factors (Pty) Ltd. It is not clear from the limited evidence available in respect of which assets the other companies, Escascape Investments (Pty) Ltd ("Escascape") trading as Sakha iBlokho, CMM Corporate Finance (Pty) Ltd ("Corpfin") and CMM Finpro (Pty) Ltd ("Finpro") issued promissory notes. Most probably they too related to property, factoring and trade finance debts. Thunderstruck Investments 15 (Pty) Ltd ("Thunderstruck") issued only one promissory note to CMF which was later split into two smaller promissory notes allocated to specific investors.This note related to the purchase of a building by Thunderstruck.

32. The specifics of the various securitisation arrangements will be elucidated in expert testimony presented in the trial. However, it is possible to describe their general characteristics with reference to certain documents admitted into evidence during Bakkes' testimony. These include: a sale agreement between an originator of debt transactions and an SPV issuing the promissory note; a facility agreement between CMF (or other investors) represented by CMM and an SPV issuing promissory notes; a cession in security between the SPV and CMF (or other investors) represented by CMM; a legal opinion prepared by an attorney, Mr Paul Tindle, for Global Credit Rating Co. (Pty) Ltd ("GCR"), a rating agency, explaining certain aspects of the transactions for the securitisation of the trade receivables of the originator; and a transaction memorandum prepared by Via Capital (an FSP) regarding the "proposed securitisation of a pool of loans relating to the discounting of property sales receivables by Miro Capital, in conjunction with Corporate Money Managers and CIA Holdings". It must be emphasised at this juncture, however, that the legal relationships and the structure described in the documents were not necessarily established or implemented in practice. From the evidence already adduced it is quite evident that the accounting treatment of the various transactions was frequently not in keeping with the envisioned contractual arrangements described in these documents. My purpose in outlining the proposed contractual arrangements is therefore merely to give a contextual background and

overview without making any finding that the scheme encapsulated in the documents was implemented or followed in practice.

33. In the documentation Miro Capital is defined and identified as the originator. It is common cause that Miro Capital issued numerous promissory notes to a value of more than R400 million. It accordingly seems in practice to have acted primarily as an SPV. Promissory notes were issued by Miro Capital before September 2007 to CMM and after September 2007 to Four Rivers purportedly as "back to back" promissory notes as security for those issued by Four Rivers. There are factual disputes in relation to the purposes of this arrangement which need not be resolved now. However, to avoid a confusion of roles, in the description that follows I have opted to analyse the transactions for the securitisation of the trade receivables with Allegro Bridging in the role of the originator. I assume for the purpose solely of elucidation (though there is no supporting documentary evidence to that effect before me at this time) that Allegro Bridging played the role of an originator similar to that assigned to Miro Capital in the written contracts included in Exhibit A and Exhibit X. I proceed on this assumption with confidence by reason of the fact that Bakkes testified that Allegro Bridging did indeed act as an originator, and the fact that the evidence of the arrangements overall supports that.

34. A significant proportion of the funds of the investors in CMF and the segregated portfolios was invested through Four Rivers and Miro

Capital, as SPVs, into property developments in the form of residential housing estates. Allegro Bridging provided so-called “bridging-finance” to borrowers usually for property developments at high rates of interest upto 4% per month. Allegro Bridging acquired funding from external sources, of which CMM was the most significant. The funding was channeled by CMM through the SPVs (after September 2007 mainly Four Rivers) utilising funds extracted from CMF. Often the loans provided by Allegro Bridging to developers were unsecured. Although the financing was referred to as “bridging finance”, the loans were actually often for long term periods and were at usurious rates. Few of the promissory notes could be redeemed at maturity resulting in them being “rolled” or re-issued in respect of the same or increased debt.

35. The legal opinion of Mr Tindle describes a proposed securitisation transaction and its structuring. In terms of that scheme the originator (Allegro Bridging) would agree in a written sale agreement to sell to an SPV (Four Rivers) the claims or existing receivables (the amounts owing to it by the developers arising from the bridging loans) for an agreed purchase price payable in cash. Provision is also made for the sale of “future receivables”. A facility agreement would then also be concluded as part of the scheme. It is a tripartite agreement between the SPV, CMM and CMF or other segregated investors referred to collectively as “the Funders”. In terms of clause 2.3 of the facility agreement it is recorded that the Funders have agreed to grant Four Rivers (the SPV) a facility on which it may draw down funds from time

to time in order to discharge the purchase price payable in respect of the receivables (purchased from Allegro). Clause 6 of the facility agreement deals with the issue of the promissory notes. It provides that to facilitate the draw down of funds under the facility, Four Rivers shall on each draw down, against payment of the amount of the draw down, deliver a corresponding promissory note to the Funders (CMF), and that each promissory note delivered would be required to relate to a separate receivable (being the debt purchased from the originator under the sale agreement), and would be drawn in favour of CMM or its nominee. Ownership of, and the risk and benefit attaching to each promissory note, would pass to CMF (or the other funder) upon payment of the draw down and delivery of the promissory note to CMM. In terms of Clause 8 of the facility agreement CMM was authorised to act as the agent of CMF and the funder in respect of whom it held a discretionary investment mandate.

36. In addition to the sale agreement and the facility agreement, the securitisation scheme set out in the documentation further involved a management agreement in terms of which CMM as manager agreed to manage and administer the business of Four Rivers, the SPV. Although I have not had sight of such an agreement, it appears from Tindle's opinion that CMM would manage the SPV to ensure the effective implementation of the securitisation programme. In the course of managing the business of the SPV, CMM would collect or procure the collection of the receivables (the amounts payable by the

developers ceded as accounts receivable to the SPV by means of the sale agreement) and would procure the amounts so collected to be deposited directly into a bank account maintained by or on behalf of Four Rivers with either Standard Bank, Nedbank, FNB or ABSA. As security for the amounts owing to CMF and the other funders in respect of the promissory notes, Four Rivers (the SPV) ceded to CMF or the other Funders *in securitatem debiti* all its rights to the bank account into which the collections would be deposited. In this way ownership of the receivables was intended to vest in the SPV which was in turn ceded *in securitatem debiti* to CMF.

37. The description of the securitisation transactions, as I have said and repeat with emphasis, is derived from the agreements and legal opinion. There is no evidence before me that these documents submitted by Tindle to GCR ever formed the basis of contractual relationships between the various role players. On the contrary, there are indications in the evidence adduced thus far that the transactions involving CMM, Allegro and the SPVs probably did not proceed in practice in accordance with the prescriptions of the different agreements. The extent of compliance or deviation and the legal consequences of the conduct of the parties in that regard is a matter to be determined in the light of additional evidence. My purpose in describing the proposed scheme is merely to provide insight into its potential workings. However, it must be kept in mind, the scheme was

described by Tindle to GCR for the purpose of obtaining ratings under CISCA.

38. The plaintiffs intend to demonstrate that the securitisation programme was a high risk investment in dodgy assets. They claim that the originated debt of the developers was self-evidently too risky. They plan to lead evidence showing that the developers were inexperienced, did not qualify for loans from banks or reputable financial institutions, did not invest their own money in the developments, used the funding obtained from the SPVs to settle old debt and rarely furnished adequate security to either the originator or the SPV. The plaintiffs say therefore that the developments were doomed to fail and that almost all of them have in fact failed, as could have been expected in the face of unsurious and punishing interest rates of 4% per month which made profitability impossible, especially because what was supposedly bridging finance was in fact long term lending. The defendants deny the plaintiffs allegations and maintain that the assets were profitable but that they are victims of the 2008 financial crisis and the subsequent bad administration of the assets by the curators.

39. Against this factual background, it is now possible to consider the legality of the issue of the promissory notes by the SPVs and the investment in them by CMM on behalf of CMF and the investors in the segregated portfolios.

The first and second question: are the promissory notes "legal commercial paper" issued in contravention of section 11 of the Banks Act?

40. The first question to be determined is whether the promissory notes issued by the companies listed in paragraph 1.1 of the notice of motion were "legal commercial paper". The second question, being whether the issue of promissory notes against the acceptance of money from the public constitutes "the business of a bank" in contravention of the Banks Act, is related to and overlaps with the first question. Should I find that the promissory notes were not "legal commercial paper" and were not issued lawfully, it will follow that the companies carried on the business of a bank in contravention of the Banks Act.

41. Section 11 of the Banks Act provides:

> "(1) Subject to the provisions of section 18A, no person shall conduct the business of a bank unless such person is a public company and is registered as a bank in terms of this Act.
>
> (2) Any person who contravenes a provision of subsection (1) shall be guilty of an offence."

42. "The business of a bank" is defined in extensive detail in section 1 of the Act. The primary elements of the definition are located in paragraphs (a) and (b) of the definition which read:

> (a) the acceptance of deposits from the general public (including persons in the employ of the person so accepting deposits) as a regular feature of the business in question;
>
> (b) the soliciting of or advertising for deposits …"

43. The term "deposit" is also defined in some detail. The essential relevant part of the definition reads:

> "**deposit"**, when used as a noun, means an amount of money paid by one person to another person subject to an agreement in terms of which –
>
> (a) an equal amount or any part thereof will be conditionally or unconditionally repaid, either by the person to whom the money has been so paid or by any other person, with or without a premium, on demand or at specified or unspecified dates or in circumstances agreed to by or on behalf of the person making the payment and the person receiving it; and
>
> (b) no interest will be payable on the amount so paid or interest will be payable thereon at specified intervals or otherwise,
>
> notwithstanding that such payment is limited to a fixed amount or that a transferable or non-transferable certificate or other instrument providing for the repayment of such amount *mutatis mutandis* as contemplated in paragraph (a) or

> for the payment of interest on such amount *mutatis mutandis* as contemplated in paragraph (b) is issued in respect of such amount;"

44. The definition of "the business of a bank" in the Banks Act excludes certain activities from falling within the primary definition. Paragraph (cc) of the definition has particular relevance. It excludes the following from the definition:

> "any activity of a public sector, governmental or other institution, or of any person or category of persons, designated by the Registrar, with the approval of the Minister, by notice in the *Gazette*, provided such activity is performed in accordance with such conditions as the Registrar may with the approval of the Minister determine in the relevant notice."

The Registrar referred to is the Registrar of Banks, who is an officer or employee of the South African Reserve Bank designated by it to perform the functions assigned to the Registrar in terms of the Act.

45. On 14 December 1994 the Registrar promulgated GN2172 in GG16167 ("the Commercial Paper notice") in which, acting in terms of paragraph (cc) of the definition, he designated the activity in paragraph 2 of the Schedule of the notice, and which is performed in accordance with the conditions set out in paragraph 3 of the Schedule, as an activity that does not fall within the meaning of "the business of a bank". Paragraph 2 of the Schedule defines the excluded designated activity as:

> "The acceptance of money from the general public against the issue of commercial paper in accordance with the conditions set out in paragraph 3."

46. The Commercial Paper notice defines commercial paper to mean:

> "(a) any written acknowledgement of debt irrespective of whether the maturity thereof is fixed or based on a notice period, and irrespective of whether the rate at which interest is payable in respect of the debt in question is a fixed or floating rate; and
>
> (b) debentures or any interest-bearing written acknowledgement of debt issued for a fixed term in accordance with the provisions of the Companies Act, 1973 (Act No 61 of 1973,
>
> but does not include bankers' acceptances;"

Promissory notes accordingly constitute commercial paper as defined.

47. Paragraph 3 of the Commercial Paper notice subjects the issue of commercial paper to numerous conditions. In the event that commercial paper is issued not in accordance with the conditions, such issue of commercial paper will not fall within the designated activity excluded from the definition and will accordingly constitute "the business of a bank" and will be illegal in terms of section 11 of the Banks Act unless the issuer is a public company and is registered as a bank; or unless the issuer can avail itself of other defences, for instance that the issue of the paper did not constitute the acceptance of

deposits from the general public as a regular feature of its business and falls outside the scope of the prohibited activity on that account.

48. The conditions set out in paragraph 3 of the Commercial Paper notice are detailed. Those relevant to this matter may be summarized as follows:-

48.1 Commercial paper may only be issued or transferred in denominations of R1 million or more.

48.2 Commercial paper may be issued only by a listed company or one that holds marketable net assets that exceeded R100 million at least 18 months prior to the proposed issue, or any other juristic person authorised by the Registrar in writing, unless the instruments are:

48.2.1 listed on a recognised finanancial exchange; or
48.2.2 endorsed by a bank; or
48.2.3 issued by the central government; or
48.2.5 backed by an explicit central government guarantee.

48.3 The commercial paper issuer must be the ultimate borrower of the money obtained from the general public, or if the issuer is a company, only a wholly owned

subsidiary or a holding company of the issuer may borrow money.

48.4 The funds to be raised through the issue of commercial paper, may only be used for the purpose of acquisition by the ultimate borrower of operating capital and may not, (except when issued by the central government), be applied for the granting of money, loans or credit to the general public.

48.5 No market may be made in unlisted commercial paper issued for a period of longer than 5 years, and commercial paper may not be used by means of market making therein or in any other manner, to obtain overnight funding.

49. Promissory notes are governed and regulated by the Bills of Exchange Act 34 of 1964. In terms of section 100 of that Act nothing in the Act shall affect or restrict any law relating to banks or companies. All the conditions contained in the Commercial Paper notice accordingly apply to promissory notes.

50. On 4 June 2004, the Registrar of Banks promulgated GNR681 in GG26415 (“the first exemption notice”) in which he designated the activity set out in paragraph 2 of the Schedule, and which is performed

in accordance with the conditions set out in paragraphs 4 to 16 of the Schedule, as an activity that does not fall within the meaning of "the business of a bank". The notice is complex, but there is no need to examine all of its terms and provisions. The designated activity is the acceptance by a special-purpose institution of money from the general public against the issue of commercial paper by it, in respect of either a traditional or a synthetic securitisation scheme. The first exemption notice was repealed and substituted by "the second exemption notice", GN2 GG30628 on 1 January 2008. The securitisation arrangements at issue in the present matter constitute a traditional securitisation scheme, defined in the exemption notice to be a scheme whereby a special purpose institution issues commercial paper to investors and uses the proceeds of such issue to obtain assets; and makes payments primarily in respect of paper so issued from the cash flows arising or the proceeds derived from the assets transferred to such special purpose institution by an originator.

51. In order for the issue of commercial paper by a special purpose institution in a traditional securitisation scheme to fall outside the scope of "the business of a bank", there must be compliance with the conditions in the notice, most importantly paragraph 13 of the first exemption notice and paragraph 14 of the second exemption notice, the latter being a re-enactment of the latter in exactly the same terms. Paragraph 14 of the second exemption notice reads:

"(1) Conditions relating to the issue of commercial paper

(a) Notwithstanding anything to the contrary contained in the Commercial Paper Notice, a special-purpose institution may issue commercial paper only for purposes of a traditional or synthetic securitisation scheme in accordance with the conditons specified in items (b) and (c) below.

(b) The commercial paper-

(i) shall be issued or transferred only in minimum denominations equal to or greater than an initial principal value of R1 million, unless the commercial paper is-

(A) listed on a licensed financial exchange;

(B) endorsed by a bank;

(C) issued for a period of longer than five years; or

(D) backed by an explicit national Government guarantee;

(ii) shall be issued only by a juristic person authorised in writing by the Registrar to issue commercial paper pursuant to a traditional or synthetic securitisation scheme, in accordance with the provisions of this Schedule and subject to such further conditions as the Registrar may determine in such written authorisation.

(c) A special-purpose institution issuing commercial paper pursuant to a traditional or synthetic securitisation scheme shall publish a disclosure document relating to the said issue of commercial paper, which disclosure document, as a minimum, shall contain the information prescribed in paragraph 16 of this Schedule.

52. Paragraph 16 of the second exemption notice and paragraph 15 of the first exemption notice impose strict disclosure requirements. Paragraph 16(1)(a) provides:

> "Investors in a traditional or synthetic securitisation scheme shall be made aware that the instruments in which they invest do not represent deposits in a bank, but that the instruments are subject to investment risk, including possible delays in repayment and loss of income and principal amounts invested, and that the institution that acts in a primary role and its associated companies and, when the institution that acts in a primary role is a bank, any other institution within the banking group of which such a bank is a member, do not guarantee the capital value or performance of the instruments issued by the special-purpose institution."

Paragraph 16(2) requires that a special purpose institution shall issue a disclosure document to investors containing important information including: the total amount of commercial paper to be issued by the special purpose institution, whether or not the particular issue of commercial paper is listed; a description of the assets transferred or purchased as collateral, or the premiums received that will be utilised for the payments by the special-purpose institution in respect of the commercial paper issued, as well as other information related to liquidity, risk and compliance.

53. When Mr Snyman, counsel for the defendants, closed his case on the separated questions, he made the concession, on behalf of his clients, that Four Rivers, Two Ships and Escascape did not have the authority in writing of the Registrar to issue commercial paper pursuant to a securitisation scheme as required in terms of paragraph 14(1)(b)(ii) of the second exemption notice and paragraph 13(1)(b)(ii) of the first

exemption notice. On the basis of that concession alone it is possible therefore to find that the commercial paper issued by these three companies was not legal commercial paper and that they had hence contravened the Banks Act by conducting the business of a bank. However, in the interests of completeness, and as I am required to consider the conduct of the other companies, it will nonetheless be useful to review the common cause facts and the evidence of Bakkes regarding the securitisation schemes.

54. With regard to all of the companies (except Corpfin), the common cause facts establish that they all issued promissory notes which constituted commercial paper. The ultimate borrower of the money advanced against the issue of the promissory notes was not the relevant SPV, nor did the SPV receive the money as operating capital. In the final analysis, the money extracted from CMF found its way to the debtors (developers) of Allegro Bridging or those of Regent and Escascape. The capital of the loans was advanced to persons who constituted the “trade receivables” of the originators. The promissory notes were not issued in denominations of R1 million or more. And, most importantly, none of the companies had the written authorisation from the Registrar of Banks to issue commercial paper.

55. Bakkes made important concessions during his testimony regarding all of the companies. In relation to Miro Capital he admitted that it had acted as an SPV and that it had issued promissory notes. It appears to

have acted as an SPV until at least October 2007, but still issued promissory notes after that. Bakkes claimed that the promissory notes issued after October 2007 were not issued to CMF but were issued by Miro Capital to Four Rivers as “back to back” security. His evidence is contradicted by Exhibit X1 which is a promissory note dated 27 June 2008 issued by Miro Capital to CMM. Miro Capital was part of the Four Rivers structures. Prior to October 2007 the funds on-lent to the Allegro developers would exit CMF through the issue of Miro Capital promissory notes. Miro Capital was rated BB- (non-investment quality) in March 2007. During October 2007, Miro Capital promissory notes were “converted” to become Four River promissory notes upon implementation of the Four Rivers structure. Miro Capital issued promissory notes to the value of approximately R434 million. Prior to March 2007, Miro Capital did not have a rating, and was accordingly not investment grade. Bakkes admitted in evidence that Miro Cpital did not have the authority of the Registrar of Banks to issue promissory notes and did not intend to seek a listing of any kind. He accepted that the promissory notes of Miro Capital constituted commercial paper. Four Rivers took over the business of Miro Capital in October 2007, by which date Miro Capital had issued promissory notes for approximately R128 million. Bakkes acknowledged that CMM has a claim against Miro Capital for the face value of the promissory notes issued by Miro Capital in favour of CMM or bearer.

56. Four Rivers, as just stated, took over the book of Miro Capital in October 2007 and began to issue promissory notes from that date, mainly if not exclusively in favour of CMM or bearer, in respect of money advanced and used to acquire receivables from Allegro Bridging. Four Rivers thus received money from the investors in CMF, represented by CMM. At the closure of the CMF, Four Rivers owed approximately R699 million to CMM in respect of the promissory notes it had issued. Four Rivers, Bakkes admitted, also did not have the written authority of the Registrar of Banks to issue commercial paper. When Four Rivers was brought into the picture it was a shelf company purchased by the management team that structured the securitisation programme in order to serve as the securitisation vehicle. Four Rivers was created and set up by CMM acting in concert with Allegro Bridging with the specific purpose of providing bridging finance facilities to developers for the development of properties. CMM was the only investor in Four Rivers' investment instruments. However, any person in South Africa could invest in Four Rivers through the agency of CMM. In terms of the facility agreement it was "the Funders" (CMF and other investors) grant the facility, acquire ownership of the promissory notes and take the risk, which seems mostly to have been the case in practice as well. CMM was the authorised agent of the investors. This means that any member of the public could through the agency of CMM invest in Four Rivers' promissory notes. CMM advertised for investments and CMM investors in CMF were members of the general public.

57. Bakkes made similar concessions and admissions in relation to Regent/Two Ships and Escascape. These two companies also issued promissory notes to CMM or bearer which also constituted commercial paper, and did so without the written authority of the Registrar. Bakkes specifically admitted that Regent/Two Ships and Escascape were securitisation vehicles. He admitted also that members of the public could invest in Regent/Two Ships promissory notes.

58. The evidence regarding the issue of promissory notes by Finpro is less comprehensive. Initially, Bakkes was of the view that Finpro had not issued promissory notes. However, when presented with a promissory note issued by Finpro to bearer in the amount of R450 000 on 25 July 2008 he conceded that Finpro did in fact issue promissory notes and later that Finpro had no authorisation to issue commercial paper from the Registrar of Banks. It is not clear whether Finpro acted as a securitisation vehicle. The promissory note of 25 July 2008 issued to bearer intimates that Finpro accepted money from the general public against the issue of a promissory note without complying with the Commercial Paper notice. There is evidence that the Finpro promissory notes issued to CMM approximated a value of R93 million in March 2009.

59. The evidence in relation to Corpfin is not straightforward. In his plea Bakkes admitted that Corpfin issued promissory notes against the

receipt of money. During cross-examination Bakkes was referred to an affidavit he filed in another proceeding, Annexure G2 File H2(b) to the Van Romburgh report. In it he stated:

> "CMM Corporate Finance ("Corpfin") authorised the managing director to commence with the operation of building a bridging finance book. This book grew to a volume and size of about R25 million. The bridging loans would be granted in accordance with all the Acts pertaining ….. These bridging loans and the security held against them would serve as assets for CMM Corporate Finance. Against these assets CMM Corporate Finance would issue promissory notes in terms of the law pertaining."

The accounting records analysed and reported on by van Romburgh indicate that Corpfin was indebted to CMM in the amount of approximately R20 million in April 2009. The version in Bakkes' affidavit equates Corpfin with a SPV in a securitisation programme similar to the one in which, for example, Four Rivers participated. It amounts to an admission that Corpfin issued promissory notes as a securitisation vehicle and is accordingly consistent with the admission by Bakkes in his plea. During cross-examination regarding Corpfin, counsel put it to Bakkes that CMM engaged directly in bridging finance in relation to assets originated by Corpfin. Bakkes denied this saying that CMM never invested directly in bridging finance because it used a securitisation vehicle for that. He then identified Corpfin as that securitisation vehicle in question, which, he added, was later reversed into Escascape. He went on to confirm that Corpfin was a securitisation vehicle which issued promissory notes in which CMM invested. Bakkes

further admitted that Corpfin did not have the written authorisation of the Registrar of Banks. Consequently, Corpfin too did not fall within the designated activity in the exemption notices and thus, on this evidence, conducted the business of a bank.

60. However, it also emerged during the cross-examination of Bakkes that the curators have not been able to locate any promissory notes issued by Corpfin. They have inferred that they were issued from the accounting entries in the Hi-Port accounting system of CMM.

61. Bakkes was also cross-examined by the seventeenth defendant, Mr Vincent Smith ("Smith"), about the Corpfin promissory notes. He then directly contradicted his earlier testimony and his plea. Smith asked him whether the Corpfin board, of which they were both members, had ever agreed to issue promissory notes. Bakkes replied: "I was under the impression that Corpfin did not issue promissory notes on their own balance sheet". Bakkes further agreed with the proposition put to him by Smith that he (Smith) had never agreed to being a party to the issuing of promissory notes by Corpfin. Smith did not testify in the separated hearing. After reserving judgment on the separated questions, and after considering the issue, but before making any ruling, I requested counsel to address me on whether I was required to make a credibility finding in relation to Bakkes in order to determine whether on a balance of probabilities Corpfin had indeed issued promissory notes. The plaintiffs opted at that moment to seek an

amendment to paragraph 1 of the notice of motion deleting any reference to Corpfin, with the result that the separated questions in relation to Corpfin will be decided at a later stage of the trial after there has been further evidence.

62. Thunderstruck issued three promissory notes against acceptance of money from CMM to finance the acquisition of an immovable property in Meyersdal in March-April 2008. Thunderstruck was not a securitisation vehicle. The acquisition was initially financed by a single promissory note of R15 million which was then split into two different promissory notes. Thunderstruck had no authorisation from the Registrar of Banks to issue commercial paper. Bakkes conceded that the money used by Thunderstruck was a long-term loan and was not operating expenses. He further admitted that when the promissory note was split into two it was allocated to two investors in CMF who were members of the public. On these facts it can be accepted that Thunderstruck accepted money from the general public against the issue of commercial paper and did not comply with the conditions in paragraph 3 of the Commercial Paper notice. In particular, because it was not a listed company or a listed company with a net asset value exceeding R100 million it required the written authorisation of the Registrar of Banks in terms of paragraph 3(1)(b)(iii) of the Commercial Paper notice, which it did not have. In consequence, the Thunderstruck promissory notes were not legal commercial paper in the sense that they fell within the ambit of the exemption. However, as Thunderstruck

issued only one promissory note, which was subsequently split into two, it cannot be said, (and it was conceded by the plaintiffs in argument) that Thunderstruck accepted deposits as a regular feature of its business, within the meaning of the definition of the business of a bank. Hence, Thunderstruck did not contravene the Banks Act by issuing the promissory note to finance the property acquisition.

63. Prior to the defendants making concessions in relation to Four Rivers, Regent/Two Ships and Escascape, they put forward a possible defence that the various companies did not accept deposits from the general public and for that reason they did not conduct the business of a bank as defined and hence did not contravene section 11 of the Banks Act. In light of the concessions, the defence falls away in relation to those three companies. For the reasons which immediately follow the defence is of no avail to the other companies either. The definitions of “general public” and “public” in the Banks Act are not inclusively descriptive or comprehensive. According to the definitions “general public” does not include a bank and the “public” includes a juristic person. The words “general public” in their ordinary connotation mean the members of the community at large, in the sense of natural persons – *Commissioner of Inland Revenue v Plascon Holdings Ltd* 1964 (2) SA 464 (A) at 470E-F. The inclusion by the Banks Act of juristic persons within the meaning of “public” means that all members of the community at large, including juristic persons, are members of the general public as envisaged by the Banks Act. As explained earlier,

the promissory notes issued by the companies were issued in favour of CMM or bearer. It is common cause that CMM acted as an authorised agent for the investors in the pool of CMF and the individual investors in the segregated portfolios. Some 870 investors invested in promissory notes in this fashion. The SPVs who were controlled by Bakkes and persons associated with him accordingly solicited and accepted through CMM investments from the general public against which deposits they issued the promissory notes.

64. The moneys advanced to the SPVs on behalf of the investors by CMM constitute deposits as envisaged in the definition of deposit in section 1 of the Banks Act in that they were "an amount of money paid by one person to another person, subject to an agreement in terms of which an equal amount…. will be conditionally or unconditionally repaid (and) … interest will be payable thereon … notwithstanding that such payment is limited to a fixed amount or that a …. instrument providing for the repayment of such amount …. is issued in respect of such amount". There is no doubt that the acceptance of money against the issue of a promissory note falls within the definition.

65. Bakkes readily conceded that the investors whose money CMM invested in the segregated portfolios were members of the general public, as was CMM itself and CMF and those who had participatory interests in it. He also admitted that any member of the public could invest in CMF and give CMM a mandate to invest in cash

management. He furthermore accepted that the issuing of promissory notes by Regent/Two Ships, and therefore by implication the other SPVs, would constitute the taking of deposits and that if deposits were taken from the general public as a regular feature of the company's business it would constitute the business of a bank. He also admitted that authorisation from the Reserve Bank was required to conduct the business of bank, or from the Registrar of Banks, to benefit from the securitisation exemption notices.

66. There is accordingly no doubt that the commercial paper issued by the SPVs, namely Miro Capital, Four Rivers, Regent Group Capital/Two Ships, Finpro and Escascape was not legal commercial paper in the sense that the activity of issuing it fell outside the definition of a business of a bank. There is equally no question that these companies solicited and accepted deposits from the general public as a regular feature of their business. In the result, the promissory notes issued by them were not legal commercial paper and the issue of the promissory notes against the acceptance of money from the general public constituted "the business of the bank", which business they conducted in contravention of section 11 of the Banks Act. For the reasons I have already stated, the same cannot be said of Thunderstruck.

The third and fourth questions: contravention of GN1503 and the breach of mandate

67. I turn now to the questions regarding the contravention of GN1503 and breach of the mandate. In terms of clause 3 of the CCM-client investment mandate, referred to as an investment management agreement for cash management between CMM and the client, approved by the Registrar and the FSB, CMM was authorised by the client to withdraw such monies and/or to sell units to make payment in accordance with the client's instructions and/or to invest all funds on behalf of the client in assets and under the strategy as set out in Clause 16 of the mandate, being the clause specifying the investment guidelines. "Assets" are defined for the purposes of the mandate in clause 1.10 to include such money market instruments, bonds, unit trusts and investment instruments deemed appropriate by CMM. Clause 16.1, as mentioned earlier, identifies the nature of the investment as "a low risk South African cash management fund", and states that the CMF aims to outperform the relevant money market benchmark over the medium term at low levels of risk within the money market asset class.

68. Clause 16.8 and 16.9 of the mandate deal with general and specific investment contracts respectively. Clause 16.8 reads:

> "CMM will invest on behalf of the client only in assets or underlying funds that invest in Rand-denominated and *investment grade* South African investment

instruments. CMM may at times use fixed income derivatives …. within the risk parameters set out below."

69. Clause 16.9 deals with the risk parameters and the specific investment constraints in two distinct tables. The first table governs the aggregate exposure to rating classes. Of particular relevance is the fact that the table limits the aggregate exposure to long term class ratings AAA, AA, A and BBB corporate debt combined to a maximum of 25% of the fund. The table expressly records that investment in instruments with a rating lower than BBB is "not permitted". The second table relates to specific investment constraints as regards the exposure to any single institution. The exposure to any single institution with an AAA, AA, A and BBB corporate debt rating is limited to "an absolute maximum" of 5% of the fund.

70. GN1503 contains additional specific investment constraints in relation to collective investment schemes, and Chapter VII thereof governs non-equity securities. Annexure B of GN1503 deals with the national rating scales of rating agencies, including Global Credit Rating, ("GCR") the agency involved in this matter. In terms of clause 25 of GN1503 read with Annexure B, the maximum permissible percentage inclusion per instrument or issuer as a percentage of the market value of the assets comprising the portfolio is: 20% in respect of instruments with a long-term GCR rating of A+, A or A-; and 5% in respect of instruments in respect of instruments with a long term GCR rating of BBB+ or BBB. No investments may be made in instruments with a

long-term GCR rating lower than BBB. Clause 25(b) read with clause 3(10) of GN1503 indicates that unlisted non-equity securities can only be included in a portfolio if they are rated by one of the rating agencies identified in Annexure B. Investment in unrated promissory notes by a collective investment scheme is therefore prohibited. Clause 25(b)(ii) prohibits inclusion of commercial paper rated A- to A+ in excess of 20% or rated BBB to BBB+ in excess of 5%, while clause 3(10) provides that unlisted non-equity securities may be included in a portfolio in the manner and on the conditions determined in Clause 25, only if they are rated. By clear implication unrated, unlisted non-equity securities (including, by definition, commercial paper) may not be included in a portfolio.

71. Bakkes conceded under cross examination that to the extent that any investment by the CMF in promissory notes exceeded the 20% threshold, this would constitute a breach of GN1503. Bakkes also conceded that CMM was not authorised, either in terms of GN1503 or the mandate, to invest on behalf of CMF or on behalf of specific investors in unlawfully issued commercial paper. That concession alone, taking into account my findings that the issue of the promissory notes did not fall within the exempted designated activity in the Commercial Paper notice and the exemption notices, and furthermore was in contravention of section 11 of the Banks Act, is tantamount to an admission that investment in the promissory notes was not

permissible in terms of GN1503 and in breach of the investment mandate.

72. The plaintiffs contend that besides breaching the mandate and GN1503 for non-compliance with the Banks Act, the investment in promissory notes issued by the various so-called SPVs contravened the provisions of both the mandate and GN1503 in other material respects. During the cross-examination of Bakkes, the plaintiffs relied upon CMM's "Hi-Port" accounting system and the report compiled by its expert van Romburgh from that system and extensive source documentation. Bakkes conceded that the asset allocation can be determined from Hi-Port. He at times sought to challenge the conclusions taken from Prof van Romburgh's expert report which were put to him, but put up no countervailing evidence. The plaintiffs have established on a balance of probabilities the value of both the investment funds in CMF under management by CMM from July 2006 until closure on 3 April 2009 and the investment in promissory notes issued by the various SPVs throughout the period, from which it is possible to calculate the inclusion per instrument or issuer as a percentage of the market value of the assets under management.

73. Miro began issuing promissory notes in August 2006 and continued to issue notes allocated to CMF until the end of September 2007. The value of these notes fluctuated between R24 172 947 and R128 165 657 in the period, while their value as a percentage of the assets of the

fund grew from 1,23% in August 2006 to 10,05% in September 2007. The percentage exceeded 5% for the first time in March 2007 and remained above that figure consistently until September 2007 when the value of the fund stood at R1,276 billion. Miro was not rated between August 2006 and March 2007. It was awarded a BB- rating by GCR in March 2007. Accordingly, the investment in these promissory notes offended the mandate and GN1503 in various respects. Firstly, the rating of Miro as BB- meant that investment in them was not permitted and prohibited in absolute terms in terms of both the mandate and GN1503. The investment exceeded the 5% limit in terms of clause 16.9 of the mandate from March 2007 up to and including September 2007. At the time of closure of the fund, Miro promissory notes (including those issued to Four Rivers) amounted to R433 148 947, representing 37,59% of the value of the funds under management.

74. Four Rivers received an A- rating from GCR in September 2007. GCR downgraded this rating in January 2009 to BB because of a "fundamental shift in the underlying risk profile of the product offering" because the SPV did not generate sufficient cash flows to fully redeem the promissory notes at maturity resulting in the need for the notes to be rolled over at maturity. It recognised that the cash flow problem was a consequence of the discounting of property proceeds for developers having changed "from a short dated bridging product to longer dated property development finance". GCR further down graded Four River to CCC in March 2009. It expressed concern about non-compliance with

legal covenants and noted that steps had not been taken to address the sizeable mismatch between assets and liabilities and other concerns in its earlier downgrade report.

75. The investment in Four Rivers promissory notes breached and contravened the provisions of the mandate and GN1503 in various respects. The investment exceeded the 5% exposure to a single institution and issuer from inception until closure, moving from 10,19% in October 2007 to 57,07% in March 2009. In so far as Four Rivers was rated A- until January 2009, and total exposure to A- corporate debt was limited by the mandate to 25% and to 20% by GN1503, the investment in Four Rivers breached the mandate from August 2008 when the investment represented 28,97% of the assets in CMF and remained in breach until the end of December 2008 when the percentage grew to 39,76%. It contravened GN1503 from May 2008. As from January 2009, Four Rivers was rated BB and therefore the investment was prohibited in terms of both the mandate and GN1503. The percentage grew in the period January 2009 until April 2009 from 41,66% to 57,17%.

76. The first investment in Two Ships/Regent was made in January 2008. Regent/Two Ships was only rated by GCR in July 2008, when it was awarded an A-rating. In April 2009 CMF held R106 779 874 in Regent/Two Ships promissory notes, representing 22,91% of CMF assets. The investment exceeded the 5% exposure to a single

institution or issuer from February 2008 until the closure of the fund. Every investment in these notes in the six months before the company was rated in July 2008 was prohibited in terms of both the mandate and GN1503, being an investment in unrated commercial paper. As at July 2008, that exposure amounted to R103 942 634, representing 9,6% of the fund invested in unrated promissory notes. The investment in A- rated corporate debt in the period from July 2008 exceeded the 20% threshold of GN1503 for February 2009 (22,52%) and March 2009 (22,91%). Thus, while the investment was within the threshold of 20% between 2008 and January 2009, it exceeded the 5% threshold of the mandate in that time. But Four Rivers and Regent/Two Ships combined in any event exceeded the 25% aggregate exposure to corporate debt permitted by the mandate.

77. The companies Finpro, Corpfin and Escascape were never rated by GCR. Consequently, every and any investment made in promissory notes issued by these entities was not permitted in terms of the mandate and GN1503. The aggregate amount of these promissory notes at 3 April 2009 was R247 851 995,19 representing an exposure of 21,42% of the funds under management. As stated, the dispute about whether or not Corpfin issued promissory notes remains unresolved. The plaintiffs have not uncovered any promissory notes issued by Corpfin and the evidence in that regard is incomplete. Should it be found that Corpfin did indeed issue promissory notes, for reasons just stated, Corpfin being unrated, any investment in them would be in

breach of the mandate and GN1503. The accounting records disclose entries in the amount of R20 643 760 being in respect of Corpfin promissory notes unpaid at April 2009, representing 1,78% of the fund. Likewise, the investment in the Thunderstruck promissory note of R15 030 000 was in breach of the mandate and GN1504 for the same reason. It too was unrated.

78. With regard to costs, I see no reason why the costs of the hearing in relation to the separated questions should not follow the result.

79. In the premises, I make the following declaratory orders:

1. The issuing of promissory notes by the following entities:

    1.1 Miro Capital (Pty) Ltd;

    1.2 Four Rivers Trading 307 (Pty) Ltd;

    1.3 Regent Group Capital (Pty) Ltd t/a Two Ships 427 (Pty) Ltd;

    1.4 Escascape Investments (Pty) Ltd t/a Sakha iBlokho;

    1.5 CMM Finpro (Pty) Ltd; and

    1.6 Thunderstruck Investments 15 (Pty) Ltd

    did not fall within the activity designated by the Registrar of Banks in paragraph 2 of the Schedule to GN 2172 of Government Gazette 16167 of 14 December 1994, or in paragraph 2 of the Schedule to GNR681, Government Gazette 26415 of 4 June 2004, or in paragraph 2 of the Schedule to GN2, Government Gazette 30628 of 1 January 2008, and hence

such promissory notes were not legal commercial paper as contemplated in paragraph 1 of the notice of motion in terms of rule 33(4) filed by the plaintiffs on 18 March 2014.

2. The issue of promissory notes, against the acceptance of monies, by the entities referred to in paragraphs 1.1, 1.2, 1.3, 1.4 and 1.5 of this order, constituted “the business of a bank” as defined in section 1 of the Banks Act 94 of 1990 and was in contravention of section 11 of that Act.

3. The investment by Corporate Money Managers (Pty) Ltd of the funds of the CMM Cash Management Fund and that of its investor clients in the promissory notes issued by any or all of the entities referred to in paragraph 1 of this order was in contravention of the provisions of GN1503, Government Gazette 28287 of 4 December 2005 and in breach of the investment mandate approved by the Registrar and/or the Financial Services Board or any variation thereof.

4. The 1st, 17th, 19th and 20th defendants are ordered to pay the costs of the proceedings in relation to the determination of the questions separated in terms of rule 33(4), jointly and severally, the one paying the other to be absolved, such costs to include the costs attendant upon the employment of three counsel.

JR MURPHY
JUDGE OF THE HIGH COURT

Representation for the Applicants:

Counsel:	Adv FH Terblanche SC
	Adv. KW Lüderitz SC
	Adv HR Fourie
Instructed by Attorneys:	Roestoff & Kruse

Representation for 1st 19th & 20th Defendants:

Counsel:	Adv MM Snyman
Instructed by Attorneys:	EY Stuart Inc.

Representation for 17th Defendant: In person