IN THE HIGH COURT OF SOUTH AFRICA

(WESTERN CAPE HIGH COURT, CAPE TOWN)

Reportable

CASE NO.: A 92/2009

In the matter between:

BID FINANCIAL SERVICES (PTY) LTD **Appellant**

And

MICHAEL TRACY FORSTER **Respondent**

JUDGMENT: 22 February 2010

Introduction

[1] This is an appeal against a judgment of Wragge AJ in which he dismissed a claim of appellant who had sued the respondent for payment of the sum of R 3,282,861.62 together with interest and costs. The claim was based on an allegation of fraudulent conduct by the defendant; alternatively in terms of s 424 of the Companies Act 61 of 1973. The appellant also claimed special damages, being the legal costs that it had allegedly incurred in a claim against the liquidator of Valuefin. The latter claim was stood over by the court a quo for later determination.

Factual Background

[2] The summary of the particulars of claim provide an accurate reflection of the facts which led to the dispute: At all material times, respondent was a director of Paradigm Capital Holdings Limited ('Paradigm Holdings'). Paradigm Direct (Pty) Limited and Paradigm Select (Pty) Limited, which later changed to Satellite Receiver (Pty) Limited, were wholly owned subsidiaries of Paradigm Holdings. During October 2000, the directors of Paradigm Holdings purported to conclude an agreement for the cession of certain rental agreements with Docufin, the trading name of the Document Finance Trust, alternatively the Digital Copier Trust. In late October/November 2000, appellant agreed with Paradigm Holdings, which was represented by the defendant and one Antony Allister Langley, to take cession from Docufin of the latter's right to title and interest in certain rental agreements.

[3] The purchase price for the acquisition by appellant of these rights was R 6,675,985.00. Appellant would make payment in an amount of R 4,450,985.00 to Paradigm Holdings and a further sum of R 2,225,000.00 to a party nominated by Paradigm Holdings. It was common cause that these payments were made by appellant.

[4] Appellant's critical allegations are made in paragraphs 8 and 9 of its particulars of claim as follows:

"*8. The Plaintiff made payment of the said purchase price on the strength of the following representations made by the directors of Paradigm Holdings that:*

8.1. a valid agreement existed for the cession to the plaintiff by Docufin of Docufin's right, title and interest in and to rental agreements.

8.2 Docufin was entitled, in terms of the rental agreements, to receive payment of monthly subscriptions from various third parties who were parties to the rental agreements.

8.3 in return for payment of the purchase price of R 6,675,985,00 the plaintiff would acquire the right to receive payment of monthly subscriptions from third parties in terms of the rental agreements.

9 The representations were false in that, to the knowledge of the directors of Paradigm Holdings (including the defendant):

9.1 Prior to Docufin and/or plaintiff acquiring the rights to the rental agreements, the rights in the rental agreements had already been disposed of to Valuefin (Pty) Ltd;

9.2 Docufin held no right, title or interest in and to the rental agreements and would be unable to obtain such right, title and interest without the agreement of

Valuefin, which agreement had not been and would not be obtained;

9.3 If the plaintiff were to pay the sum of R6,675,985,00, it would receive no value in consideration of such payment."

The original monetary amount of the claim was reduced by the time of the trial on account of settlement payments made by other directors of the Paradigm Group in the context of separate proceedings instituted in the Gauteng High Court

[5] It was appellant's case that, as a consequence of these alleged fraudulent misrepresentations made by respondent, appellant, before the end of November 2000, paid an amount of R 6, 675, 985.00 in accordance with the agreement but received no value in consideration of these payments.

[6] In the alternative, appellant claimed that respondent's conduct had been reckless in terms of section 424 of the Companies Act 61 of 1973 in that:

"*He knowingly concluded or allowed his fellow directors to conclude on behalf of Paradigm Holdings agreements for the sale of the same rental agreements to different parties, and knowingly allowed Paradigm Holdings to receive payment of the agreed purchase price in respect of these rental agreements from the plaintiff although delivery of the rental agreements to the plaintiff were* (sic) *not longer possible*."

[7] To further understand the nature of appellant's claim, it is necessary to briefly canvass the manner in which business was conducted, particularly by Paradigm Direct and Paradigm Select. Customers would agree to subscribe to the Multichoice Satellite Service and to enter into a contract for equipment necessary to receive and to view the service with Paradigm Select. The contract would then be concluded with the customers and Paradigm Direct, acting on behalf of Paradigm Select, to which the customer would pay a rental for the service. In effect, this would constitute a rental stream for the period of the agreement. At the commencement of its business, Paradigm Select was strapped for cash. It was therefore crucial to both its and Paradigm Holdings' financial future that it generated a cash flow by ceding the income streams from these rental agreements to financial institutions in return for immediate payment of a discounted amount and thereby obtain the cash flow that would enable it to continue to operate and expand its business.

[8] Initially, Paradigm Holdings ceded income streams from the rental agreements to New Republic Bank (NRB). The evidence suggests, however, that NRB was not prepared to pay for all of the income streams arising from the rental agreements which had been concluded by Paradigm Select. Further, not all the agreements which had been sent to NRB were accepted by the latter because it had stricter credit criteria than that which was adopted by Paradigm Select. Payment would be made in respect of the agreements accepted and the remaining agreements would be returned to Paradigm Select which would then seek to find another

financial institution that might acquire the income streams at a discount, alternatively advance a loan in a sum equivalent to the discounted value of the income streams against the security of a cession of the rights to collect the income streams.

[9] At the end of the period of the agreement and once the income stream had been paid by the customer to the financial institution in question, the agreement would be returned to Paradigm Select as the agreement had a notice period which, if not invoked by the customer, obliged the customer to continue to subscribe to the service and to continue to rent the equipment, until at least the end of the notice period. Thus, the opportunity existed for Paradigm Select to continue to earn further income from such an agreement.

[10] During 1998, respondent and his fellow directors were approached by Boland Financial Services which proposed a securitisation scheme which would involve the interposition of a company between Paradigm Holdings and the financial institution which eventually took over the income stream. The purpose of this structure was to insulate the financial institutions from any consequences of a liquidation of Paradigm Holdings or its subsidiaries. To this end, a company was acquired for this purpose which ultimately took on the name of Valuefin.

[11] The directors were advised that it would be necessary for this company to have reserves of at least R50 million in the form of cash or an income

stream from agreements that had been ceded to it to fulfil this purpose. Each of the five shareholders of the Paradigm group contributed R5 million. Attempts were then made to raise the remaining R25 million.

[12] From its inception, it appears that all the shares of Valuefin were owned by one Anthony Glass. However, the beneficial shareholders were various trusts controlled by Paul and Anthony Glass, Mr Havenga and respondent, together with a company controlled by a Mr Rimer.

[13] It appears that agreements which were not ceded to NRB were then ceded to Valuefin. Valuefin did not only take cession but paid for the income streams arising from agreements concluded by Paradigm Select. It also took cession and paid for the income streams from other companies operated by respondent and his colleagues.

[14] During 1999, the business fortunes of Paradigm took a marked decline. It appears that respondent and his colleagues were unable to obtain an overdraft facility of R25 million that was needed to complete the securitisation process for which Valuefin had initially been created, although shares in Valuefin which were placed through Investec Bank and various investors had raised R15 million. In the same year, NRB was placed under curatorship.

[15] By September 1999, Valuefin had employed a sum of R40 million which it had obtained both from its original shareholders and the share placement

which had been effected by Investec. Accordingly, by the latter part of 2000, the financial position of Paradigm Holdings was desperate. The cession of some rental streams took place between Valuefin and Saambou and Allianz but other financial institutions were reluctant to take cession of rental agreements. Hence, the insufficient volume of ceded agreements meant that Valuefin was unable to support Paradigm Holdings' demand for further funds.

[16] At this time, respondent and Mr Langley met with Mr Sean Cambier, who represented Docufin. Docufin was a trust that discounted or ceded rental streams from various rental agreements to the appellant, Bidfin. An agreement was concluded between Mr Cambier and Mr Langley, pursuant to which it was agreed that Paradigm Holdings would cede to Docufin certain rental agreements which had been concluded by Paradigm Select in return, upon payment on delivery, of these agreements to Docufin,

[17] Pursuant to this transaction, Docufin required a resolution to be signed by the directors of Paradigm Holdings which authorised the latter to enter into the finance agreement with Docufin, providing for the cession of the rental agreements. That resolution was signed by respondent and Mr Langley on 2 October 2000. On 9 October 2000, the two men signed a deed of suretyship in terms of which they bound Paradigm Holdings as surety and co-principal debtor in respect of the liabilities of Paradigm Holdings and Paradigm Select in favour of Docufin. On the same day, respondent and Mr Langley signed a further resolution in terms of which Paradigm

Holdings agreed to discount various rental agreements to Docufin. Mr Langley, in his capacity as director of Paradigm Holdings, was authorised to sign the relevant documentation on behalf of Paradigm Holdings. On 10 October 2000, Docufin formerly ceded the rental agreements, that were the subject of its agreement with Paradigm Holdings, to appellant. The interpositioning of Docufin in the scheme of events is, however, of no real importance because it is apparent that it acted throughout as either an agent of the appellant or as a broker.

[18] On 24 July 2001, Valuefin was wound-up. During that year Paradigm Holdings and its other subsidiaries were also wound-up. The liquidator of Valuefin was Mr C P van Zyl. In the amended first liquidation distribution accounts which were lodged by Mr van Zyl, the rental agreements which had been ceded to appellant were treated as being an asset of Valuefin. Appellant's objection to the first liquidation distribution account proved to be unsuccessful and accordingly the rental streams that were related to the agreements, but purportedly ceded to appellant, were regarded as being the property of Valuefin.

[19] Once appellant was confronted with the problem that the liquidator of Valuefin considered the assets to be those of Valuefin and not of appellant, it considered it had little alternative but to launch the action which has been the subject of this dispute.

The decision of the court *a quo*

[20] The critical evidence which was placed before the court *a quo* was given by Mr Clyde Herman who, in 1999, took over the administration of Valuefin, after having become the financial director of Paradigm Holdings in 1998. Mr Herman remained a director until Paradigm Holdings was liquidated during July 2001. He testified on behalf of the appellant. Further significant evidence, on behalf of respondent, was given by respondent himself.

[21] In essence, Mr Herman testified that, as soon as the rental agreements had been signed by the customer, they were ceded to Valuefin. Valuefin would then obtain the right to receive the rental stream from the customer, in effect, without having made any payment to the cedant, Paradigm Select. Because respondent would have been aware of the manner in which the system operated, namely that it was Valuefin which acquired the rental agreements by way of cession, he would have also been aware that the invoices recording the cession of the rental agreements to Docufin were 'fictitious invoices'. In Mr Herman's view, respondent caused the rental agreements to be ceded to Docufin because he was desperate to obtain further funds for the Paradigm group which, by then, was in dire financial straits.

[22] Respondent testified that, with the demise of NRB, Paradigm Select continued to cede income streams which were related to the rental agreements to Valuefin, so long as Valuefin had funds to pay for these

cessions. After September 1998, Valuefin no longer had the necessary funds and there was thus no commercial justification for Paradigm Select to continue to cede income streams to Valuefin on credit.

[23] The reason why agreements, that were eventually the subject of the cession to Docufin, were reflected as being owned initially by Valuefin was due to administrative and accounting procedures. In other words, respondent claimed the only way in which the Paradigm group could monitor the agreements which were ceded, was to batch them and then attach them to an invoice made out in the name of Valuefin. This procedure gave Paradigm Holdings and Paradigm Select knowledge of the value of the agreements in each batch. In other words, the fact that an invoice was made out to Valuefin did not, in itself, prove that Valuefin acquired the income streams which were related to the rental agreements by way of cession, but rather that these invoices had been made out pursuant to administrative and accounting policy adopted by the Paradigm group.

[24] In his decision, Wragge AJ found that the testimony of respondent, to the effect that invoices which had been made out to Valuefin regarding the rental agreements which were the subject of the purported cession to Docufin had reflected the manner in which the group sought to exercise control over the rental agreements, could not be rejected. As respondent was in control of both Paradigm Holdings and Valuefin, the former company was able to transfer the rental streams in terms of the relevant

agreements. For this reason, the learned judge found that appellant had not discharged the onus of proving, on a balance of probabilities, that the representation made by respondent and upon which appellant relied was false.

[25] Turning to the claim in terms of section 424 of the Companies Act, Wragge AJ found thus:

> "*In my view, while it is evident that on occasions the separate identity of the companies within the Paradigm group was disregarded, there is insufficient evidence to suggest that Mr Forster conducted the business of Paradigm Holdings recklessly or with intent to defraud creditors. Mr Forster went to some length in his evidence to explain what motivated him and his fellow directors in establishing Valuefin. There was also no suggestion that Multichoice was unaware of the manner in which the affairs of Paradigm Holdings were conducted.*
>
> *Further, the respects in which it was suggested during argument that the business of Paradigm Holdings was carried on recklessly or with intent to defraud creditors had no relation to the transaction which is the basis of Bidfin's claim. Having regard to the punitive effect of an order in terms of section 424 of the Companies Act, I would in any event exercise my discretion against making the order that Bidfin seeks.*"

Appellant's case on appeal

[26] Mr Cassim who appeared, together with Mr Lamplough, on behalf of the appellant, submitted that both the evidence of Mr Herman and respondent confirmed that the invoices issued by Paradigm Select, which were evidence of the sale from Paradigm Select to Valuefin, formed part of the accounting records of Holdings and Select, whereas the invoices recording the sale from Paradigm Select to Docufin were not part of the accounting records of a public listed company. In Mr Cassim's view, this omission provided external corroboration for Mr Herman's evidence that these latter invoices were 'fictitious' and was indicative of an appreciation by Mr Forster that something more was required to make the purported cession of the rental streams by Paradigm Holdings to Docufin or to the appellant effective.

[27] Mr Cassim also placed emphasis upon a letter by Nedbank Limited to the directors of Paradigm Holdings dated 15 November 2000. The letter was written in the context of arrangements that the directors of Paradigm, in particular Messrs Forster and Langley, had been seeking to make for increased loan credit from the bank. In this regard a meeting with the bank's representatives had been held on 2 November 2000 attended by Mr Forster, amongst others. The bank's letter referred to the content of this meeting in the following relevant respect:

> '*At our meeting of 2 November Tony Langley advised that the unencumbered debtors (rental agreements) of Valuefin were not available to us as security, as these were being held by various*

financiers as additional collateral. Tony estimated that only R5m was really unencumbered. At our first meeting of 7 September we were advised that +/- R85m was unencumbered. We later took a cession of these unencumbered debtors believing that we would have title to them.'

In reply to this letter written on the same date, respondent wrote as follows:

"*At the meeting of 07/09/00 I told the forum that we had a rental book of approximately R300m with borrowings of approximately R145m. A net difference of approximately R155m. No discussion took place as to whether or not they were encumbered. Without asking any questions or getting further details you insisted on us signing the cession form.*

…..

For at least the third time we enclose annexure A setting out the position regarding the rental agreements."

Annexure A to Mr Forster's letter purported to set out the particulars of various batches of contracts as at 1 October 2000, described therein as 'Valuefin Batches 1 to 56 at 1 October 2000'. Mr Forster did not dispute that the contracts ceded to BOE that were in part the subject matter of the cession agreement with the appellant were included in the contracts described in annexure A to his letter. In short, there was no suggestion in any of this correspondence that Paradigm Select as opposed to Valuefin was the owner of the rental agreements which purported to be ceded to Docufin. Furthermore, Mr Forster, in his reply, did nothing to disabuse Nedbank of the evident apprehension by its representatives on the basis of

meetings with Forster and Langley that the rental agreements were held by Valuefin.

[28] Mr Cassim also criticised the finding of the court *a quo* that Mr Herman's evidence represented a reconstruction of events as opposed to reflecting direct knowledge of what had occurred at the time. According to Mr Cassim, Mr Herman testified directly about the system that was in place in the Paradigm group for dealing with these rental agreements. His investigation established that, prior to the purported cession to Docufin, Valuefin had never ceded the relevant rental streams back to Paradigm Select. In other words, there was neither the possibility of a re-cession nor had it occurred. The evidence of Mr Herman had unequivocally pointed in the direction of Valuefin being the owner of the rental streams at the very time that invoices were created and representations were made to the effect that Paradigm Holdings and not Valuefin was the owner thereof. This explained why the invoices issued by Paradigm Holdings could not be accepted by the Group's accounting system.

[29] Mr Cassim further submitted that, whatever the role of Mr Langley, once it was accepted that the rental streams were owned by Valuefin, it followed that respondent, as the person in effective control of the Paradigm group, was aware of this feature of the group's *modus operandi*. He signed the resolutions and subjectively, must have appreciated that the agreement to be signed by Mr Langley, coupled with the delivery of the underlying agreements, would not, on their own, have the effect of transferring

ownership of the rental streams to Docufin. However, he must have foreseen that the appellant, by contrast, would have believed on the strength of this documentation, that it had acquired ownership. In other words, by making the representations in these circumstances, respondent had reconciled himself to the possibility of appellant suffering a loss. Accordingly, his conduct was intentional; that is he had the intention to defraud appellant.

Evaluation

[30] A party which seeks relief on the basis of a fraudulent misrepresentation, must establish the following elements:

1. A pre-contractual, incorrect statement;
2. Which was material or wrongful;
3. Made by the other party to the contract;
4. With the intention of inducing the contract or fraudulently;
5. Which induced the contract to cause the representee to suffer loss.

See LAWSA: Volume 5 Part I at para 149

[31] The key requirement which will resolve the present dispute concerns the intention of inducing the contract or acting fraudulently.

[32] A false representation is made fraudulently when the maker thereof has no honest belief in its truth, or makes it recklessly careless as to whether it be true or not. R v Myers 1948 (1) SA 375 (A) at 382. Further he or she

must foresee the possibility that the representee will act on it to his or her prejudice. Non disclosure of a fact is fraudulent if the guilty party foresees the possibility that failure to disclose that fact will cause harm to the other party, for instance, by inducing such party to enter into a prejudicial transaction. LAWSA: Volume 5 Part I para 149.

[33] The question which arises is whether the evidence revealed that respondent made the representation to appellant with no honest belief as to its truth or, similarly, in a reckless and careless manner, foreseeing the possibility that the representee (appellant) would act to its prejudice.

[34] Mr Herman testified that three invoices generated by Paradigm Select in favour of Docufin which reflected that a cession had taken place to Docufin of rental agreements were fictitious and that respondent had been fraudulent in the generation of these invoices:

> "*Because Mr Forster was fully aware of the whole system, that immediately the agreements are signed by the subscriber they are onsold to Valuefin and I think that was the system that was set up right from the start*."

For Mr Herman the reason was clear:

> "*He (respondent) wanted to get money into the group and – I think the simple reason is that, to fund the group and also to enable the group to continue for another month or two months*."

Furthermore, Mr Herman placed emphasis on Annexure A, which reflected 'Valuefin batches 1-56 at 1 October 2000. In his view, this document

revealed that Valuefin owned the particular batches and that 'everyone knew that those agreements were owned by Valuefin'.

[35] Viewed holistically the evidence suggests, by contrast, at least to this extent, that the Allianz group which was reflected in the document entitled 'Valuefin batches 1-56 at 1 October 2000' held, by way of cession, some 7307 contracts. Accordingly, it could not be argued that Valuefin, as opposed to Allianz, was the owner thereof. This evidence showed that Annexure A could not be employed as unqualified support for the argument that Valuefin owned all the contracts reflected in the document. In short, this evidence called into question the veracity of annexure A as unequivocal support for Mr Herman's contention about Valuefin being owner of all the income streams.

[36] Mr Herman's evidence was not entirely convincing when he dealt with Valuefin's alleged ownership of all the income streams derived from the rental agreements. For example, there was clear evidence that certain rental agreements had been ceded to the Board of Executors by Paradigm Select. Under cross-examination, Mr Herman was asked as to how a cession could take place without Valuefin's participation, given his earlier testimony that all the rental agreements were automatically ceded to Valuefin. His reply was particularly vague as is illustrated in the following passage from the evidence:

> "*Are you saying somewhere in an arrangement with BOE there was an agreement that Valuefin's documents could be used as security.*

--- I have no idea. Because, you know, I must see all the documentation. It was five years ago, and you know it's not part of, you know, this documentation here. And that documentation. I actually collected all the documentation. They gave it to the liquidator. And that's the last I saw of the documentation.

So you don't know about that. ---So I don't know exactly what documentation was formed, and I'm only assuming. I can give you what the accounts show. The accounts show that the BOE, you know, loan was in the name of Paradigm Capital Holdings and the money came into Paradigm Capital Holdings and it was also shown in the financial statements in June that Para….. – that there was security over the Valuefin, you know, rental agreements.

But that must have been given by Valuefin. --- I have no idea. I don't remember, and I haven't seen the documentation."

[37] Significantly, it must be noted that Mr Herman signed the resolution authorising these cessions to BOE.

[38] Apart from a justifiable dispute about Mr Herman's account of Valuefin's ownership of income streams, Respondent provided the following reason for the role of Valuefin in the transaction involving appellant. The relevant testimony is the following:

"*The allegation is without foundation and I can explain how these invoices came to be. The workflow system, as I spoke about earlier, was that we entered on each agreement, each contract was entered*

next to it which bank had been discounted to. And I'm not sure if I made the point earlier, because we jumped around a little bit, but when agreements were sold to Valuefin it wasn't entered on there, it was left blank waiting for who the ultimate owner would be, but those contracts would be on the system, would be attached to a batch and the batch would have an invoice, in this case made out to Valuefin. So when Valuefin was unable to pay for these transactions, and therefore unable to take these transactions, we were able to place these with Bidfin, and Bidfin required an invoice to pay us out. But Paul Allan was unable to generate a system invoice because these batches had already been allocated in terms of the Valuefin on the workflow system, so it was, it required him to journalise that and reverse those transactions. Because of the urgency of our requirements to get cash he did a non, this invoice, and Mr Herman is right, was generated on our normal system, and the reason it wasn't because it couldn't be."

[39] That evidence was not disturbed under cross-examination. In short, the court was faced with a detailed explanation provided by respondent as to how it came about that the rental agreements were reflected in the name of Valuefin. It was common cause that respondent controlled both Paradigm Holdings and Valuefin. In other words, given that respondent considered Valuefin to be no more than a 'nominee' for the rental streams, his evidence that he could have caused Paradigm Holdings, through Valuefin to cede the necessary rental agreements to appellant cannot be

summarily rejected. On the probabilities, it is difficult to justify the conclusion that respondent intended, viewed subjectively, on the available evidence, to make a false representation in circumstances where he well knew that the rental agreements had already been disposed of to Valuefin, in circumstances where the contract entered into between Paradigm Holdings and appellant could never be implemented.

[40] For these reasons, the contentions relating to fraudulent misrepresentations cannot be sustained and the court *a quo* was correct to so reject them. That, however, leaves for further consideration the application of section 424 of the Companies Act.

Section 424

[41] Section 424 (1) of the Companies Act provides 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*."

[42] As Wragge AJ held, given that the court *a quo* did not act fraudulently in the conclusion of the transactions which have given rise to the dispute, the only part of section 424(1) which is potentially applicable to the present dispute is contained in the phrase 'that any business of a company was or is being carried on recklessly'.

[43] In support of the submission that respondent had acted recklessly, Mr Cassim submitted that the fundamental basis for this claim was to be found in the invoices which reflected that respondent had allowed a double sale to take place. The group's books of account, invoices and correspondence with other creditors disclosed a sale and cession to Valuefin while the relevant resolution, which had been generated, disclosed to appellant that a cession had taken place to appellant. This form of accounting justified an inference of fraud, and if not fraud at least an inference of gross negligence should follow. This finding would be sufficient to justify a claim in terms of section 424. As evidence of recklessness Mr Cassim referred to the letter generated by Nedbank on 15 November 2000 (quoted in paragraph [27]) which confirmed the contents of a meeting which had been attended to by both Mr Langley and respondent.

[44] In short, at the meetings with the Nedbank representatives in September and November 2000 it was accepted by those who attended, including respondent, that the rental agreements had been ceded to Valuefin. It was further argued that, to the extent that certain of the agreements were

unencumbered, they could be used as security by Valuefin. This impression was never corrected by respondent, neither at the meeting, nor, given the contents of the Nedbank letter, thereafter. In dealing with Docufin and Bidfin, the respondent was party to a representation that Paradigm Holdings held the agreements and proceeded recklessly in allowing the company to purport to give cession of the agreements for consideration in circumstances in which he must have appreciated that nothing had been done to transfer them from Valuefin.

[45] In his written argument, Mr Forster, who appeared in person, submitted that the Nedbank letter was manifestly incorrect. He contended that it was clear from Annexure A that the majority of the agreements making up the residual book were not in Valuefin's name; in fact only those reflected as Planet Finance/Saambou were in Valuefin's name. The surplus on Planet/Saambou amounted to only R21m. Further, the respondent did not reply on behalf of Valuefin but rather replied on a Paradigm letterhead, i.e. on behalf of the Paradigm Group. Mr Forster claimed that this was the reason why the respondent was so caustic in his reply to the Nedbank letter. But, this *ex post facto* rationale, is insufficient in my view, to explain the reason for respondent's omission to correct an allegedly fundamental legal misconception contained in the letter to the effect that Valuefin was the owner of the agreements. On the contrary, Mr Forster's failure to correct what he now claims was a misapprehension on the part of the Nedbank representatives' evidence supports the inference that the bank's representatives had been informed that the agreements were held by

Valuefin, which, of course, is consistent with the evidence given by Mr Herman.

[46] The approach adopted by our courts to the phrase 'any business being carried on recklessly' was set out by Howie JA in Philotex (Pty) Ltd and others v Snyman and others 1998 (2) SA 138 (SCA) at 145 I in which the following dictum from the judgment in Ozinsky NO v Lloyd and others 1992 (3) SA 396 (C) at 414 G-H was cited with approval:

> "*If a company continues to carry on business as to incur debts when, in the opinion of reasonable businessmen, standing in the shoes of the directors, there would be no reasonable prospect of the creditors receiving payment when due, it will in general be a proper inference that the business is being carried on recklessly*."

[47] In an expansion of this *dictum* Howie JA went on to say:

> "*The above-quoted approach suggested in Ozinsky is, of course, an evidential test, not a statement of substantive law. However, it appears to me to accord recognition to the difference between negligence, on the one hand, and recklessness, at least in the form of gross negligence, on the other. Participation in business necessarily involves taking entrepreneurial risks but s 424 only penalises the subjection of third parties to risk where (apart from the case of fraudulent trading) it is grossly unreasonable. If, therefore, in a given case there is some ground for thinking that creditors will be paid but a reasonable businessman would nonetheless, because*

of circumstances creating a material but not high risk of non-payment, refrain from running that risk, the director who does run that risk by incurring credit, and thus falls short of the standard of conduct of the reasonable businessman, trades unreasonably and therefore negligently vis-à-vis creditors. That departure from the reasonable standard could not fairly be described as gross, however, and the director concerned would not be hit by the section. By contrast, an instance that manifestly would fall foul of the section is where the reasonable businessman would realise that in all the circumstances payment would not be made when due. To incur credit in that situation would, as a matter of degree, be so plainly more serious a departure from the required standard than the conduct in the first example that one has no difficulty categorising it as grossly unreasonable and therefore grossly negligent.

This second example, one must emphasise, is an extreme one and it would, in my view, impose an unduly heavy burden on a plaintiff in s 424 proceedings to require proof of circumstances in which a reasonable businessman would assess non-payment as a virtual certainty. So, if a plaintiff were to present evidence warranting the conclusion that when credit was incurred there was, objectively regarded, a very strong chance, falling short of a virtual certainty, that creditors would not be paid, that case would, I think, also involve the mischief which the section was intended to combat. It is not possible to attempt to draw the line between negligence and

recklessness more exactly. Each case must turn on its own facts and involve a value judgment on those facts". at 146 -147

[48] Applied to the present dispute, and objectively considered (which is the appropriate basis of enquiry), there was a very strong chance in the context of the Group's pressing financial predicament, given the structure that had been adopted with regard to the cession of rental agreements to Valuefin (no matter what might have been the internal arrangement), obviously falling short of a certainty, that appellant would suffer financial disadvantage in the manner in which respondent had sought to structure these rental agreements; that is without due regard to the separate legal entities within the group or the law of ownership as applied to the rental agreements. Certainly, the respondent and the other directors involved with the transactions owed a particular duty in the circumstances to ensure that the necessary underlying procedures were followed within the Group so as to give an effective transfer of the ceded agreements to the appellant. Respondent's failure to discharge this duty constituted reckless conduct in that he must have appreciated the risk to the appellant, but failed to do anything at all to address it, irrespective of what he must or, at least, should have realised could be the consequences of this omission. In the context, the respondent's acquiescence in the issuance of invoices that could not be accepted on the Group's accounting system assumes a telling significance.

[49] Of further relevance to the present dispute, Howie JA in the Philotex (Pty) Ltd case gave further content to the test of recklessness when he said:

> "*From what has been said above regarding the meaning of recklessness and the objective nature of the enquiry as to its proof, it will be plain that a director's honest belief as to the prospects of payment when due, while critical in a case of alleged fraudulent trading, is not in itself the determinant of whether he was reckless. It will be irrelevant if a reasonable person of business in the same circumstances would not have held that belief*." at 147 D

[50] Respondent must have known that, so long as appellant received monthly rentals it would not have been aware of the fact that Valuefin might be the owner of the rental streams. Because respondent controlled both Valuefin and Paradigm Holdings, he would be able to manage the process and therefore satisfy the monthly payments. Yet under cross-examination, respondent gave the following answer to the following: in November 2000 if appellant's payment had not 'come in, you [i.e. the Paradigm Group] would not have survived is that right the Holding company?' to which respondent replied 'we had other things that we're working on there were other transactions in the minutes in the time there was a facility with Reunert so if we haven't given the money [?rental streams] to Bidfin we would have gone to Reunert and use their R5 million.'

[51] The point is that, absent receipt of appellant's funds and absent a positive outcome to 'the other things that we were working on', Paradigm Holdings

would have been forced into liquidation. In short, it was in a parlous financial situation when the transaction with appellant took place. That conclusion was never rebutted by respondent during his testimony. Indeed, respondent was forced to concede that the various accounting treatment of the relationship between Paradigm Holdings and Paradigm Select was incongruent with the practical position contended for by respondent. An independent party, as appellant would unquestionably have been misled as to the legal position contended for by respondent. The respondent, who was an experienced businessman and former corporate banking manager with one of the leading commercial banks in the country, must have appreciated that, in the event of the liquidation of the effected entities within the Group, the accounting records, or the objectively determinable facts which would be used to construct such records, and not his, or any other company officer's *ipse dixit* would in all likelihood be taken to reflect the state of the companies' affairs. What actually transpired after the liquidation of Valuefin was therefore eminently foreseeable.

[52] Precisely, because of the manner in which Paradigm Holdings and its subsidiary companies chose to reflect the various transactions relating to the rental agreements, the liquidator of Valuefin was placed into a position where he could justifiably adopt the view that the rental agreements had been ceded to Valuefin. Accordingly, he concluded that the acquisition by appellant of these agreements by way of a cession from Paradigm Holdings were legally invalid. To this extent, respondent had conducted

the activities of the various companies in the Paradigm group in a manner which, examined objectively, placed appellant in a legally and thus financially vulnerable situation, where the likelihood that it would suffer financial harm was extremely foreseeable.

[53] The evidence reveals that the manner in which respondent carried on the business of the group, while not constituting fraud upon appellant, blurred the legal boundaries between discrete corporate entities thereby, creating a situation whereby, in law, one entity owned less assets than it should have or as it was reflected to the third parties. In the peculiar circumstances that constitutes reckless business activity within the scope of section 424(1) of the Companies Act. Hence, the appellant was entitled to invoke the provision against respondent. For these reasons therefore, the court *a quo* erred in its dismissal of the claim pursuant to section 424 of the Companies Act.

[54] In the circumstances, the following order is made:

1. The appeal is upheld with costs including the cost of two counsel.
2. The decision of the court *a quo* is set aside and replaced with the following order:
    2.1 It is declared in terms of s 424 of the Companies Act 61 of 1973 that the defendant was knowingly a party to the carrying on of the business of Paradigm Capital Holdings Limited in a reckless manner and that he shall be personally responsible, without any limitation of liability, for the debt of

the company arising out of the company's purported cession of rental agreements to the plaintiff on or about 10 October 2000 as recorded in the invoices issued to Docufin, dated 10 October 2000, 19 October 2000 and 10 November 2000 respectively in the amounts of R1 972 316, 79, R428 048,00 and R4 002 382,56, respectively.

2.2 Pursuant to the aforementioned declaration judgment is granted against the defendant in the sum of R3,282,861.62 together with interest thereon a tempore morae at 15.5 % per annum from date of the service of summons in the action.

2.3 The defendant is ordered to pay the plaintiff's costs of suit, including the cost of two counsel;

2.4 The trial of the claim as set forth in paragraph 11.2 of the particulars of claim is postponed sine die.

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DAVIS J

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NDITA J

I agree.

BINNS-WARD J:

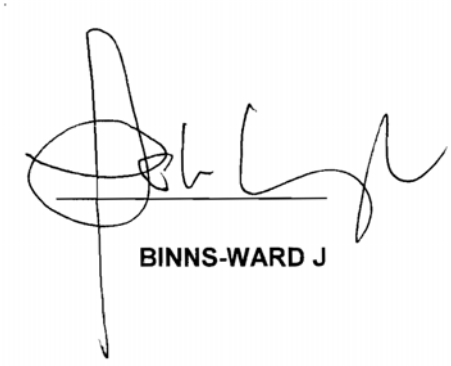
[55] I have had the advantage of reading the judgment of Davis J. I agree with the finding by Davis J that the court *a quo* should have found that the appellant had made out sufficient cause for the making of a declaration in terms of s 424(1) of the Companies Act that the respondent was knowingly party to the carrying on of the business of Paradigm Capital Holdings in a reckless manner and for the granting of consequential relief. Save as set out in the succeeding paragraphs I also concur in the terms of the orders made in terms of the judgment of Davis J.

[56] It was apparent from the evidence that equivalent proceedings are or were pending against the respondent's former co-director, Mr Langley, in the Gauteng High Court. It appears that the only reason that proceedings were instituted separately against the respondent and Mr Langley was because it was considered by the appellant that Mr Langley was not amenable to the jurisdiction of this court. In my view it would therefore be appropriate, if the proceedings in the Gauteng Court were to result in a declaration that Mr Langley should be personally liable to the appellant either in fraud or in terms of s 424 of the Companies Act, that the respondent's liability, in that event, should clearly be understood to be joint and several with that of Mr Langley In saying this I do not

wish to be misunderstood as anticipating in any way the outcome of the proceedings against Mr Langley, or even to be suggesting that the appellant is bound to prosecute them to completion. Equally, I should not wish it to be misunderstood that the order made in this case in any way pre-empts uncompleted proceedings against Mr Langley in the other court on the same cause of action.

[57] I would therefore have added the following sentence to paragraph 2.2 of the order made by Davis J:

> 'The defendant's liability in terms of this order shall be deemed to be joint and several with that of Anthony Allister Langley in the event and to the extent that Langley is found liable to plaintiff in respect of the same claim in the proceedings being prosecuted against Langley by the plaintiff in the South Gauteng High Court.'



BINNS-WARD J