<u>FREE STATE HIGH COURT, BLOEMFONTEIN</u>
<u>REPUBLIC OF SOUTH AFRICA</u>

Case number: 6113/2009

In the matter between:

PETER FRANCIS N.O.	**1st Applicant / 1st Defendant**
HILARY BARRIS N.O.	**2nd Applicant / 2nd Defendant**

and

ALITORI 1470 CC	**Respondent / Plaintiff**

CORAM: **J. B. MTHEMBU.AJ**

HEARED ON: **27 MAY 2010**

JUDGMENT BY: **J. B. MTHEMBU,AJ**

DELIVERED ON: **25 JUNE 2010**

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[1] This is an Application in terms of Section 8 of the Close Corporations Act 69 of 1984 read with Section 13 of the Companies Act 61 of 1973, requiring the Respondent

(Plaintiff in the main action) to provide security for the Applicants' costs in the sum of R142 500.00.

[2] The Applicants contend that the Respondent, a Close Corporation, will be unable to meet an adverse costs order as envisaged in terms of the provisions of High Court Rule 47 and is impecunious and insolvent. The Applicants' principal contention is that the financial statements referred to in the Founding Affidavit, which are dated the 28th of February 2007, reveal a trading loss of R1.72 million and reflects a hopelessly insolvent position. The Respondents contend that an analysis of its most recent financial statements, being the 2009/2010 financial statements, reveals that the Respondent Close Corporation is not insolvent. The Applicants respond that on the Respondent's own version it is insolvent.

THE LEGAL POSITION:

[3] Section 13 of the Companies Act 61 of 1973 reads:

> "Where a company or other body corporate is Plaintiff or Applicant in any legal proceedings, the Court may at any stage, if it appears by credible testimony that there is reason to believe that the company or body corporate, or if it is being wound up

the liquidator thereof, will be unable to pay the costs of the Defendant or Respondent if successful in his defence, requires sufficient security to be given for those costs and may stay all proceedings until the security is given."

[4] In **HENRY v RE DESIGNS CC** 1998 (2) SA 502 (C) the principles as set out at page 507G-508D by the court are as follows:

1. "The Court would have the power to order that security for costs be furnished by the Respondent only if it appeared that there was reason to believe that the Respondent would be unable to pay the Applicant's costs in the unsuccessful application for Leave to Appeal or her costs in the action if she was successful in her defence thereof. See **VIVIERS v WILLIAMS BUILDERS AND CONTRACTORS LTD** 1936 TPD 273 at 274

2. For such reason to believe that the Respondent will not be unable to pay the Applicant's costs to exist, it is not necessary that the Respondent should be found to be insolvent. As Greenberg J, as he then was, said in **VIVIERS**' case supra loc cit:

   "The section does not refer to bankruptcy or insolvency; it bases the power to make an order on the fact that there is reason to believe that the company will be unable to pay the costs. The company might be solvent, but the figures may show that it will be quite unable to pay the costs.

3. Once the court is satisfied that such reason to believe exists it has discretion whether or not to order the Respondent to furnish security; See **FRASER v LAMPERT N.O** 1951 (4) SA 110 (T) at 115 A-B.

4. In exercising this discretion, (a) the Court will lean towards ordering security to be furnished; (b) it would not deprive the Applicant of the benefit of the Section unless special circumstances were found to exist; (c) the Court would consider what the Respondent's financial position was after having lost the Application for Leave to Appeal, and what it would be if and when it lost the action; In that regard its present financial position was relevant; (d) the Court would not enquire fully into the merits of the action and form an opinion of the Applicant's prospects of success, but the nature of the claim and defence thereto are not irrelevant the Applicant ought to specify her defence. All this was held mutatis mutandis by Hiemstra J, in the full bench decision of the Transvaal Provincial Division in **TRUST BANK VAN AFRIKA BPK v LIET AND ANOTHER**, 1963 (4) SA 752 (T) at 754 H – 755 B."

[5] Once the requirements of Section 13 have been satisfied, the only remaining issue is the exercise of the Court's wide discretion. It is trite that this discretion is to be exercised upon a consideration of all the relevant facts and in so doing the Court will have regard to the nature of the claim, the financial position of the Company at the stage of the

Application for security and its probable financial position if it should lose the action.

[6] In the exercise of its discretion, the Court does a balancing exercise which requires that the Court needs to be apprised of all the relevant information. The Applicant, for security, will need to show that there is a probability that the Respondent will be unable to pay costs. The Respondent, on the other hand, will have to explain the nature of the litigation and should indicate the nature and importance of its litigation to rebut allegations that the litigation is without prospects of success. A full enquiry into the merits of the contemplated litigation between the Respondent as Plaintiff and the Applicants as Defendants is not required.

[7] The discretion which the Court is enjoined to exercise is a narrow and strict one. The *onus* in this regard rests on the Applicants in that they have to convince this Court that not only are there such facts before the Court entitling it to conclude that there is reason to believe that the Respondent will be unable to satisfy an adverse cost order but, furthermore that notwithstanding, it should exercise its discretion in favour of the Applicants.

THE ARGUMENTS:

[8] The Applicants state in the Founding Affidavits that the Respondent's financial statements dated 28th of February 2007 reveal a trading loss of R1, 72million and an insolvent position in excess of R1, 5million. The Respondent contends that the 2007 earlier financial statements are outdated and irrelevant and the Court should only have regard to the current financial statements.

[9] The Applicants contend that an analysis of the Respondent's most recent financial statements, 2009/2010, annexed to its Opposing Affidavit, reveals a Net Deficit of R3 076.00. In addition it has non-current assets totaling R635 000.00. These non-current assets comprise of loans to Group Companies and fixed assets. Part and parcel of the Respondent's financial statements incorporate revenue to the extent of R4 120 612.32, being the amount paid by Applicants to the Respondent. This amount is in contention.

[10] The Applicants aver that the current financial statements of the Respondent reveal that the Respondent's liabilities exceed its assets. This position is exacerbated by the fact that the Respondent's trade and other payables are R928 000.00 while its current assets are R726 000.00.

[11] The Applicants aver that on the Respondent's own version, it is admittedly insolvent. On the facts, the averment that the Respondent will not be able to meet an adverse costs order cannot be disputed.

[12] The merits on the main action are that the Respondent has instituted proceedings for payment of the sum of R445 307.73 being the value of computers and ancillary equipment allegedly removed by the Applicant from the premises of the Respondent.

[13] The Applicants argued that whilst it is not submitted that the Court should pronounce on the merits of the matter, having regard to the admitted facts, the failure of the Respondent to explain documents which have been authored by it which

are contrary to its claim, should be taken into account by the Court in the exercise of its wide discretion.

[14] The Applicants submitted that the Respondent has not placed the quantum of the costs in dispute. The Respondent’s only contention in this regard is that there is no factual basis to believe that the Respondent is “either insolvent, alternatively, will be unable to pay a costs order in favour of the Applicants”.

[15] Mr. De Wet argued on behalf of the Applicants that Section 8 of the Close Corporations Act must be kept in mind. The Applicant must satisfy the Court that “there is reason to believe” that the Close Corporation is insolvent and unable to pay its debts. The purpose of Section 8 is to see to it that impecunious litigants must put up security and not to actually pay it, because if the Close Corporation wins the case it gets the money which it put up as security back.

[16] Mr. De Wet argued that if the Court finds that the Respondent’s liabilities are more than its assets, then “there is reason to believe” that the Respondent is unable to meet

its financial obligations. The Respondent must convince the Court that there are special circumstances to deny the Applicants' *prima facie* right to be given security. *In casu* no special circumstances have been pointed out by the Respondent. If one looks at the assets and liabilities of the Respondent, there is no way that it can pay its liabilities. The loans referred to in the financial statements are unsecured, non-interest bearing with no specific time frame of repayment.

[17] On the other hand the Respondent states in its Answering Affidavit that it is quite clear from the authorities that a two-stage enquiry is envisaged, namely:

17.1 Are there facts on which the Court can conclude that there is reason to believe that the Respondent will be unable to satisfy an adverse cost order? and;

17.2 If that be so, should it nevertheless still exercise its discretion as to whether or not to compel security to be filed?

[18] The Respondent submitted that the debate between the parties relates essentially to what can be inferred from the financial statements filed on behalf of the Respondent. The Applicants adopt the attitude that Respondent is factually insolvent. The latter is a fallacious argument and that this whole question should be approached in the context of the following:

18.1 The Application was initially premised on the first set of financial statements for the financial year ending 28 February2007;

18.2 This was the Respondent's first year of trading and clearly did not represent the nature and extent of growth within the Close Corporation;

18.3 A comparison between the liabilities of Respondent in 2007 as compared to 2009 and 2010 clearly shows a remarkable turn around in excess of R3 million in reductions thereof;

18.4 In 2007 the accumulated loss was R1 728 857.00, in 2009 it was R3 554 824.00 whilst in 2010 it was R3 076.00 being the current balance between liabilities and assets;

18.5 Similarly the gross revenue generated in 2007 amounted to R2 998 225.00, by 2009 it had increased to R5 706 956.00, whilst by 2010 it had increased to R8 685 110.00 evidencing a very strong growth index;

18.6 Similarly the operating expenses between the 2009 and 2010 financial years were literally halved from R4 160 639.00 to R2 146 799.00.

[19] On behalf of the Respondent Mr. Fisher submitted that, on the aforementioned facts there is insufficient factual basis for this Court to conclude that there is reason to believe that Respondent will be able to satisfy an adverse cost order. It is furthermore submitted that even should the Court conclude that there are facts giving rise to a doubt as to whether the Respondent could satisfy an adverse cost

order, this Court is nevertheless entitled to exercise its discretion in favour of the Respondent, especially if regard be had to the nature of the claim instituted.

[20] *In casu* the Respondent has contested its liability to provide security and it is submitted that in such a case the demand by the Applicants as well as the amount demanded, must be an amount that the Applicants are entitled to by reason of a determination by the Registrar or agreement between the parties prior to the launching of the Application. There is nothing to suggest that this procedure has been employed by the Applicant.

[21] Mr. Fischer argued that there is nothing that shows that the Applicant sought the Registrar's guidance before approaching Court. At best the Court must direct the parties back to the Registrar to determine an amount. Rule 47(3) of the Uniform Rules says that if you "contest your liability to pay" after determination by the Registrar then you must approach Court. Mr. Fischer argued that the 2009/2010 financial statement are an exceptional circumstance. A Court should interpret and apply Section 8 of the Close

Corporations Act 69 of 1984 in accordance with the principles which have evolved and have been laid down in the cases pertaining to the corresponding provisions in Section 13 of the Companies Act 61 of 1973.

CONCLUSION:

[22] The Applicant bears the *onus* of establishing on a balance of probabilities that there is reason to believe that the Respondent will be unable to pay adverse costs. The normal method to be adopted by Respondent in endeavoring to resist such an application for security, being to furnish a balance sheet for the Court to see by how far assets exceed liabilities.

[23] It is indeed so that the Application was initially premised on the Respondent's first set of financial statements for the financial year ending 28 February 2007, which was its first year of trading and did not represent the nature and extent of its growth. A comparison between the liabilities of Respondent in 2007 as compared to 2009 / 2010 seems to show a turn around in excess of R3million. In 2007 the accumulated loss was R1 728 857.00, in 2009 it was R3 554 824.00, whilst in 2010 it was R3 076.00, being the

current balance between liabilities and assets. However, the accumulated loss of R3 076.00 incorporates the sum of R4 120 612.32 that Applicant paid to Respondent which forms the basis of Applicants' claim in the main action. In addition the Respondent has non-current assets totaling R635 000.00 which comprise loans to Group Companies and fixed assets. These are unsecured with no specific date of payment. The current statements reveal that the Respondent's liabilities exceed its assets. This position is exacerbated by the fact that the Respondent's trade and other payables are R928 000.00, while its current assets are R726 000.00. On the Respondent's own version, it is admittedly insolvent.

[24] In **BROLLOMER TIN EXPLORATION CO. LTD v KAMEEL TIN PROPRIETARY CO. LTD** 1928 TPD quoted with approval in **FERREIRA v ARLINDERS LTD 1964 (1) 631 (OPD)**, De Waal JP at Pages 601 and 602 had this to say:

> "A large volume of evidence has been placed before us on Affidavit by the Respondent Company seeking to justify its refusal to find security on the ground that the defence of the Defendant in the action is not *bona fide;* but it seems to me that

> all reference to the *bona fides,* or otherwise, of the Defendant Company is somewhat irrelevant, because if the Court is satisfied that the Plaintiff Company possesses no assets, or insufficient assets, it seems to me it should exercise its discretion in favour of ordering the Plaintiff to give security, as it is manifestly undesirable, if not impossible, for the Court at this stage of the proceedings to express any opinion as to the *bona fides* or otherwise of the defence" (my own emphasis)

This, however, does not mean that the Court is bound to order security in every case where it is plain that if the action fails the Company will be unable to pay the Defendant's costs. See **KRUGER STORES (PTY) LTD AND ANOTHER v KOPMAN AND ANOTHER** 1957(1) SA 645 (W).

[25] It was submitted on behalf of the Respondent that *in casu* the amount of the security has not been agreed or established by the Registrar and this Court should find as an exceptional circumstances. I disagree. I agree with the Applicant's submission that its Application is premised on the fact that Respondent contests its liability to give security.

[26] The Respondent's submission that the Applicant rushed to Court cannot hold water. In **SASKO BPK v FUTURUS**

<u>CONSTRUCTION (PTY) LTD</u> 1998 (4) SA 170 at 175B – 176B the Court held that the word "demanded" cannot be given its narrow or literal meaning – it means agreed and then demanded. *In casu* the amount of security has not been agreed upon. Upon receipt of the Applicants' demand for security the Respondent disputed its liability to give security in that the grounds advanced by the Applicants are unfounded and unsubstantiated. I agree with Mr. De Wet that the **<u>SASKO</u>** case *supra* has no relevance to the present dispute, apart from the fact that it says you cannot apply for a stay under Rule 47(3) of Uniform Rules of Court until the amount has been agreed or determined by the Registrar.

[27] The reasons advanced by Mr. De Wet, in particular that there has not been growth over the past three years, and the most recent statements are not correct because the R4 million Applicant paid the Respondent as a consequence of a representation made by the Respondent that goods were delivered, when in fact goods had not been delivered is included as an asset, and the fact that the loans are unsecured, satisfactorily established that there is reason to

believe that the Respondent will be unable to pay the Applicants' costs.

[28] In the result I make the following order:

1. The Respondent is ordered to furnish security;
2. The registrar must determine the amount of the security;
3. The Respondent is to pay the costs of this application.

J B MTHEMBU, AJ

On behalf of the Applicants:	Adv. P J T De Wet Instructed by: Matsepes BLOEMFONTEIN
On behalf of the Respondent:	Adv. P U Fischer Instructed by: Lovius Block BLOEMFONTEIN

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