Reportable

IN THE HIGH COURT OF SOUTH AFRICA

[CAPE OF GOOD HOPE PROVINCIAL DIVISION]

CASE NO: 7277/2001

In the matter between:

SONNENBERG McLOUGHLIN INC Applicant

and

MARK SPIRO Respondent

JUDGMENT DELIVERED ON 30 MAY 2003

H.J. ERASMUS, J

Introduction

On 8 August 2002 the applicant, a private company incorporated in terms of the provisions of the Companies Act 69 of 1973 ("the Companies Act"), read with section 23 of the Attorneys Act 53 of 1979, instituted proceedings for the sequestration of the respondent, a former director and shareholder.

The applicant says that the respondent has committed acts of insolvency in terms of section 8(a), (c) (e) and (g) of the Insolvency Act 24 of 1936 ("the Insolvency Act"). The applicant further avers that the "probabilities are that the respondent is factually insolvent", and that the sequestration of the respondent's estate will be to the advantage of his creditors.

The respondent opposes the application of the ground that he is not indebted to the applicant in any amount and that he has not committed any act of insolvency.

In their heads of argument, counsel for the respondent raised two further issues --

1. that the applicant has not complied with Court Notice 15 of this Court; and

2. that the court does not have jurisdiction.

Court Notice 15 requires that notice of intention to apply for a provisional order of sequestration be given to the debtor and, if married, to the debtor's spouse (whether married in or out of community of property), who shall be joined as a respondent. In this matter, the applicant has not joined the respondent's spouse nor was a copy of the application at the outset served on her.

The applicant has brought an application for condonation of its failure to comply with the provisions of the court notice. A copy of the application was served on the respondent's spouse on 8 April 2003. The applicant did not join the respondent's wife as is required by the court notice. It is, however, apparent that the respondent's spouse is, and has been since the beginning, aware of these proceedings.

At the hearing, counsel for the respondent did not press for dismissal of the application on the ground of the applicant's non-compliance with the court notice, nor by reason of the alleged lack of jurisdiction. Counsel made it clear that the respondent wants these proceedings to be finalised as soon as possible. Counsel for the respondent in argument accordingly focussed on the substantive issue between the parties; namely, whether the applicant has discharged its onus in respect of the existence of the alleged indebtness of the respondent to the applicant.

The background

The respondent was a director of the applicant until August 1999. At that time, the other directors were Peter Fritz Sonnenberg ("Sonnenberg") and Steven McCloughlin ("McCloughlin").

While the respondent was a director of the applicant, the applicant incurred certain liabilities. The applicant says that the respondent is

jointly and severally liable with the applicant for the debts and liabilities of the applicant contracted during the period while the respondent was a director of the applicant.

The applicant says that it has discharged debts to its creditors in the sum of R2 761 773.00. These were debts that were incurred during the respondent's term of office as director. The applicant contends that, having discharged these debts, it has a claim against the respondent in his capacity as a co-debtor for his proportionate share.

The applicant further contends that the respondent agreed that he was liable for 43% of the applicant's liabilities as at the date of his resignation. The respondent is, therefore, indebted to it in the sum of R1 892 218.00, which sum includes interest calculated at 15% per annum until September 2002.

The respondent denies that he has concluded an agreement with the applicant and that he is indebted to the applicant in any amount. He contends that he has substantial claims against the applicant on loan account in respect of payments made on behalf of the applicant to various of its creditors. The aggregate of these claims exceed R1 million.

The respondent’s indebtedness

The applicant alleges that a meeting was held between McLoughlin and the respondent on 11 October 1999. A minute of the meeting was prepared and a copy forwarded to respondent in the United Kingdom. Paragraph 2 of the minute records that --

"in the event that MDS [respondent] should elect to resign, then he is liable for 42.5% of the total liabilities of the firm at the date of resignation, alternatively MDS will be entitled to 42.5% of the total profit of the company as at the date of his resignation."

This alleged agreement falls short of an undertaking by a director to be liable for the company's debts in his personal capacity vis-à-vis the company. Regarding the alleged agreement, the respondent states in his answering affidavit (paragraph 18.3 and 18.4):

18.3 I deny that I held a "confidential" or any other formal meeting with McLoughlin during October 1999. I only recall that I had a brief discussion with McLoughlin and I advised him that my permit had been approved. Nobody kept minutes of this meeting.

18.4 I also deny that I entered into the alleged, or any other, agreement with the Applicant. I did not consider myself liable for the debts of the Applicant, let alone 43.5% thereof. I was aware of the fact that certain of the Applicant's creditors were holding me and my mother liable on the strength of suretyships given by us. I was furthermore aware that in terms of section 53(b) of the Companies Act, 61 of 1973, I could be held liable by creditors of the Applicant for all debts and liabilities contracted by the Applicant during my term of office as a director. I accordingly would never have assumed liability for a specific portion of such debts without

> knowing the extent thereof of without insisting upon a recoverable indemnification from any erstwhile co-directors against claims of creditors exceeding such portion. The extent of the Applicant's liabilities at that point in time was still unknown as an audit had not yet been done. Also, the financial position of my said co-directors was so precarious that an indemnity from them would have been virtually worthless.

The applicant says that a further meeting was held between Sonnenberg, McLoughlin and the respondent on 16 February 2000. At that meeting, the applicant contends, the parties entered into a further oral agreement in terms whereof it was agreed that upon the respondent's resignation as a director of the applicant, the respondent would be liable for 43% of the applicant's net liabilities calculated at that date. The applicant says that it was further agreed that a business audit in respect of the business of the applicant would be carried out in order to quantify the extent of the applicant's liabilities, as well as the respondent's pro-rata liability.

The alleged agreement was subsequently reduced to writing and forwarded, in the form of "Heads of Agreement", to the respondent in the United Kingdom for his signature. These heads of agreement were not signed by the applicant, Sonnenberg or McLoughlin. The respondent has declined to sign the heads of agreement. The respondent submits that if it had indeed been a firm agreement that was recorded in this document, one would have expected on the probabilities that the respondent would have been presented with a

document signed by the applicant, and Sonnenberg and McLoughlin, with only the respondent's signature to be added.

In regard to this alleged agreement entered on 16 February 2000, the respondent states in his answering affidavit:

19.1 I admit that I returned to the Republic of South Africa for AITH business during February 2000, during which time I had an informal meeting with McLoughlin and Sonnenberg.

19.2 I deny that any oral agreement was reached at the said meeting …

19.3 I agree that I have refused to sign the Heads of Agreement but I deny that any agreement was reached between the parties. Whilst it is admitted that the Heads of Agreement reflect certain proposals by McLoughlin and Sonnenberg, it is denied that agreement was reached thereon.

The correspondence

The respondent contends that upon analysis, the contemporaneous correspondence is at variance with the existence of any agreement on 11 October 1999 and 16 February 2000.

On 20 December 1999, Sonnenberg writes to the respondent that he has checked "previous correspondence … as well as minutes of the meeting between Steve and yourself on 11 October 1999". He then states --

"As per the agreement reached between you and Steve, if you choose to resign and be released from your commitments to the firm, you will be responsible to repay to the firm 42.5% of the obligations as at 8 August 1999 which are huge"

The terms of the agreement set out in the letter differs from the terms set out in the minute (cited above). In the minute it is recorded that the respondent would be "liable for 42.5% of the total liabilities of the firm at the date of resignations". The letter says that it was agreed that the respondent "will be responsible to repay the firm 42.5% of the obligations".

The respondent replies on the same day:

"I never agreed with Steve that I would be liable for 42.5% of the firm's obligations. The terms of my release were never discussed with Steve. Should it come to this, we would have to work out the net

value of the firm, which according to me would be the value of the assets, including the work in progress as at the 8th August 1999, less the firm's obligations and less any monies paid by me to the firm since this date. My interest in the sale of the building and interest in Theewaterskloof must also be taken into account".

In regard to the alleged oral agreement entered on 16 February 2000 which was subsequently reduced to writing and forwarded to the respondent in the United Kingdom for his signature, the respondent on 28 February 2000 writes to Sonnenberg:

"I haven't had a chance to properly look at the contract as time hasn't allowed me to. I will do so after Wednesday".

On 12 June 2000, the applicant writes to the respondent:

"4. Further to the meeting on 20 May 2000 held in Cape Town … we advise that this correspondence serves as confirmation of the material issues which were discussed pertaining to the finalisation of your (hereinafter referred to as MDS) resignation from Spiro Slot Sonnenberg Inc (hereinafter referred to as SSS).

5. However in an effort to resolve all issues relating to MDS's resignation on the basis of expediency, fairness and in an attempt to achieve a full and final resolution of all outstanding issues without further ado, the parties discussed the following Without Prejudice proposals:…"

The letter then proceeds to suggest a compromise whereby the applicant would accept payment of the sum of R625 000.00 in full and final settlement of the respondent's obligations. The amount is to be paid in two instalments: a payment of R400 000.00 before transfer of the Margayle Properties CC is registered, registration being anticipated on 23 June 2000, and the balance of R225 000.00 on or before 30th June 2000. In return Sonnenberg and McLoughlin and the applicant would indemnify the respondent from liability in respect of any obligations of the applicant for which the respondent has bound himself as surety and co-principal debtor. It is further stated that the offer is open for acceptance by the respondent for a period of 72 hours from the date of transmission and is tendered on a without prejudice basis. The letter is signed by Sonnenberg and McLoughlin.

On 13 June 2000, the respondent responded by email:

> "This is more along the lines of our discussions. There are other issues which come to mind, especially the issue of me being released from my obligations which obviously concern me, but we can deal with this in the agreement. As I said before, I am concerned that I pay all this money and then find myself on the hook for sureties ETC. It remains my intention to try and repay the 75% ASAP as soon as the deal is finalised ….."

It is clear from the email that the parties had not yet reached consensus. Attached to this email of 13 June 2000 is an amended, unsigned version (incorrectly dated 18 June 2000) of the letter of 12 June 2000. The proposal

contained in this letter is for an instalment of R185 000.00 to be paid before the transfer of the Margayle Properties CC is registered, and the balance of R440 000.00 to be paid on or before 30th September 2001 upon the respondent being satisfied that he has been released form all liabilities in respect of any obligations of the applicant for which he has bound himself as surety and co-principal debtor. The offer is made without prejudice and subject to the respondent receiving a certified audit for the period 1 March 1999 to 28 February 2000 from the applicant's auditors. This amended version of the letter was clearly intended as a counter proposal to the applicant's offer of settlement contained in the letter of 12 June 2000.

On 14 September 2000, Sonnenberg writes to the respondent:

"2. The debts of the practice as at the date of your resignation were approximately R2 200 000,00 and your 43% liability amounted to approximately R940 000,00.

9. Unless the amount of R435 000,00 is paid in full by no later than 30 September 2000, our offer of settlement of R625 000,00 will fall through and we will have to revert strictly to Company Law and will assess your indebtedness to the Firm in accordance with your 43% shareholding as at 8 August 1999'.

On 8 November 2000, Sonnenberg writes to the respondent:

"I would like to have signed heads of agreement in place by Friday 10 November

2000".

On the same day, the respondent replies:

"I have told you 100 times, I cannot commit to anything until I have seen the signed-off business audit. Please forward a certified copy of both the trust and business audits to me ASAP, as I am also anxious to finalise things. You also need to realise that I have already committed R400 000.00, and will not commit any further payment, until I am satisfied that I have been sufficiently covered against possible claims from creditors! Would you expose yourself to a possible double exposure under the same circumstances?"

The respondent reiterates this stance in a lengthy email dated 16 November 2000.

In a letter dated 23 November 2000 the applicant carries out the threat to act in accordance with company law. In the letter it is inter alia stated—

6. We can no longer wait for you to fulfil your obligations and are adamant that this matter is finalised forthwith.
7. In the light of the above we must now insists that you furnish your proposals in writing by no later that 12h00 on 30 November 2000 as to how you intend liquidating your indebtedness (R805 922.00)."

On 6 December 2000, the respondent writes:

"4. I deny that I am indebted to the firm for the amount claimed in your letter of 23rd November 2000, or any other amount.

5. I further deny that I am liable for 43% of the alleged indebtedness of the firm as at the 27th of July 1999"

A perusal of the documentation shows a lengthy process of negotiation between the parties, an exchange of views and of proposals and counter-proposals. The respondent's attitude is consistent throughout: he did not regard himself liable for the liabilities of the applicant except in so far as he had bound himself as surety for such liabilities; he wanted to be indemnified against possible claims by creditors should he make any payment to the applicant, and he wanted a certified audit for the period 1 March 1999 to 28 February 2000 from the applicant's auditors.

The applicant has failed to show that on a consideration of all the affidavits, the alleged indebtedness on which it relies has been established on a balance of probability. On the contrary, the probabilities on the papers favour the respondent and the application must be dealt with in accordance with the principles enunciated in Kalil v Decotex (Pty) Ltd and Another 1988 (1) SA 943 (A) at 978D—E and 979E—980A. In accordance with those principles, the application falls to be dismissed. At 979I Corbett JA (as he then was) says that "only in rare cases would the Court order the hearing of

oral evidence where the preponderance of probabilities on the affidavits favoured the respondent".

Sequestration proceedings are not the appropriate vehicle to resolve disputes which arise from the withdrawal of a director of a private company of the nature of the applicant. The procedure is, in particular, not designed for the resolution of disputes as to the existence or non-existence of a debt (Meskin Insolvency Law §2.1.5 and cases cited in fn 5; Kalil v Decotex (Pty) Ltd and Another, supra, at 980B—H; Investec Bank Ltd v Lewis 2002 (2) SA 111 (C) at 116C—F).

Section 53(b) of the Companies Act

In its replying papers, the applicant says that apart from its main claim based upon oral agreements between the parties, the applicant has an alternative claim against the respondent which, it submits, "is unassailable in fact and in law".

The applicant founds its alternative claim upon the provisions of section 53(b) of the Companies Act. The section provides as follows –

The memorandum of a company may, I addition to the requirements of section 52 –

a) ……..

b) in the case of a private company, provide that the directors and past directors shall be liable jointly and severally, together with the company,

> for such debts and liabilities of the company as are or were contracted during their periods of office, in which case the said directors and past directors shall be so liable.

Paragraph 6.1 of the applicant's Memorandum of Association dated 24 November 1993 records that --

> All past and present directors of the company shall be liable jointly and severally with the company for the debts and liabilities of the company contracted during their period of office.

The applicant says that it has discharged debts to its creditors in the sum of R2 761 773.00, debts which were incurred during the respondent's term of office as director. The applicant's stance is that, having discharged the debts, it has a claim against the respondent in his capacity as a co-debtor for his proportionate share (43%) in the sum of R1 187 562.00.

Fundstrust (Pty) Ltd (in liquidation) v Van Deventer, 1997 (1) SA 710 (A) the history of section 53(b) was traced. The section had a predecessor in section 6A of the Companies Act of 1926 – the latter section was inserted into the 1926 Act by the Companies Amendment Act 62 of 1968. The section provided as follows:

> The directors and former directors of a private company limited by shares shall be liable jointly and severally, together with the company, for such debts and liabilities of the company as were contracted during their period of office, if the

memorandum of association of the company contains a provision to that effect.

The insertion of section 6A proceeded form a recommendation of the Commission of Enquiry into the Companies Act (usually referred to as the Van Wyk de Vries Commission) that provision be made "for a private company with the concurrent joint and several liability of the directors for the debts and liabilities of the company". The intention was not to impose upon directors a liability equal to the common law liability of partners, but rather –

"to impose on them [directors] an entirely new statutory liability and to provide creditors with an entirely new remedy not hitherto available to them which would enable them to hold the directors liable singuli et in solidumfor company debts and liabilities before the company's liquidation".

(Fundstrust (Pty) Ltd (in liquidation) v Van Deventer, supra, at 731G)

A similar intention clearly underlies section 53(b) of the present Companies Act which "is intended primarily for the case of certain types of private company, ie incorporated associations of professional persons (see eg s 23 of the Attorneys Act 53 of 1979)." (Henochsberg on the Companies Act 5th ed volume I 106).

Section 53(b) is an empowering section – it empowers a private company to

include in its memorandum of association a provision that the directors and past directors shall be liable jointly and severally, together with the company, for debts and liabilities of the company that were contracted during their periods of office. If this is done, the effect is twofold: (a) creditors would be able to hold the directors liable singuli et in solidum for company debts and liabilities, and (b) if a director pays any of the company debts, he would have a right of recourse against his fellow directors for their proportionate share.

The section does not provide a right of recourse to a company against its directors where the company has paid its debts.

The alternative ground based upon section 53(b) on which the applicant relies cannot be sustained.

Conclusion

The application accordingly falls to be dismissed by reason of the fact that --

1 The applicant has failed to show that on a consideration of all the affidavits the alleged indebtedness on which it relies has been established on a balance of probability.

2 The applicant's reliance on section 53(b) of the Companies Act cannot be sustained.

In the result, I make the following order:

The application is dismissed with costs, such costs to include the costs occasioned by the employment of two counsel.

HJ ERASMUS, J