THE SUPREME COURT OF APPEAL
OF SOUTH AFRICA

Reportable
CASE NO 387/2004

In the matter between

HENEWAYS FREIGHT SERVICES (PTY) LTD Appellant

and

KLAUS GROGOR Respondent

Coram: Zulman, Cloete JJA and Theron AJA
Heard: 24 August 2006
Delivered: 26 September 2006

Summary : Whether the conduct of the respondent constituted fraud or recklessness within the meaning of s 424(1) of the Companies Act, 1973 rendering him personally liable for the debts of a company of which he was the sole director and manager of its business.

Neutral citation: This judgment may be referred to as *Heneways Freight Services v Klaus Grogor* [2006] SCA 116 (RSA)

JUDGMENT

ZULMAN JA

[1] The appellant is a clearing and forwarding agent. The appellant, with the leave of the court below (Selvan AJ), appeals against the dismissal of its claim against the respondent for an order declaring the respondent, Mr Grogor, personally liable, in terms of s 424(1) of the Companies Act, 1973 (the Act) for the indebtedness to it of a company, ITITC (Pty) Ltd which traded as *The House of Sports Cars* (the company). The respondent was the sole director, and managed the business of the company.

[2] The main argument on appeal was based on fraud. The submission was that by providing creditors with cheques when he knew or reasonably foresaw the possibility that there might not be funds in the company's bank account to meet them, the appellant committed a series of frauds. Assuming the submission to be correct, the conduct does not fall within the section. The section, as will appear more fully below, penalises the carrying on of business with intent to defraud creditors. As I will indicate hereinafter, that conclusion is not justified, if the totality of the facts are considered.

[3] In summary, the appellant contends with regard to recklessness that the following conduct of the company, to which it is common cause respondent was knowingly a party, rendered the respondent personally liable in terms of the section:-

(1) The use by the company of a practice where certain cheques issued by the company for amounts due to creditors, including the appellant, were stopped or dishonoured almost immediately after the due dates appearing on the cheques, in order to overcome liquidity difficulties of the company.

(2) Seeking credit from the appellant after that practice had been adopted for more than a year which amounted to the business of the company being

carried on recklessly or with the intent to defraud creditors or for a fraudulent purpose as envisaged in the section; and

(3) The respondent, on behalf of the company, did not have a reasonable expectation of funds coming from two potential sources and if so, whether this was sufficient to exclude the respondent's conduct from falling within the ambit of the section.

[4] The relevant portion of s 424(1) provides as follows:

'When it appears, ... that any business of the company was or is being carried on recklessly or with intent to defraud creditors of the company ... or for any fraudulent purpose, the Court may, on the application of ... any creditor ... 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' (the emphasis is mine).

The correct legal interpretation of the section is not in real dispute between the parties. The essential issue between the parties concerns the proper inferences to be drawn from various facts, many of which are not really in dispute. The section penalises fraud or recklessness on the part of anyone who carries on or manages the business of a company 'with intent to defraud creditors of the company'. 'Recklessness' includes gross negligence with or without consciousness of risk taking (see for example *Philotex (Pty) Ltd v Snyman*[1] where the law is succinctly set out by Howie JA). As to fraud the judgment of the English Court of Appeal in *R v Grantham*[2] is instructive. The case concerned the relevant provisions of the 1948 English Companies Act. It was pointed out with reference to *In Re William C Leitch*

[1] 1998 (2) SA 138 (SCA).
[2] [1984] QB 675 (CCA).

Bros Ltd[3] that that Court had expressly disavowed an intention to define fraud. The Court of Appeal approved, instead, the trial Judge's direction to the jury in *Grantham*, according to which they would be entitled to find fraud if the accused realised, when the debt in question there was incurred, that there was no reason for thinking that funds would become available to pay the debt when it became due or shortly thereafter.[4] (See also *Philotex*.[5])

Plainly the onus is upon the party alleging fraud or recklessness in civil proceedings, such as these, to prove same on a balance of probabilities (cf for example, *Philotex*[6]*).*

[5] Turning firstly to the appellant's contention that the practice of stopping the payment of cheques when they fell due for payment rendered the respondent personally liable, it is important to note that it was not disputed that all the cheques that were stopped were post-dated. These cheques were among approximately 700 cheques that were issued during the period under consideration.

It is therefore necessary to initially inquire into the respondent's state of mind at the time that the post dated cheques in question were handed over to the various creditors of the company. Furthermore it is necessary to consider whether the appellant proved, on a balance of probabilities, that he had no reason for thinking that there would be funds available to pay the cheques on their due dates. This issue is plainly relevant both to the question of fraud and recklessness. The matter was not adequately explored by counsel appearing for the appellant at the trial. It was never put squarely to the respondent that he did not entertain such a belief. In my view there is no acceptable evidence to support an inference of fraud or even reckless

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[3] [1932] 2 Ch 71 at 77.
[4] At 682 (QB).
[5] (Supra) at 145J to 146F.
[6] Supra at 142I.

conduct on this account.

Of further significance is the evidence which was led concerning the reason why payment of the cheques was stopped.

In a schedule prepared by the appellant's attorneys from the records of the company's bank the reason given for 47 cheques which were stopped starting with a cheque dated 3 June 199 and ending with a cheque dated 5 July 2000 was 'alternative arrangements'.

The company's bookkeeper, Mrs Alexander, was called as a witness by the appellant. She was asked during her evidence in chief to comment on the whether the cheques had been stopped because alternative arrangements had been made. Although she first said 'no' in answer to the question whether the true reason was that alternative arrangements were made, she went on to state that the reason was that there were no funds in the account and that she did not know 'what Mr Grogor tells the clients'. When the appellant, who conducted his own defence, put to her that she did not know whether he had made alternative arrangements she replied that she could not say and did not know. Counsel, in support of his argument that the respondent had in fact made no alternative arrangements for payment with creditors of the company to whom post-dated cheques were issued, pointed to the following exchange in his cross examination of the respondent. This concerned a stopped cheque dated 31 March 2000, for R23 484,00 issued to SARS:

'…you were running an exercise where you had to stop cheques in order to prevent yourself from being overdrawn on your bank account and where you had to ask indulgences from your landlord and where you had to take indulgences from the Revenue Services for amounts that totalled hundreds of thousands of Rand --- That is correct'.

The appellant's counsel placed emphasis on the word 'take' as opposed to 'ask'. The respondent's home language is not English. It may well be that what he was trying to

convey by his answer to the question was that he had ‘taken’ an ‘indulgence’ which had been given to him by agreement with SARS and not that he had unilaterally ‘taken’ an ‘indulgence’. It is not as though he was asked directly whether he had or had not made arrangements with the creditor concerned.

Indeed the general thread running through the respondent’s evidence was that he had an explanation for stopping all of the cheques issued. The appellant presented no evidence to gainsay this. So for example the respondent gave perfectly plausible explanations, in my view, for stopping cheques issued to Attorney Barry Farber with whom he had a friendly relationship at the time; Attorney Nossel who accepted that the respondent was waiting for cash from the Imperial deal, which I will refer to presently; and a Mr Essay with whom he had several other transactions.

As regards arrangements with the company’s landlord, Domain Properties, the respondent testified that he had arrangements with it that it would not deposit a cheque dated 2 August 2000 for R160 858,46 in its favour until the Imperial deal, came to fruition.

As regards Sabila Cape (Pty) Ltd (Sabila), the company’s previous clearing agents, the respondent testified that there was a dispute with this party because it had incorrectly filled out certain customs documentation which caused the company financial loss. Because of this cheques in favour of Sabila were stopped.

The respondent gave a general explanation that he was expecting a large sum of money and handed over various post dated cheques in anticipation of receiving this money. When the receipt of the money was delayed he stopped certain cheques. The respondent was probably referring to an amount in excess of R2 million which was in fact received by the company in August 2000.

[6] One also needs to bear in mind that the majority of the 700 cheques issued by

the company during the relevant period were met.

As pointed out by Selvan AJ the reality of the matter was that the company was experiencing cash flow problems during the year in question. The respondent was aware of this and in order to keep the business of the company going he delayed, and I would add, made arrangements, with some of the company's creditors, in order to pay more pressing debts by buying time as it were.

[7] It is of considerable significance that Selvan AJ made no general adverse finding of credibility against the respondent, thus leaving this court to draw what it considers to be the appropriate inferences from the evidence presented. The learned judge said of the respondent that he

'did not get the impression that in giving evidence he was deliberately lying; on the contrary he seemed to me to be trying to the best of his ability to give an accurate account of what had happened. But, there was a tendency on his part to put forward a version of events most favourable to his case due no doubt in part to the blurring of his role as witness with that of his role as advocate.'

[8] As regards the seeking of credit from the appellant after the stopping of the cheques referred to in the schedule of stopped cheques to which I have previously referred, it is convenient to consider what may be termed the proposed Imperial deal. The respondent's unchallenged evidence in this regard was to the following effect: The company was formed in or about 1995. Its main business was to sell exotic cars. It had a franchise for the sale of Lamborghini, Aston Martin, Bugatti and Bentley cars from the manufacturers. At about the middle of 2000 he was approached on behalf of the Imperial Group of companies (Imperial) to enter into a joint venture with them. He met with Mr Lynch, the managing director of Imperial, who indicated a firm intention of going into business with the company. Lynch, according to the

respondent, was not particularly interested in balance sheets or accounts. What he had in mind was the formation of a new company of which the respondent would be a director and holder of half the equity capital. Lynch had proposed that capitalisation for the new company would be R20 million of which R10 million would be contributed by Imperial and R10 million by the respondent who would borrow the amount from Imperial and repay it out of profits over a period of five years. If the deal had come to pass the assets of the existing company would have been taken over by the new company and all the company's creditors paid.

As an alternative defence to the imputation of the appellant that he had incurred credit with the appellant recklessly, the respondent claimed that even without the Imperial deal, he expected the company to be in a position to meet all its obligations given time. He pointed to the fact that the company had a number of cars in stock including a Rolls Royce manufactured in about 1990 for which it had paid R400,000.00, a Lamborgini four wheel drive for which it had paid R600,000.00 to R700,00.00 and a racing car valued at approximately R1 million. According to the respondent the profit margin on cars sold was considerable and one or two transactions would have solved the company's liquidity problems.

The evidence of the respondent was that he had good reason to believe that the Imperial deal would eventuate, not only because he been assured by Lynch that the preparation of legal documents was a formality but also because the broad basis for the new arrangement had been agreed upon.

Selvan AJ did not consider that his evidence in regard to the Imperial transaction could be rejected and considered that the respondent was largely corroborated by contemporaneously produced documents and other circumstantial evidence.

As pointed out by the learned acting judge, the crucial question is whether, when credit was obtained from the appellant, there were grounds upon which a reasonable

person in the position of the respondent would have believed that a deal would be concluded. The appellant's credit application form was delivered to the respondent on 8 August 2000 and was signed by him on 15 August 2000. What reasonable expectations could the respondent have had at this time?

The first invoice of the appellant for R309 734,36 was produced on 18 August 2000. In his evidence in chief, the respondent initially said that he met with representatives of Imperial about June or July 2000. At what he thought was his second meeting with them, he considered that an agreement in principle had been arrived at. According to his evidence it was then that Lynch said to him he was not interested in balance sheets. I do not think that there is anything improbable about that or about the respondent's assertion that it was his knowledge and experience in the market for exotic cars and his trade connections with their manufacturers in overseas countries that Imperial was keen to acquire.

As to when the second meeting took place the respondent was somewhat vague when answering questions in cross examination but he undertook to produce his diary on the following day which he did. The first entry having a bearing on his negotiations with Imperial is dated 20 June 2000 and relates to a telephone call to one Da Cunha of Imperial. There are entries on 27 June and on 29 June 2000 and a reference to a telephone call to one Colin Rezec who was a business consultant whom the respondent had consulted in relation to the deal. The next significant entry is under the date 27 July 2000 where there is a note in regard to an appointment with Da Cunha at 11:00a.m. Also written in the diary against that time is the name Associated Motor Holdings, which was a company in Imperial that figured in the draft contracts. On 7 August 2000 there is a note to telephone Da Cunha and under the date 14 August 2000 there is mention of a further meeting at 12 noon with him. On 18 August 2000 there is a notation of a meeting with Lynch at 3:30 p.m. The last

significant entry is on 21 September 2000 where a note is made of a meeting with Lynch and Da Cunha at 12 noon.

On a conspectus of all the evidence I agree with Selvan AJ's conclusion that by 14 August 2000, at latest, the negotiations between the respondent and representatives of Imperial had progressed to a stage when he was justified in believing that the transaction would go ahead. An important circumstance in this regard is that the proposed business plan, to which I have referred, was outlined on that day.

[9] Neither party called as witnesses any of the representatives of Imperial. The respondent expressed an intention to call Lynch, but he relinquished that idea when it was pointed out to him by Selvan AJ that since Lynch had not been subpoenaed it would be unlikely, having regard to his other commitments, that he would make himself available at short notice to give evidence in the case. I agree with Selvan AJ that no adverse inference may be drawn against either party for not calling witnesses from Imperial. [7] Even if there was an evidential burden on the respondent to satisfy the court that the negotiations with Imperial had progressed to a point where as a reasonable man in his position he was entitled to rely upon their coming to fruition, he discharged such onus.

[10] It was put to the respondent by counsel for the appellant that the financial state of the company at various times constituted proof, within the meaning of s 424(1) of the Act, that its affairs were conducted recklessly or with intent to defraud; this was particularly so when he issued the cheque for R309 734,36 post dated to 21 September 2000, as he knew that it would not be paid and therefore he was

[7] (See for example *Galante v Dickinson* 1950 (2) SA 460 (AD) and *Elgin Fireclays Limited v Webb* 1947 (4) SA 744 (AD) at 750 and *Minister of Justice v Seametso* 1963 (3) SA 530 (AD)).

acting with fraudulent intent. The respondent denied this. He pointed out that in a telex which he gave the instruction to his bank to stop payment of this cheque he also stopped payment of a cheque in favour of his wife for R35 000,00. In my view the court *a quo* was correct on the basis of the undisputed evidence that I have mentioned above in finding that the respondent had not acted with fraudulent intent. Furthermore as the respondent stated, apart from the appellant and Sabila, nearly all of the trade creditors of the company had been paid within a maximum of thirty days from the date of their claims.

[11] It was also contended by the appellant that during the period commencing June 1999 to the date when the company was placed under winding-up the respondent knew or should have known that it would not be able to pay its debts on due date. This notwithstanding, the company, represented by the respondent, continued to incur credit with the appellant amongst others. This conduct, so it was argued, constituted reckless trading within the meaning of the section. It would not be proper to consider this state of affairs in isolation. As pointed out by the respondent in his evidence the matter needs to be looked at in the context of the number and amounts of cheques issued by the company during the period in question. As already pointed out, of the approximately 700 cheques issued, the number of cheques stopped was not considerable in number or amount and was approximately only about 8 per cent of the total number of cheques issued. Indeed it is apparent that approximately 650 out of 700 cheques were paid on the due date thereof and that of those that were countermanded, all but the cheque handed to the appellant, were met shortly after the due date of the cheque. It is well to bear in mind the following remarks in *Ex parte De Villiers NNO:In Re Carbon Developments (Pty) Ltd (in*

liquidation)[8]

'In short, the mere carrying on of business by directors does not constitute an implied representation to those with whom they do business that the assets of their company exceed its liabilities. The implied representation is no more than that the company will be able to pay its debts when they fall due.'

In other words it is not a corollary to this proposition that where the assets of a private company exceed its liabilities this has no bearing on whether its directors are justified in carrying on business. On the contrary, where a company is technically solvent it must often follow that it will be in a position to pay its debts either because it will be in a position to realise its assets or because it will be able to obtain loan finance on the security thereof. What is important in this context is to enquire, proper regard being had to the onus of proof, whether the directors of the company genuinely believed that 'the clouds will roll away and the sunshine of prosperity will shine upon them again and disperse the fog of their depression'[9] entitling them to incur credit to enable them to get over the bad times.

[12] The court *a quo* considered whether the company was factually insolvent during the period of approximately twelve months before it was placed under winding-up and what the belief would have been of a postulated reasonable businessman as to the proposed discharge of its liabilities as they fell due. Taking into account various subjective factors to which the court *a quo* referred, it does not necessarily follow that because the respondent put the creditors of the company who became such during the last year of trading, at risk, he thereby acted negligently. But even if he did, his negligence was not of such an order that it constituted

[8] 1993 (1) SA 493 (AD) at 504E.

[9] Palmer's Company Law (24 ed) at 1463 quoted with approval in *Carbon Developments* (supra) at 504B. See also *Ozinsky NO v Lloyd* 1992 (3) SA 396 (C) at 415I-418D.

recklessness within the meaning of the section. The proposed Imperial deal in itself justified carrying on with the business of the company at the time when it had dealings with the appellant. A court should not, as pointed out in *Philotex,*[10] lightly find recklessness.

[13] In summary I am therefore of the view that the court *a quo* properly and for good reason found that the appellant had not discharged the onus resting on it to prove that the respondent was either fraudulent or reckless within the meaning of the section.

[14] The appeal is dismissed with costs.

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R H ZULMAN
JUDGE OF APPEAL

CONCUR:) CLOETE JA
) THERON AJA

[10] At 142H.