IN THE SUPREME COURT OF APPEAL OF SOUTH AFRICA

REPORTABLE

Case no: 522/2003

In the matter between

P FOURIE N.O.	**1ST APPELLANT**
J H J VAN RENSBURG N.O.	**2ND APPELLANT**
J L LUBISI N.O.	**3RD APPELLANT**
L M M TEFFO N.O.	**4TH APPELLANT**

and

C S EDELING N.O.	**1ST RESPONDENT**
D ABEY	**2ND RESPONDENT**
J A A DA COSTA	**3RD RESPONDENT**
H CRONJE	**4TH RESPONDENT**
J A LANDSBERG	**5TH RESPONDENT**

Coram: HARMS, ZULMAN, CONRADIE, HEHER JJA and VAN HEERDEN AJA

Date of hearing: 23 MARCH 2004
Date of delivery: 1 APRIL 2004

Summary: Liquidation of unlawful pyramid scheme – whether repayment by scheme of participants' contributions was undue preference – whether payment by scheme of gains to participants was a disposition without value

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JUDGMENT

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CONRADIE JA:

[1] The audacity of its perpetrators and the credulity of its participants combined to produce a gargantuan fraud notoriously known as the Krion Pyramid Investment Scheme. It was operated from the beginning of 1998 and, as all these schemes do, collapsed when the inflow of funds could no longer sustain the outflow of extravagant returns to participants. Each participant on average 'invested' in the scheme three times. Its turnover was some R1.5 billion. In order to throw regulatory authorities off the trail it was at one time or another conducted by entities called M P Finance Consultants CC, Madicor Twintig (Pty) Ltd, Martburt Financial Services Ltd, M & B Kooperasie Beperk and Krion Financial Services Ltd. The way in which the scheme was conducted made it attractive for investors to invest for periods as short as three months. When the loan capital with 'interest' was repaid at the end of the agreed investment period, the investor would more often than not reinvest the capital and interest. The advantage for the investor of doing business in this way was of course that his already enormous interest was compounded. Typically an investor would invest an amount in the scheme having been promised a return of 10% per month, capital and profit repayable within three months. Until the collapse of the scheme, investors received repayment of their capital and their profit when due. Sometimes an investor would leave the capital and/or the profit in the scheme and this would then have been reflected by means of a book entry as a payment and a new investment.

Other investors would take their capital and profit on the due date, some of whom returned after a while to reinvest a similar amount.

[2] The appellants are the joint provisional liquidators of the companies and the joint liquidators of the close corporation. The first respondent is someone called the 'investor representative'. I shall say more about him shortly. The other respondents are from the ranks of the investors. Only the third, fourth and fifth respondents are parties to the appeal. It is anomalous to speak of investors in a scheme that was illegal from beginning to end but everyone else has done so and I shall do so too.

[3] In an attempt to simplify the administration of the various insolvent estates the liquidators proposed a scheme of arrangement in terms of s 311 of the Companies Act 61 of 1973 between those of the entities that are companies and their creditors. The scheme, sanctioned on 22 November 2002, purported to ratify and confirm the consolidation of the assets and liabilities of the companies in the MP Finance Group. In fact, an order for such consolidation was only granted on 4 February 2003. Nothing turns on this small irregularity. MP Finance Group is cited in the papers as a close corporation but in fact is not a legal persona. It is no more than the name under which the liquidators are winding up the affairs of the Krion scheme. What became of the assets and liabilities of MP Finance Consultants CC, a close corporation at one time used in the Krion scheme, is not clear. Being a close corporation, it could not have been a party to the scheme of arrangement. However, the uncertainty does not matter because it probably had no assets at the time of its liquidation and the entitlement of

its creditors to lodge claims against MP Finance Group is not in dispute.

[4] The appeal arises from an order made by Hartzenberg J on 28 February 2003 confirming in part a rule *nisi* issued pursuant to an application launched by the appellants for orders under ss 26 and 30 of the Insolvency Act 24 of 1936. He declared inter alia that the investment scheme was at all material times (from and after 1 March 1999) insolvent in that its liabilities exceeded its assets and that contracts concluded between the investment scheme and investors in the scheme were illegal and null and void. The order was in these terms:

> '1. It is declared that the investment scheme [concluded] by Marietjie Prinsloo (formerly Pelser) during the period 1998 to June 2002 under various names including M P Finance Consultants CC, Madikor Twintig (Pty) Ltd, Martburt Financial Services Limited, M & B Ko-operasie Beperk en Krion Financial Services Limited ("the investment scheme") was at all material times from and after 1 March 1999, insolvent in that its liabilities exceeded its assets.
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> 2. All contracts concluded between the investment scheme and investors in the scheme were illegal and null and void.
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> 3. All actual payments from and after March 1999 by the aforesaid investment scheme to investors, including the Second and further respondents are set aside as dispositions by the scheme to investors at times when its liabilities exceeded its assets with the intention of preferring the particular investor above other investors in terms of section 30 of the Insolvency Act, provided that a reinvestment is not to be regarded as a payment and that the right of investors to rely on the provisions of section 33 of the Insolvency Act is in no way affected by this order.
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> 4. An inquiry is ordered into the details of the amounts of the aforesaid payments and the examination and investigation provisions of paragraph 38 of the scheme of arrangement, sanctioned

on 22 November 2002 under case number 27035/2002, shall apply *mutatis mutandis* for the purposes of this inquiry.

5. The applicants may set the matter down for judgment against any investor, at any time, on the same papers, duly supplemented by evidence, as to the *quantum* of the claim.

6. The costs of all parties who appeared in the matter, and of the *amicus curiae*, are payable as costs of the administration and liquidation of the investment scheme. Where applicable such costs are to include the costs of two counsel.'

[5] The part of the order in para 3 setting aside 'all actual payments' read with the reasons given by Hartzenberg J shortly after the granting of the order soon gave rise to an interpretational difficulty. It was not clear whether the order meant that all payments to investors, including capital repayments, were set aside or whether it meant that only the gain of each investor was set aside.

[6] The appellants and the first respondent interpreted the order in the first sense while the third to fifth respondents thought it meant that they needed to repay only their 'profit'. Everyone was agreed, though, that book-entry type reinvestments, that is to say, investments that were not paid out before being reinvested but were simply 'rolled over' in the scheme's books did not qualify as 'dispositions' and were therefore untouched by the order. That explains the use of the term 'all actual payments' at the outset of para 3.

[7] This difference of opinion on the meaning of the order persuaded the appellants to ask the court for its clarification. This application resulted in an amended order being granted by Hartzenberg J on 10 November 2003, an order which made it clear

that only that amount which exceeded the investment of each investor, in other words, the gain made by each investor, was set aside in terms of s 30(1) of the Insolvency Act and recorded that the question whether a reinvestment qualified as a new investment was to be determined according to the facts of each case. The amended para 3 then read (with the changes italicized):

'3. All actual payments from and after March 1999 by the aforesaid investment scheme to investors including the Second and further respondents *in so far as they exceed the investment of each particular investor* are set aside as dispositions by the scheme to investors at times when its liabilities exceeded its assets with the intention of preferring the particular investor above other investors in terms of section 30 of the Insolvency Act, provided that a reinvestment is not to be regarded as a payment and that the right of investors to rely on the provisions of section 33 of the Insolvency Act is in no way affected by this order; *what is to be regarded as a re-investment is to be determined objectively in each case.'*

[8] It is unnecessary to decide whether, in interpreting the first order, Hartzenberg J was empowered to amend it by way of the second order to make it conform to what he had intended to say in the earlier order. He then and there granted leave to the appellants and to the first respondent (who had purported on behalf of investors to agree to the first order) to appeal to this Court against the second order. The other respondents received leave to cross-appeal against para 3 of the first order in case it should be found that it ought not to have been amended. The practical effect of this is that the first order is open for reconsideration.

[9] Section 30(1) of the Insolvency Act deals with undue preferences:

'(1) If a debtor made a disposition of his property at a time when his liabilities exceeded his assets, with the intention of preferring one of his creditors above another, and his estate is thereafter sequestrated, the court may set aside the disposition.'

A colourless disposition, one not made with the required intent, is not caught by the provisions of s 30(1). In attempting to discharge the onus of proving that Ms Marietjie Prinsloo as the directing mind of the scheme had the intention to prefer one creditor above another, the appellants relied upon the content of a report from the first respondent to the Master. I demonstrate its fatuousness by quoting the relevant paragraph in the founding affidavit in full:

'On the question of intention to prefer, as required in section 30 of the Insolvency Act, I [the deponent is the first applicant] respectfully refer to the content of the first respondent's report to the Master, specifically paragraphs 112 to 115 thereof which read as follows:

"112 I am prima facie of the view that it will be the duty of the liquidators to apply for the setting aside of many transactions in terms of sections 26 and 30 of the Insolvency Act or under the Actio Pauliana (common law setting aside for fraud).

113 It is probable that:

113.1 The scheme business (regardless of which entity was being used at any particular time) was insolvent at all material times and that the liabilities substantially exceeded the assets;

113.2 Almost all the payments, whether to agents or investors and whether for interest, dividends or redemption of capital, were made under insolvent circumstances;

113.3 Those in control knew, at all material times, that:

113.3.1 The liabilities of the business exceeded the assets;

113.3.2 The scheme was fraudulent and that there was no underlying genuine profit producing business activity;

113.3.3 Every payment would have the effect of preferring the payee, and prejudicing unpaid creditors (as a class regardless of the identity of the members of that class at any given time);

113.4 Such knowledge is, in my view, sufficient to establish an intention to prefer. The payment under insolvent circumstances objectively establishes the preference which is the natural consequence of making the payment.

113.5 Knowledge of the fact of insolvency, coupled with the doctrine that one is presumed to intend the natural consequences of one's actions, suffice to prove the requisite intention to prefer.

114 Furthermore, since the scheme was illegal and there were no valid underlying causae for the payments in question, it would follow that the payments were 'without value' as contemplated in section 26.

115 For these reasons it will appear that the liquidators have good prospects of success in claiming back moneys received by investors and gang members."

[10] The only other material on this topic in the papers is an answering affidavit from the investor representative, the very person whose views as to the probable solvency of the scheme and the knowledge of those in control of the scheme of this state of affairs are relied on in para [9]. Although meant to bolster the appellants' case, it adds nothing to it, being merely the investor representative's summary of certain evidence given at an enquiry in the insolvent estate of Prinsloo as well as some other odds and

ends that are of no use in the determination of any of the issues.

[11] The nature of the evidence presented in the founding affidavit and the affidavit of the first respondent leaves one with no doubt that it was hoped that agreement between the appellants and the first respondent on all the essential issues would carry the day. Relying on authority supposedly given to him by a large number of investors to consent to the terms of the first order, the first respondent agreed that all dispositions by the scheme to creditors after March 1999 ought to be set aside. There are many reasons why he was not competent to have represented the investors or made such an admission on behalf of investors. They were debated before us in argument. He relied first on an appointment or authorization by the Master to the liquidators to appoint him to represent investors. Neither the Insolvency Act nor the Companies Act confers any such power on a Master. The first respondent's other ground is that he was appointed by the court in terms of the scheme of arrangement. Apart from the fact that the court did not have the power to appoint him, the worrying feature of the appointment (and that by the liquidators supposedly authorized by the Master) is that someone who had been struck from the roll of advocates was appointed in a fiduciary position. (The grounds for his striking off have been reported: *Society of Advocates of South Africa (Witwatersrand Local Division) v Edeling* 1998 (2) SA 852 (W) at 898H-899F.) Whether due disclosure of these facts had been made we do not know. Leaving aside that fact and the grave doubt whether the mandate given to the first respondent by investors was broad enough to permit him to make admissions on behalf of those

whose agent he professed to be, the most fundamental objection to the first respondent's representation of a large body of scheme investors is that in discharging what was after all a fiduciary duty he was faced with a major conflict of interest between those investors who had lost money in the liquidation of the scheme and therefore were creditors of the scheme and those who were not. There were investors who were not scheme creditors at the date of its liquidation (those who had put money into the scheme, taken their gains and wisely not re-invested) who could not have been parties to an arrangement under section 311 of the Companies Act. On behalf of them he could have had no authority to act. Even among the scheme's creditors there were divergent interests. The interests of a multiple investor would be quite distinct from those of a once only investor. The difficulty around the first respondent's conflict of interests did not pass unnoticed. The court *a quo* sought to address it by appointing an *amicus curiae*. The latter made submissions to the court *a quo* and presented helpful argument to this Court; but his appointment could not overcome the fundamental flaw that the first respondent was not empowered to make the admissions that he purported to make. Finally the first respondent is not in the position of a *curator ad litem* who could litigate on behalf of someone else.

[12] When the hope that consensus between the appellants and the first respondent might carry the day was dashed by the third respondent's answering affidavit, the first respondent, taking up the cudgels on behalf of the liquidators, delivered another affidavit, annexing to it extracts from the evidence of Prinsloo and others at an enquiry

held in terms of s 152(2) of the Insolvency Act. It could not aid the appellants in establishing a cause of action based on s 30(1) of the Insolvency Act which they were obliged to include in their founding papers; that defect alone was fatal to the success of the application. Apart from that, it was not satisfactorily explained how the annexing of extracts from the evidence could, at any rate in the absence of any reliance on s 3 of the Law of Evidence Amendment Act 45 of 1988, possibly have made them admissible as testimony.

[13] It is best therefore to do as the court *a quo* appears to have done and ignore any factual material that is not common cause between the appellants and their supporter the first respondent on the one hand and the remaining respondents on the other. The only material of this kind which is of any use is the admitted fact that the scheme's liabilities exceeded its assets on and after 1 March 1999. On the probabilities it is correct. All loans made to the scheme were – in the light of at least the provisions of s 11 of the Banks Act 94 of 1990 and a prohibition under the Consumer Affairs (Unfair Business Practices) Act 71 of 1988 – illegal and therefore void; this proposition of law is uncontested. The scheme never had the least entitlement to retain investors' money until the date which had supposedly been agreed as the due date for repayment. The perpetrators of the scheme knew the investments to be illegal. There is, on the other hand, no evidence that any of the investors knew their investments to be tainted, nothing from which to infer that any of them acted *ex turpi causa.* That being so, no question arises of relaxing the *in pari delicto potior est defendentis* rule

and the ratio in *Visser en 'n ander v Rousseau en andere NNO* 1990 (1) SA 139 (A) is not applicable to the facts of this case. Upon receipt of a payment the scheme was liable promptly to repay it to the investor who had a claim for it under the *condictio ob iniustam causam*. Instead, it used the money to pay the claims of other investors who had invested earlier. That was the whole idea of the scheme. The interest realized by the micro-lending business carried on by the scheme as a cover for its illegal activities came to a mere R1,76 m. The profit before tax was a paltry R4 530,77. The returns to investors on the other hand totalled some R30m. There was no income from which to pay this. Not only was the capital of later investors being unlawfully retained, but it was being used to pay others their capital and extravagant returns while their only chance of recovery was that yet other investors might be found whose money could in turn be used to pay them. The nature of the scheme dictated its insolvency. It had no assets of any importance and huge liabilities, all of which were due and payable and very few of which could be met except by incurring further liabilities; so later investors were clearly prejudiced. But the effect of the transactions does not by itself demonstrate any undue preference. The issue is whether earlier investors were deliberately unduly preferred, not whether they were prejudiced.

[14] In the incestuous eagerness of the appellants and the first respondent to augment the scheme estate the many judicial *dicta* that a trustee or liquidator cannot show an intention to prefer simply by proving insolvency and then relying on an inference that the insolvent debtor must have intended the natural consequences of an act of disposal

were forgotten or perhaps ignored.

[15] It is established law that in considering whether an intention to prefer has been shown, all the relevant facts must be considered. One such relevant (and important) fact is whether the insolvent at the time of the disposition contemplated insolvency (*Pretorius NO v Stock Owners' Co-Operative Co Ltd* 1959 (4) SA 462 (A) at 472E–G); proof of such a contemplation (of which there was none) would have brought the appellants some distance but possibly not far enough since the inference to be drawn from a contemplation of sequestration is not necessarily that the insolvent's subjective 'dominant, operative or effectual intention' in making the disposition (see *Cooper and Another NNO v Merchant Trade Finance Ltd* 2000 (3) SA 1009 (SCA) at 1026G) was the intention to prefer. The intention to prefer is nothing but a resolve 'to disturb what would be the proper distribution of assets' in insolvency. (*Pretorius NO* at 476D–F, a passage cited with approval in *Gert de Jager Bpk v Jones NO en McHardie NO* 1964 (3) SA 325 (A) at 331E–F.) From the scanty material in the founding affidavit, shored up by the probabilities, it seems that Prinsloo knew that continuing to make dispositions to creditors was the only way to give credibility to the scheme and so keep it afloat and that this was her dominant intention. She envisaged not the liquidation but the continuation of her fraudulent business. Depending on how convincingly she did this, and Marietjie Prinsloo was a gifted swindler, liquidation might be some way off. She also made attempts to recapitalize the scheme by converting loan into equity capital and issuing share certificates to investors. This

exploit, as deceitful as the rest of her business dealings, nevertheless demonstrates that she did not consider her enterprise lost.

[16] The order of the court *a quo* set aside the gains of each investor under section 30(1) of the Insolvency Act. All parties are agreed that the gains were illegal and that investors may not retain them. Making the order under s 30(1) was, however, an error. There was no evidence that the gains were paid over with the intention to prefer one creditor above another any more than that the investments were repaid with that intention.

[17] An order could have been made under s 26 of the Act, the first subsection of which reads:

'26 (1) Every disposition of property not made for value may be set aside by the court if such disposition was made by an insolvent –

(a) more than two years before the sequestration of his estate, and it is proved that immediately after the disposition was made, the liabilities of the insolvent exceeded his assets;

(b) within two years of the sequestration of his estate, and the person claiming or benefited by the disposition is unable to prove that immediately after the disposition was made, the assets of the insolvent exceeded his liabilities:'

The proviso that follows the subsection does not concern us.

[18] A disposition, it has been decided on more than one occasion, is not made for value if the payment is illegal. *Estate Jager v Whittaker and Another* 1944 AD 246 dealt with the payment of usurious interest. 'No obligation of any sort,' said Watermeyer CJ at 251-52, 'to pay a higher rate of interest than that permitted by the

Act can arise from a promise to pay a higher rate, and it therefore follows that such a promise is a mere nullity, and any payment of such a higher rate in pursuance of such promise is in effect a donation, or disposition not made for value, and is consequently liable to be set aside under sec. 26 of the Insolvency Act.' In *Rousseau en Andere v Malan en 'n Ander* 1989 (2) SA 451 (C) at 459I-J this dictum was applied to illegal commission payments from a scheme found to have been a lottery. In *Visser en 'n ander v Rousseau en andere NNO* 1990 (1) SA 139 (A) where the operators of a pyramid scheme paid participants for a useless product such payments were (at 154I–156F) found to be dispositions without value.

[19] The promise to reward investors with the returns paid by the scheme was a 'mere nullity' and any payment of a profit or interest would have been a disposition not made for value. Although the application was, *inter alia*, premised on a contention which was suggested by the first respondent to the liquidators that book-entry repayments by the scheme were dispositions, they, during argument before Hartzenberg J, prior to the granting of the first order, decided not to persist in this contention. They did not in this court depart from that attitude. If a 'repayment' of capital retained in the scheme by way of a book entry re-investment does not qualify as a disposition, then the 'payment' of gains retained in the scheme is not a disposition either. Where gains on retained gains were made (in the manner that compound interest might be earned by capitalising it) only the actual payment of the accumulated gains would be a disposition without value. The question that arose in the court *a quo*

in relation to a disposition of capital under s 30(1) of the Insolvency Act regarding the circumstances under which the repayment of a re-investment could be characterized as a disposition does not arise in the case of the payment of a gain. It is accordingly not necessary to issue any order in that regard. All the parties before the court accepted that the repayment of an investor's capital was not a disposition without value: the investor's *condictio* prevented it from taking on that character: where a disposition was made it was made in discharge of an obligation to return the illegal payment.

[20] An investor who was the recipient of a disposition defeasible as one without value and who parted with property or security held by him, or lost a right against another as consideration for a disposition of this kind need not restore anything received under the disposition if he acted in good faith unless the liquidators indemnify him for parting with such property or security or for losing such right (s 33 of the Insolvency Act). The court *a quo*, *ex abundanti cautela* it seems to me, preserved this right in its order. The appellants have not suggested that this ought not to have been done.

[21] The order granted by the court below purported to bind all investors, or at least all those whose names appeared as respondents on a list appended to the notice of motion, on the footing that a rule nisi was issued and published according to directions from the court calling upon those respondents who wished to do so to object to confirmation of the rule on the return day. Normally, citing multiple parties and serving an application by publication in the manner adopted here might have sufficed.

In the present case, however, service fell gravely short of what would have been required to ensure that the investors receive a fair trial. The publication as ordered by the court described the role and set out the recommendations of the first respondent who was held out to be the 'investors' representative'. There is in this scenario a great danger that investors might have considered their interests to be adequately represented by a court-appointed guardian and for that reason might have neglected to take steps to put their views before the court or even to obtain legal advice. The sad truth of the matter is that those investors who were informed of the application were probably at the same time discouraged from defending the proceedings. The third, fourth and fifth respondents do not fall into this category. They defended the proceedings; they did not suffer from any misunderstanding that their interests would be protected by the first respondent; there is no reason why they should not be bound by a declaration of this court that places no reliance on any contribution to the proceedings made by the first respondent.

[22] Section 32(3) of the Insolvency Act is in these terms-

'When the court sets aside any disposition of property under any of the said sections, [which include s 26], it shall declare the trustee entitled to recover any property alienated under the said disposition or in default of such property the value thereof at the date of the disposition or at the date on which the disposition is set aside, whichever is the higher'.

Para 5 of the order confirming the rule envisages recovery proceedings. Any investor against whom such recovery proceedings are brought would be free to maintain that he or she is, for lack of notification or by reason of having been misled by the terms of the publication, not bound by the order of Hartzenberg J. It may be that fresh setting aside proceedings against such an investor would then have to be combined with the recovery proceedings. It seems unlikely that it will come to this since an investor would have to deny that the gains paid out by the scheme were dispositions without value, a proposition that has not been challenged by any of the parties and one that I consider to be correct.

[23] The contention that Hartzenberg J had no power to amend para 3 of the first order granted by him was not pressed before us. If it had been and had succeeded it would have made no difference to the result or to the costs orders.

[24] The following order issues:

A. The appellants' and the first respondent's appeals are dismissed with costs that include the costs of two counsel.

B. The cross-appeals of the third, fourth and fifth respondents succeed with costs that include the costs of two counsel. Paragraph 3 of the order is set aside and replaced by the following paragraph:

'3. All actual payments, whether as profit or interest, from and after 1 March 1999 by the aforesaid investment scheme to the second, third, fourth , fifth and further respondents, in so far as they exceed the investment of each particular investor are set aside, under s 26 of the Insolvency Act as dispositions without value by the scheme to investors at times when its liabilities exceeded its assets, provided that the right of investors to rely on the provisions of s 33 of the Insolvency Act is in no way affected by this order.'

C. The costs of the *amicus curiae* are to be costs in the liquidation.

J H CONRADIE
JUDGE OF APPEAL

HARMS JA	**)Concur**
ZULMAN JA	**)**
HEHER JA	**)**
VAN HEERDEN AJA	**)**