CASE NO 130/89

IN THE SUPREME COURT OF SOUTH AFRICA

(APPELLATE DIVISION)

In the matter between:

ROBIN FRANCIS HOWARD APPELLANT

AND

OTTO FRIEDRICH CHRISTIAN HERRIGEL, N.O. FIRST RESPONDENT

BAREND GERT STEYN DE WET, N.O. SECOND RESPONDENT

CORAM: JOUBERT, SMALBERGER, NESTADT, KUMLEBEN et GOLDSTONE JJA

DATE HEARD: 18 February 1991

DATE DELIVERED: 8 March 1991

J U D G M E N T

GOLDSTONE, JA:

The respondents are the liquidators of Loredo (Pty) Limited ("Loredo"). In that capacity they brought proceedings in the Witwatersrand Local Division against the appellant, Robin Francis Howard ("Howard"), Ellison Dateling ("Dateling"), Coenraad Marthinus Vermaak ("Vermaak") and the Standard Bank of South Africa Limited ("SBSA"). They sought orders against each of these parties holding them jointly and severally liable for the payment of all of the debts of Loredo. The claims were made in terms of the provisions of section 424(1) of the Companies Act 61

of 1973 ("the Act") and alternatively were based on the common law delict of fraud. In the result the claims against Dateling, Vermaak and SBSA were dismissed. The claim against Howard succeeded to the extent reflected in the order made by Morris AJ in the Court a quo. The terms thereof now relevant read as follows:

> "A.1 The first respondent [Howard] is declared to be liable in terms of Section 424(1) of the Companies Act, No 61 of 1973 for debts incurred by Loredo (Proprietary) Limited (the Company) to persons and in the amounts reflected in Annexure B to the applicants' founding affidavit as having been paid to the Company by such persons during the period from and including 14 November 1984 to the date of liquidation.
>
> 2. The first respondent is to pay sixty percent of the applicants' costs.

.....

E. Subject to any resolution to the contrary by creditors and subject to the preferences set forth in the Insolvency Act, No 24 of 1936, any amount paid by the first respondent, shall be apportioned pro rata amongst the creditors for whose claims the particular respondent is liable."

The reference to "the particular respondent" in the last sentence should have been a reference to "the first respondent".

With leave of the Court a quo, Howard appeals to this Court against the whole of the order made against him. The respondent applied to that Court for leave to cross-appeal in respect of the date from which Howard was held to be liable for the debts incurred by Loredo. They contend that it should have been 20 September 1984, the

date on which the first investment was received by Loredo. They also applied for leave to cross-appeal against the costs order, contending that Howard should have been ordered to pay all of the costs of the respondents. That application for leave to cross-appeal was refused with costs. The respondents thereafter applied to the Chief Justice for leave to cross-appeal. That application was successful and in so far as it is now relevant it was ordered that:

> "1) Verlof is aan die applikante verleen om 'n teenappèl te loods teen die gedeelte van die uitspraak ten opsigte van eerste respondent wat nie voorsiening maak vir betaling van die skulde aangegaan vanaf 20 September 1984 tot 13 November 1984 nie, en teen die gedeelte wat eerste respondent aanspreeklik stel vir slegs 60% van die applikant se koste, na hierdie hof, op 10/05/1989.
>
> 2) .....

3) Die koste van hierdie aansoek sal koste in die teenappèl wees behalwe dat die applikant die koste van die 2de en 3de respondente in die aansoek moet betaal."

The issues on appeal are considerably narrower than those which were argued in the Court a quo. In the first place we are only concerned with the liability of Howard. It is conceded by Howard that the business of Loredo was conducted fraudulently in that investors' moneys were misapplied by a director of Loredo, Mrs C. Smith ("Smith") and Loredo's attorney, Mr. L. Gelb ("Gelb"). Secondly, it is not sought on behalf of the respondents to hold Howard liable other than under the provisions of section 424(1) of the Act. Consequently, the following broad issues were argued on appeal:

1. Whether the respondents were entitled to bring their claim for relief against Howard by application proceedings and not by way of action;

2. Whether Howard was knowingly a party to the business of Loredo being carried on recklessly or with intent to defraud its creditors or for any fraudulent purpose;

3 If Howard was knowingly a party as aforesaid, the extent of his liability under section 424 of the Act;

4 Whether the costs order made by the Court a quo should be amended.

THE FORM OF THE PROCEEDINGS

Section 424(1) of the Act reads as follows:

> "(1) 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."

In Food and Nutritional Products (Pty) Ltd v Neumann 1986(3) SA 464 (W) it was held by Schabort J that this section of the Act does not restrict a litigant to application proceedings and that relief thereunder may properly be sought in action proceedings. In other words, that the choice of procedure is governed by the ordinary rules. The correctness of that decision was not questioned on behalf of the respondents and I shall assume that it is correct. The question is whether, on that assumption, the respondents were obliged to proceed by way of action.

The correct approach in a case such as the present

was laid down by this Court in Tamarillo (Pty) Ltd v B N Aitken (Pty) Ltd 1982(1) SA 398 (A) at 430 G - 431 A. Miller JA said this:

> "A litigant is entitled to seek relief by way of notice of motion. If he has reason to believe that facts essential to the success of his claim will probably be disputed he chooses that procedural form at his peril, for the Court in the exercise of its discretion might decide neither to refer the matter for trial nor to direct that oral evidence on the disputed facts be placed before it, but to dismiss the application. (Room Hire Co (Pty) Ltd v Jeppe Street Mansions (Pty) Ltd 1949 (3) SA 1155 (T) at 1168.) But if, notwithstanding that there are facts in dispute on the papers before it, the Court is satisfied that on the facts stated by the respondent, together with the admitted facts in the applicant's affidavits, the applicant is entitled to relief (whether in respect of all his claims or one or more of them) it will make an order giving effect to such finding, with an appropriate order as to costs. (Cf Stellenbosch Farmers' Winery Ltd v Stellenvale Winery (Pty) Ltd 1957 (4) SA 234(C) at 235;

Burnkloof Caterers (Pty) Ltd v Horseshoe Caterers (Green Point) (Pty) Ltd 1976 (2) SA 930 (A) at 938.) The Court does not exercise a discretion in motion proceedings whether or not to grant claims established by the admitted or undisputed facts; except perhaps in very extraordinary circumstances the applicant has a right to an order in respect of such established claims. (Room Hire case at 1166.)"

The learned Judge a quo expressly sought to follow that approach. In the course of his judgment he said:

"I shall decide [this matter] on application with the result that if there is a dispute on any material fact I must resolve that fact on the basis that it cannot be decided on affidavit and the applicants do not or did not elect to adopt the ordinary proceedings of rauw actie.

.....

In these circumstances the case against Howard must be approached on the basis that his version of the facts is correct, and on the basis that the applicants do not seek an order under rule 6(5)(g) or that the matter be referred to trial.

.....

> It was further submitted that the Court has no discretion in the matter but that on the facts set out by the respondent, together with admitted facts set out by the applicants, the applicants must be given the relief which the law allows. There appears to be weighty authority in support of this proposition. I do not propose to exercise any sort of discretion. I propose to approach the matter on the facts set out in the respondent's affidavit (Howard in this case) and his evidence at the inquiry."

In testing the factual findings of Morris AJ it is necessary to keep in mind this approach to disputed evidence. On that basis I can conceive of no valid cause for complaint with regard to the respondents having approached the Court a quo by way of application proceedings. If the admitted facts together with the facts stated by Howard did not entitle the respondents to relief then the application should have been dismissed and this appeal should succeed. If these facts did establish

liability on the part of Howard under section 424(1) of the Act, then the respondents were entitled to relief. In that event the other issues referred to above will fall to be considered.

It is convenient at this point to canvass the factual background which emerged from the affidavits and supporting documents. Having regard to what I have already said concerning the proper approach in these proceedings, I do so on the basis that we must accept as correct Howard's version.

According to Howard, at the time of signing his affidavit on 9 November 1987, he was a 64 year old businessman. He was a director of a number of companies in Johannesburg in what he refers to as "The Howard Group of Companies". He had been involved in their activities since their inception many years before. The business of those

companies was described by Howard as follows:

> ".... the said companies are engaged in the business of portfolio management, and my participation therein has largely been confined to the performance of analyses relating to stock market and economic trends, both locally and elsewhere and stock market research."

Howard alleges that in January 1984 he was approached by Smith. He had not previously known her. She informed him that she was employed as an investment consultant by an estate agent, Inter Control Plan, which, inter alia, was engaged in the business of lending out moneys on behalf of clients over the short term at high rates of interest. She also said that she had previously been an employee of the Trust Bank of Africa Ltd. She enquired whether Howard was prepared to invest his own funds with her employer. She also informed him that Inter Control Plan offered security to investors in the form of mortgage bonds registered over both the immovable and movable property of borrowers.

In response to a query raised by Howard, Smith advised him that Inter Control Plan was not registered to do business in the field of participation mortgage bonds but was in the process of securing such registration. Howard states in his answering affidavit that:

" (i) I was not particularly interested in placing any investments with Smith; I however did advise her that it seemed to me that the activities of the said Inter Control Plan might constitute a violation of both the Banking Act and the Unit Trust Act, inasmuch as it appeared to me that it was acting as a deposit receiving institution in respect of funds well in excess of the limitation imposed by law.

(ii) I wish to make it perfectly clear that I was not, and did not regard myself as an expert insofar as the legalities relating to the functioning of a deposit receiving institution are concerned.

(iii) I had however come across the matter from time to time in relation to my dealings on behalf of The Howard Group of Companies, and I raised the question pertinently with Smith as I had shortly before my meeting with her had occasion to consult Senior Counsel in relation to certain aspects of the Banking Act."

Smith again approached Howard in March 1984. She was upset and informed him that she feared that monies which she had obtained from clients for investment by Inter Control Plan might not have been properly secured. Howard stated that he was:

> "particularly impressed at the concern shown by Smith in relation to the welfare of her clients; such concern was to my mind genuine, and by reason thereof I formed an extremely favourable impression of Smith in relation to the ethical standards which she wished to maintain in her dealings on behalf of her clients."

She informed Howard that she was well acquainted with

banking and accounting practice and procedures. He says that she "created an impression of being a person of financial standing".

Howard suggested to Smith that she consult the firm of attorneys, Gelb, Benjamin and Kaplan in order to clarify the issues she had raised with him. That firm occupied offices in the same building in which The Howard Group of Companies hired offices. He recommended that firm because he knew that they acted on behalf of a very large property company and therefore had "the necessary expertise to furnish Smith with the advice she required".

Some months later, Smith again visited Howard. She said that she had consulted Gelb who had satisfactorily dealt with her problems and that her concern in regard to the affairs of Inter Control Plan had been misplaced. She informed Howard that she intended to commence her own business in the field of participating mortgage bonds and

for that purpose she would register a company. She invited Howard to become a shareholder in that company. He agreed to do so. According to Howard, he had "no reason to suspect her integrity". In return for his participation he required that three conditions be met, viz:

i. that the auditors of the Howard Group of Companies, viz. S. Taitz, Kaplan and Company were to be the auditors of the envisaged company;

ii. Dateling, then the senior audit clerk of S. Taitz, Kaplan and Company, was to have access to the books and records of the company for the purpose of preparing trial balances and the performance of certain secretarial work on its behalf; and

iii. Gelb was to attend to the legal work of the company.

Howard further explained to Smith that he would

have very little time to devote to the affairs of the company. He would be in a position to furnish the company with advice but would not play an active role in the day-to-day administration and affairs of the company. He added:

> "I made it plain to Smith that regard being had to the restraints on my time, I could be no more than a non-executive director of the company with responsibility for furnishing advice from time to time."

With regard to Gelb, Howard stated in his affidavit that he was "favourably impressed by him and regarded him as a competent, honest, responsible and efficient attorney".

Smith agreed to the requirements of Howard, and Gelb was "instructed to register a participation mortgage bond company". Pending such registration, it was agreed that moneys would be obtained from clients for investment by way of short term loans at high rates of interest. More

particularly, it was agreed that the company would endeavour to procure investments not to exceed a total aggregate of R500 000 to be lent by it to suitable borrowers at high rates of interest for periods not to exceed one year. Loans were to be secured by the registration of first mortgage bonds over the immovable properties of borrowers, the amount of any single loan not to exceed 70% of the sworn valuation of the property over which such mortgage bond was to be registered. Because of the high prime bank lending rate at that time and the demand for loans, explained Howard, the company would generate sufficient income to secure the interest due by it to its investors and the payment of commissions to such of its agents as became entitled thereto. It was also agreed that the company would charge its borrowers a management fee. The limit of R500 000 was presumably introduced in an attempt to take advantage of proviso (iii) to section 1(2A)(b) of the Banks

Act, 23 of 1965, which provides that:

> "(iii) a person (including a co-operative society) other than a person who solicits or advertises for deposits, shall not be deemed to be carrying on the business of accepting deposits if he does not at any time hold deposits from more than twenty persons or deposits amounting in the aggregate to more than five hundred thousand rand."

According to Howard, moneys in excess of R500 000 would be paid directly into a banking account in the name of the customer (the lender) and from there paid to the selected borrower against the registration in favour of the lender of a first mortgage bond over the borrower's immovable property. The company would not be privy to any contract between the lender and the borrower. These arrangements were obviously also designed in an attempt to avoid the provisions of the Banks Act.

Howard refers in some detail to his own reputation and financial position. He refers to the Howard Group of Companies as "one of the leading portfolio managers operative in the Republic", managing funds well in excess of R80 million.

Smith, alleges Howard, readily agreed to all of his requirements and that "fortified my belief in her honest intent to deal in a financial market in which she was well versed".

Pursuant to those arrangements, Loredo was registered on 26 July 1984. It had an authorised share capital of 1000 shares of R1 each. After the initial allotments, Howard and Smith each owned 50 shares in the company. On the date of incorporation both Howard and Smith became the directors of Loredo. The auditors were S. Taitz, Kaplan and Company and Howard was appointed as the public officer of the company.

On 1 September 1984, Howard accompanied Smith to the Stock Exchange Branch of SBSA where he introduced her to Vermaak who was then the manager of that branch. Howard advised Vermaak that:

> "Loredo would ultimately do business in the field of participation mortgage bonds, but that because of the strictures governing the securing of consent to do so, this would take some time before taking effect."

The banking account of Loredo was opened on that day and Smith and Howard were the signatories thereto. In fact Howard never signed any cheques on behalf of the company. According to Howard his signature "was required to cater for any situation of emergency necessitating the need for the cheques to be signed on behalf of Loredo in the absence of Smith".

Smith operated the affairs of Loredo from an office in the premises hired by The Howard Group of

Companies. Initially, so Smith reported to Howard, very little business was done by Loredo.

Shortly after the commencement of business by Loredo, Smith called at Howard's office with a Mr Boshoff. He was introduced as a client of Loredo. It is not in issue that Boshoff was the first investor and he paid to Loredo the amount of R90 000. He was promised a rate of interest of 27% per annum. Shortly thereafter, a Mr C H Smith invested the amount of R59 000 with Loredo.

On 28 September 1984, Vermaak, in his capacity as manager of the Stock Exchange Branch of SBSA issued a document addressed "TO WHOM IT MAY CONCERN". It read thus:

> "This will serve to introduce
>
> MRS CYNTHIA SMITH
>
> Who is a Director of a Company styled Loredo (Pty) Ltd. This latter Company conducts its account with us and we know the directorate to be of a very high integrity who should not commit the

Company beyond its means. They have been known to us in their personal and through their wide business activities for a number of years."

This document contains false representations and especially with regard to Smith. Vermaak had only met her on one occasion about a week before when the company opened its account. Howard denies knowledge of the document or of its use by Smith to obtain investments. For the purposes of these proceedings that denial must be accepted as being truthful.

Smith had contacts in what was then South West Africa. At about the beginning of October 1984, she visited Windhoek in order to obtain agents and investors for Loredo.

During October 1984, Smith presented Howard with a number of certificates which were to be the formal record of investments with Loredo and which were to be delivered to

the investors. These certificates were printed documents. Under the name of Loredo they recorded that the named investor had invested a stated amount of money. The type of security was stated as well as the interest payable. They also recorded that:

> "Beleggings word deur geregistreerde Eiendoms-verbande/Deelnemings vergaande (sic) beveilig."

Provision was made for a signature on behalf of Loredo. Smith informed Howard that, on the advice of Gelb, the certificates should be signed by both of the directors of Loredo. She requested Howard to sign the certificates in blank in order to obviate any delays in sending them to investors. In answer to a query from Howard, Smith stated that the aggregate of the amounts reflected in the certificates would not exceed R500 000. Gelb telephonically confirmed to Howard that on his advice both directors should sign the certificates. According to

Howard, on the strength of the representation that the certificates would not reflect investments in excess of R500 000, he signed them.

In the middle of November 1984, at the invitation of Smith, Howard accompanied her to to Windhoek to address the agents and potential clients of Loredo. The meeting took place in the home of Mr Tobie van Zyl in Windhoek. Apart from Smith, Howard and Van Zyl, there were present Van Biljon and some twelve salesman in the employ of an insurance company in Windhoek. Van Biljon would appear to have been the only potential investor present at this meeting. The others, apart from Howard and Smith, were potential agents of the company, who, so it was intended, would seek investments for Loredo. Howard addressed the meeting. That address was recorded and the correctness of the transcript produced by the respondents was not seriously challenged.

In his answering affidavit, Howard confirmed that he addressed the meeting, and that:

> "I made it plain that any investment placed with Loredo would be secured by the registration of a first mortgage bond over immovable property, the moneys so invested to be retained in trust until the registration of the said bond. If circumstances so demanded, additional forms of security could be obtained."

Howard explains his statements as follows:

> "(i) I would point out that the representations which I made at the said meeting were firmly rooted in what had been agreed to by Smith, Gelb and me in relation to the manner in which Loredo would operate.
>
> (ii) Its mode of operation had frequently been discussed in the past, and what I stated at the said meeting was fully consonant with the mode in which it had been resolved the affairs of Loredo would be conducted."

He added that his statements to the meeting were made in "the firm and honest belief that the affairs of Loredo would in fact be conducted in this manner".

In the period thereafter Smith continued to occupy the office in the same building. He saw her often and she informed him that business was slow. He was not called upon to play any role in the day-to-day administration of the company. He says that:

> "I was not called upon to sign any cheques on behalf of Loredo, and aside from participating in short informal meetings with Smith on a weekly basis where my advice in general was sought, I was not required to fulfil any other role in the conduct of its affairs."

At the beginning of December 1984, Smith went overseas on vacation. She only returned at the end of January 1985. During her absence, her secretary, Mrs

Alexander, attended to the affairs of Loredo. She did not consult Howard and assured him that everything was under control.

When Smith returned to Johannesburg at the end of January 1985, her mother took ill and that necessitated her absence from the office for a further month. From time to time she came into Howard's office and remained in daily contact with Mrs Alexander.

Howard states that in February 1985 he received a telephone call from Mr Tobie van Zyl. He advised him that he had received complaints from investors of Loredo that they had not received monthly interest payments on their investments. Howard informed Van Zyl that he had nothing to do with the administration of Loredo. However, he took down the names of the investors and informed Van Zyl that he would instruct Smith to contact him. When Howard took up this complaint with Smith, she advised him that everything

was under control and that the interest payments had already been sent to the investors in question. Howard urged her to avoid that "type of shoddy administration". Van Zyl did not again contact Howard.

At the end of February 1985, Smith informed Howard that she was moving the offices of Loredo to other premises at Commercial Centre, Bree Street, Johannesburg. At that time Smith also told him that she intended lending moneys to Loredo on loan amount. He believed that she was well able to do so. Howard did not lend moneys to Loredo and he was not asked to do so. At no time did he draw any moneys from Loredo, either in the form of salary or otherwise. As far as he was aware, Smith had also not drawn any moneys from Loredo.

Prior to Smith moving the premises of Loredo to Commercial House, Howard instructed Dateling, who by then was employed by the Howard Group of Companies, that he

required him to prepare a trial balance sheet of Loredo. Towards the end of January 1985, Dateling informed Howard that he needed the books of Loredo in order to prepare the trial balance sheet. Smith had previously informed Howard that the books of the company had been written up by a bookkeeper she had employed for that purpose. Howard instructed Dateling to make arrangements with Mrs Alexander to obtain the books of account. Some time thereafter, Dateling informed Howard that he had been unable to make arrangements to inspect the books. Howard did not regard this as being in any way sinister. In March 1985 Dateling informed Howard that he was still experiencing difficulty in obtaining the books. Dateling attributed this to the problems which Smith was experiencing with regard to the illness of her mother. Dateling later informed Howard that he had eventually obtained the books, only to discover that none of them had been completely written up. Howard was

annoyed at receiving this information and instructed Dateling to complete the writing up of the books of account. Howard so advised Smith. During the middle of March 1985 Dateling informed Howard that he had been unable to locate source documents such as bank statements and vouchers. Smith had told him that such documentation must have gone astray. Again Howard alleges that he "did not detect any sense of urgency in the situation". The year-end of Loredo was 30 June 1985 and there was then still time available for the writing up of the books of account for presentation to the auditors of the company.

During the first two weeks of April, Dateling informed Howard that he had "commenced the completion of the writing up of the said books of account". He also advised him that he was experiencing some difficulty in collating the moneys which had been invested with Loredo and those which had in turn been placed by it on loan on behalf of

such investors. Dateling told Howard that the problem stemmed from his inability to obtain the register containing details of the bonds which had been registered to secure such investments. The register was in the possession of Gelb and he was unable to obtain it from him. According to Howard:

> "I wish to make it perfectly clear that the Second Respondent (Dateling) told me nothing which ought by any stretch of the imagination to have aroused a suspicion in my mind that the affairs of Loredo were not being administered in a proper fashion."

> "There was nothing in what he told me which suggested that any irregularities had been committed, or that moneys had been or were being misappropriated."

Toward the end of April 1985, Gelb informed Howard that Smith had terminated his services as the attorney of

Loredo. Howard said that he was startled by that disclosure. He said that he was also dismayed that Smith had not sought to consult him in regard to the matter. On the advice of Gelb he resolved to resign as a director of Loredo. He telephoned Smith and advised her of that decision. Howard said that Smith accepted his resignation with immediate effect. She also agreed to purchase his shares in Loredo at their par value. Howard also instructed Dateling to request the auditors to formalise his resignation. According to Howard, until the date of his resignation he was unaware of any irregularities in the conduct of the affairs of Loredo. In July 1985 Howard received a document from the auditors of Loredo relating to his resignation as a director. He signed it without paying particular attention to it. It records that Howard resigned as a director of Loredo on 1 July 1985.

That then, broadly speaking, is the version given

by Howard of his involvement with Loredo. There are a number of important respects in which his version is contradicted by the affidavits of other deponents relied upon by the respondents. Having regard to what I have already said concerning the proper approach in application proceedings, the Court a quo was obliged to accept the version of Howard. It will serve little purpose to refer to the detail of the matters in dispute or the contrary versions which emerge from the evidence.

To complete the factual background no more need be said than that in fact over R2,5 million was invested with Loredo. None of the investments was secured. Smith and Gelb fled the country having stolen the investors' funds. The company was left devoid of any funds. The loss amounted to R2 226 736,61.

As mentioned earlier, it is common cause that the business of Loredo was conducted with intent to defraud its creditors. The theft of the funds of Loredo was the real and proximate cause of the losses sustained by Loredo. There was no evidence which established that Howard was knowingly a party to the fraud or theft. Counsel for the respondents accepted that position. The respondents' case, however, is that in other respects the business of Loredo was carried on recklessly and that Howard was knowingly a party thereto. For that reason, so claim the respondents, the court, in terms of section 424(1) of the Act, was entitled to declare Howard personally responsible for the debts of Loredo.

At common law a director of a company who is knowingly a party to fraud on the part of his company would be liable in damages for any loss suffered by any

person in consequence of the fraud. It would be necessary, in order to fix the liability of such a director, to establish a causal connection between the fraud of the company and the damages claimed from the director. The quantum of these damages would also have to be proved. The provisions of section 424(1) of the Act enable the court to declare such a director liable "for all or any of the debts or other liabilities of the company" without proof of a causal connection between the fraudulent conduct of the business of the company and the debts or liabilities for which he may be declared liable. In In re William C Leitch Brothers Ltd [1932] 2 Ch 71 at 79/80, Maugham J, with reference to the similar provisions of section 275 of the 1929 English Companies Act, said:

> "I am inclined to the view that s. 275 is in the nature of a punitive provision, and that where the Court makes such a declaration in relation to

> 'all or any of the debts or other liabilities of the company,' it is in the discretion of the Court to make an order without limiting the order to the amount of the debts of those creditors proved to have been defrauded by the acts of the director in question, though no doubt the order would in general be so limited."

Whether so to limit the order and the extent of such limitation would be matters for the court to consider in the due and proper exercise of the discretion conferred upon it by the section.

In the Court a quo, Morris AJ was clearly aware that for an order to be made against Howard under section 424(1) it had to be established that he was "knowingly a party to the carrying on of the business in the manner aforesaid", i.e. "recklessly or with intent to defraud creditors of the company or creditors of any other person or for any fraudulent purpose". With regard to the necessary

element of knowledge, Morris AJ correctly observed in his judgment that:

> ".... where the legislature has specifically introduced the word 'wetens' or 'knowingly' specific knowledge is to be proved, not by the respondent/defendant (or by the accused) but on the part of the accuser."

The reference to an "accused" arises from the provisions of section 424(3) which read as follows:

> "(3) Without prejudice to any other criminal liability incurred, where any business of a company is carried on recklessly or with such intent or for such purpose as is mentioned in subsection (1), every person who was knowingly a party to the carrying on of the business in the manner aforesaid, shall be guilty of an offence."

In my opinion the word "knowingly" must be given the same

meaning in both subsections (1) and (3) of section 424. In S v Parsons en 'n Ander 1980 (2) SA 397 (D) at 400 F, Leon J held that the word meant "met kennis van die feite". That conclusion finds strong support from the judgment of Schreiner JA in R v Thornton and Another 1960 (3) SA 600 (A). The statutory provision there relevant was section 10(1) of the Rents Act, 43 of 1950. It provided that an offence would be committed if a lessor "knowingly required or permitted a lessee to pay" a rent for controlled premises exceeding that determined by a rent board. At 611 F - 612 A, the learned Judge of Appeal said the following:

> " Although we are not here concerned with the general question of mens rea in statutory offences it is useful, I think, to have regard to the well-known statement by STEPHEN, J., in Cundy v Le Cocq, 13 Q.B.D. 207 at p. 210, that
>
> > 'it is necessary to look at the object of each Act that is under consideration to see whether and how far knowledge is of the essence of the offence created'.

In sec 10(1) we have the word "knowingly", so that no question of whether knowledge is essential arises; but the question of how far it is essential remains. The general rule is that even where knowledge is required it need not extend beyond the facts into the legal consequences flowing therefrom. So in Twycross v Grant, 2 CPD D 469, a civil case dealing, inter alia, with the meaning of "knowingly issuing" a prospectus in which mention was omitted of certain contracts which should have been mentioned, COCKBURN, C.J., at p. 541, said -

> 'Next, was the prospectus issued by the defendants 'knowingly' within the meaning of the section? It was contended that the term 'knowingly' must be taken to mean with a knowledge that the contracts were such as the statute required to be referred to: consequently, that, the jury having found that the mention of the contracts was omitted from the prospectus from a bona fide belief that such mention was unnecessary, the contracts had not been 'knowingly' omitted. But this is to misconceive the meaning of the term. 'Knowingly issuing' means neither more nor less than issuing with a knowledge of the existence of the contracts within the

> section, and the intentional omission of them from the prospectus. Ignorance or mistake of the law cannot be admitted as an excuse for disobeying an Act of Parliament.'
>
> I read the last sentence in its context as providing a reason for interpreting 'knowingly' as meaning 'with knowledge of the facts.'"

After referring to other authorities, the conclusion of Schreiner JA was expressed thus at 612 H:

> "In my view the word 'knowingly' in sec 10(1) means only that the party providing the premises must know of the determination and that he is receiving from the party who is being given use and occupation sums in excess of the determination. It matters not what his views are on the nature of the legal relationship between himself and the other party or on the proper legal description of the sums received by him."

Having regard to the provisions of section 424 and to its purpose, to be entitled to an order the applicant

must prove, on a balance of probabilities, that the person sought to be held liable had knowledge of the facts from which the conclusion is properly to be drawn that the 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. It would not be necessary to go further and prove that the person also had actual knowledge of the legal consequences of those facts.

In order to be held liable under section 424 (1) knowledge of the aforesaid facts is not on its own sufficient. It is further necessary that the person was "a party to the carrying on of the business in the manner aforesaid". In Re Maidstone Buildings Provisions Ltd [1971] 3 All ER 363 (ChD) at 368 f - g, Pennycuick V-C said of the corresponding provision of the 1948 English Companies Act (section 332(1)):

> "The expression 'party to the carrying on of a business' is not, I think, a very familiar one but, so far as I can see, the expression 'party to' must on its natural meaning indicate no more than 'participates in', 'takes part in' or 'concurs in'. And that, it seems to me, involves some positive steps of some nature. I do not think it can be said that someone is party to carrying on a business if he takes no positive steps at all. So in order to bring a person within the section one must show that he is taking some positive steps in the carrying on of the company's business in a fraudulent manner."

It should be borne in mind that section 332(1) of the English Companies Act did not include the reckless conduct of business and that the person sought to be held liable in the Maidstone case was a company secretary. A director of a company, however, has a duty to observe the utmost good faith towards the company, and, in doing so, to exercise reasonable skill and diligence. In Fisheries Development

Corporation of S A Ltd v Jorgensen and Another; Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd and Others 1980(4) SA 156 (W), Margo J said at 166 D-E:

> "Obviously, a director exercising reasonable care would not accept information and advice blindly. He would accept it, and he would be entitled to rely on it, but he would give it due consideration and exercise his own judgment in the light thereof. Gower (op cit at 602 et seq) refers to the striking contrast between the directors' heavy duties of loyalty and good faith and their very light obligations of skill and diligence. Nevertheless, a director may not be indifferent or a mere dummy. Nor may he shelter behind culpable ignorance or failure to understand the company's affairs."

In other words, a director has an affirmative duty to safeguard and protect the affairs of the company.

In my opinion, it follows that when the person sought to be held liable under section 424(1) is a

director, he may well be a "party" to the reckless or fraudulent conduct of the company's business even in the absence of some positive steps by him in the carrying on of the company's business. His supine attitude may, I suppose, even amount to concurrence in that conduct. Whether such an inference could properly be drawn will depend upon the facts and circumstances of the particular case.

In the case of Howard, Morris AJ held that he was knowingly a party to the reckless conduct of the business of Loredo. He did so on the strength of the address made by Howard at the Windhoek meeting on 24 November 1984. According to the transcript of that address, Howard said, inter alia, the following:

> "This is a typical certificate which we all agree is very appropriate. The person gets this the president of the company signs there, gives the client the amount of the investment, the return on

the investment, the fact that they are either taking their interest out or they are compounding it and having got that, it gives a lot of what would be the correct term, a lot of carpet, a lot of credibility. You get a thing like that you can stick it away. Something like a stock market certificate and its all there. It looks good. Not only does it look good but in fact it is good because we are using a different technique of management of these products. Where the client has a large amount of money which goes into a single bond that does not present a problem at all. What we've done - we've got an account, a special account with Standard Bank so all the capital interest if paid into that particular account which the bank then controls and our auditors debit the trust account so at all stages we've got all the money there equal to the capital to be repaid plus the interest .....
(T)he underlying asset is the first mortgage bond in tangible property which has been evaluated by a sworn appraiser, the amount of 70% owing on the current price value of the property is given as a bond. We deal with, through a very big firm of attorneys who specialise in this particular field. They are also Anglo American's attorneys so they

are pretty good and they have a sworn appraiser and they register the bond and they vet out the client and they get as much cover as they can so we've got complete security."

After quoting these words Morris AJ said:

> "His statements in regard to security and the trust account were reckless in themselves. As a fact the only first bond was in favour of Smith. In fact there was no trust account as Howard well knew. If he knew this, then he knew that the business of Loredo was being conducted recklessly in that there was no protection for money received from investors or, alternatively, his own conduct of the business was reckless in that he was inducing the agents or sub-agents to believe that a trust account did exist when he knew that the statement was false."
> (My emphasis).

If, in fact Morris AJ held that Howard had knowledge in these respects, then, in my judgment the learned Judge erred. There was no evidence to

establish that Howard knew that the investments which had been made were unsecured or that the only first bond was registered in favour of Smith. He stated expressly that he had no such knowledge and that he believed the assurances to the contrary from Smith and Gelb. Furthermore, there is no evidence which establishes that Howard had knowledge that there was no "trust account", whatever that may have meant. As I have already mentioned, in his answering affidavit, Howard referred specifically to his having said at the meeting that there would be the security of a first mortgage bond and that the moneys from investors would be retained in trust. In my opinion, there was no basis for rejecting, in application proceedings, the averments by Howard that these representations were made in consequence of what had been agreed to by Smith, Gelb and himself, and that what he stated at the meeting "was fully consonant with the mode in which it had been resolved the affairs of Loredo

would be conducted".

Then, too, there is no evidence which establishes that Howard had knowledge that no special account or accounts had been opened at SBSA. It is true that only one ordinary account had been opened when he attended with Smith at Vermaak's office on 1 September 1984. Nothing would have prevented Smith opening further accounts in the period between that date and the time of the Windhoek meeting some seven weeks later.

Objectively speaking, Loredo, acting through its two directors, Smith and Howard, was conducting its business fraudulently in making what were indeed false statements at the Windhoek meeting. Smith obviously knew that. However, on Howard's version it cannot be held that he was knowingly a party thereto. Furthermore, having regard to the trust which, on his version, Howard not unreasonably placed in Smith and Gelb, I do not believe that it can be

said that his acceptance thereof and the repetition of his understanding of the position can be said to have amounted to the reckless conduct by him of the business of Loredo. It may well be that he was negligent in not having taken more active and efficient steps to confirm what he had been told. That is a question difficult to answer after the event when the knowledge of hindsight can be misleading and give rise to unfair criticism. Even if Howard was negligent in that respect, that would not be a sufficient basis for making him liable in terms of section 424(1) of the Act In this context, I would repeat that but for the machinations of both Smith and Gelb the investors would not have been defrauded. On his version, Howard had no reason to think that both of those persons, one of them an attorney, would have conspired with one another to commit fraud.

Morris AJ also referred to "a further factor which may be mentioned". That consisted of two passages from the evidence which Howard gave at an enquiry held under the provisions of section 415 of the Act. They read as follows:

> "She (Smith) appreciated, she said that for the first couple of years the company would be running in the red. You cannot start a company like this and from day one get into top gear and generate profits.
>
> That is very interesting. So from the beginning you were proceeding with this business on the basis that for the first few years the company would run in the red? ---- Would either break even or go into the red, bearing in mind that the participating bond company.....
>
> You said before you qualified it now, that she specifically told you that for the first couple of years the company will be running in the red?---- Well, probably - break even, run in the red. It would not have a big profit."

"Alright, so this one or two years, did she tell you that this company would run in the red for the first few years? ------ Well, she said that you cannot expect - she emphasised that you could not expect a profit.

Whatever the reason, whether it is a good reason or a bad reason, did she tell you that you must expect that the company will run in the red for the first few years?----- Yes, you could expect no great profit, it would possibly run in the red."

The learned Judge a quo made no express finding on the strength of those passages. If the suggestion is that Howard had knowledge that Loredo was carrying on business in insolvent circumstances, I am of the opinion that such a conclusion is unjustified. The fact that the company would not make a profit in no way has as a corollary that it would have been be insolvent. That would depend upon the manner in which it had been capitalised.

With regard to the question of Howard's knowledge, Morris AJ said the following:

> "Only one thing has to be added on the question of liability and that is Howard's statement in his affidavit (vol. 12 p. 1631) in the paragraph designated "(b)":
>
> > 'I at all times assumed that moneys were being funnelled through the trust account which was in fact used for Loredo, being that of Gelb.'
>
> I cannot believe that Howard had forgotten what he said to investors, through the agents, at the meeting of November 1984. He must have realised that there was something wrong in the way affairs were being managed. Despite what he had said in regard to remonstrating, and despite the fact that he alleges that at least on one occasion he did remonstrate with Smith, he raised no query in regard to this rather strange method of dealing with the company's funds. This is a factor which, to some degree, supports the proposition that he was knowingly a party to the manner in which the business was being conducted."

That conclusion is not justified if one has regard to Howard's version that:

> "I have no knowledge as to whether or not a trust account was ever opened by Smith. I was at all times given to understand by Smith and Gelb that a trust account operated by Gelb was used in which to deposit investments of clients of Loredo. I believe that this was quite adequate for the said purpose."

Again there is no basis upon which, in application proceedings, those averments can be rejected as untruthful. The evidence referred to by Morris AJ does not justify the conclusion that Howard was knowingly a party to the manner in which the business of Loredo was being conducted by Smith and Gelb.

In argument in this Court, counsel for the respondents, in support of the order made by the Court a quo, relied upon two additional grounds, viz:

1. That the signature of the certificates in blank by Howard constituted the reckless conduct of the business of Loredo; and

2. There were "warning lights flashing" which should have alerted Howard and his omission to take any active steps made him a party to the reckless conduct of the business of Loredo.

At the time Howard signed them, the certificates in fact contained no false statements. He understood from Smith and Gelb that the investors' funds would be secured by the registration of first mortgage bonds. He trusted Smith, and Gelb confirmed that he should sign the certificates in blank. Again, his doing so may have amounted to negligence in the performance of his duties as a director of Loredo. In my opinion, it did not make him knowingly a party to the fraudulent conduct of its business and did not amount to the reckless conduct by him of the business of Loredo.

Turning to the second additional ground, it is correct that to a degree Howard did participate in the business of Loredo. He was a party to its incorporation. He was its public officer. He introduced Smith to Vermaak and SBSA. He assisted in the opening of the bank account of Loredo. He was instrumental in appointing the auditor and attorney of the company. On 19 October 1984 he met with Van Zyl who was one of the customers of Loredo. On one occasion he authorised the bank to pay an amount of R50 000. He addressed the Windhoek meeting. He signed the certificates. In January 1985 he met with another customer, Casper Gerhardus Boshoff. In February 1985, Van Zyl complained to Howard about non-payment of interest and he took this up with Smith. Also at about that time he instructed Dateling to prepare a trial balance sheet. For some months during 1984, Smith operated from an office in the suite occupied by Howard's other companies and she

reported to him "the whole time".

All of those activities and others - submitted counsel for the respondents - ran counter to Howard's assertion that he was a "non-executive director" of Loredo. In my opinion it is unhelpful and even misleading to classify company directors as "executive" or "non-executive" for purposes of ascertaining their duties to the company or when any specific or affirmative action is required of them. No such distinction is to be found in any statute. At common law, once a person accepts an appointment as a director, he becomes a fiduciary in relation to the company and is obliged to display the utmost good faith towards the company and in his dealings on its behalf. That is the general rule and its application to any particular incumbent of the office of director must necessarily depend on the facts and circumstances of each case. One of the circumstances may be whether he is

engaged full-time in the affairs of the company: see the Fisheries Development case, supra, at 165 G - 166 B. However it is not helpful to say of a particular director that because he was not an "executive director" his duties were less onerous than they would have been if was an executive director. Whether the inquiry be one in relation to negligence, reckless conduct or fraud, the legal rules are the same for all directors. In the application of those rules to the facts one must obviously take into account, for example, the factors referred to in the judgment of Margo J in the Fisheries Development case and any others which may be relevant in judging the conduct of the director. His access to the particular information and the justification for relying upon the reports he receives from others, for example, might be relevant factors to take into account, whether or not the person is to be classified as an "executive" or "non-executive" director.

In the present case, on the version of Howard, I cannot find that he acted recklessly in trusting Smith and Gelb. Having regard to the degree in which he did participate in the activities of Loredo, Howard clearly had a duty to the company to check on its financial affairs and in particular the manner in which the moneys of investors were being handled. That duty he had from the inception. It may be that initially he was entitled to rely on the reports he received from Smith and Gelb. However, when he heard from Dateling about the books of the company not having been written up and the difficulty in locating the list of securities it could be said that he ought to have taken further steps to ascertain the facts and that his his failure to do so was negligent. When later he heard of Van Zyl's complaint about non-payment of interest again it could be said that he should have done more than accept Smith's assurances. That, too, may well have

constituted negligence on his part.

Thus, to sum up, one is bound to accept Howard's denial of knowledge of the malfeasance of Smith and Gelb: on this basis it cannot be said that Howard was knowingly a party to any fraudulent conduct of Loredo's business. Moreover, any respect in which Howard might have been negligent fell short of recklessness. Thus, he cannot be declared liable under section 424(1) of the Act.

In the result, in my opinion, the order made by the Court a quo must be set aside. It may well be that had the evidence of Howard been tested by a trial court either in an action or by reason of a reference for the hearing of oral evidence, the result may have been different. The respondents, having elected to proceed by way of application and to have the matter determined on the affidavits, ran the risk of being non-suited by obliging the Court, as it were, to accept at face value the version of Howard.

The following order is made.

1. The appeal is upheld with costs.

2. The order made against the appellant in the Court a quo is set aside and the following order is substituted therefor:

   "The application against the first respondent is dismissed with costs".

3. The cross-appeal is dismissed with costs.

R J GOLDSTONE

JUDGE OF APPEAL

JOUBERT JA)

SMALBERGER JA) CONCUR

NESTADT JA)

KUMLEBEN JA)