CASE NO. 172/87
/CCC

IN THE SUPREME COURT OF SOUTH AFRICA

(APPELLATE DIVISION)

In the matter between

H NEUGARTEN AND TWO OT APPELLANTS

and

THE STANDARD BANK OF SOUTH AFRICA LIMITED RESPONDENT

CORAM: CORBETT, VAN HEERDEN, SMALBERGER, KUMLEBEN JJA et NICHOLAS AJA

DATE HEARD: 25 AUGUST 1988

DATE DELIVERED: 11 NOVEMBER 1988

J U D G M E N T

NICHOLAS, AJA:

The dramatis personae in this appeal are:

the Standard Bank of South Africa Limited; two companies

2/.....

now in liquidation - Neugarten Fashions (Pty) Ltd ("Neugarten") and Paul Vivaldi Fashions (Pty) Ltd ("Vivaldi"); and five individuals - Messrs H Neugarten, M Hirschowitz, M Sacks, J Rosmarin and S Eagle. (When I refer to Mr Neugarten I shall call him "H Neugarten" so as to distinguish him from the company which is abbreviated to "Neugarten").

Neugarten carried on the business of importers and wholesale distributors of ladies' clothing and knitwear. At the date of its liquidation, the 200 issued shares which had been issued were held by H Neugarten (100 shares), Michael Hirschowitz Family Investments (Pty) Ltd ("MHFI") (50 shares), Sacks (25 shares), and Rosmarin (25 shares). The directors were H Neugarten and Hirschowitz. Its business and affairs were managed by H Neugarten, Hirschowitz and Sacks, who were the company's principal executive officers. H Neugarten was in charge of buying, marketing and sales; Hirschowitz was in charge of general

administration; and Sacks's responsibilities were those of a financial director. No important decision was taken in regard to the affairs of Neugarten without prior discussion by H Neugarten, Hirschowitz and Sacks.

Vivaldi was incorporated on 5 May 1982. Its business was the importation and wholesale distribution of men's clothing and knitwear. At the date of liquidation, the 100 shares which had been issued were held by H Neugarten (40 shares), MHFI (20 shares), Rosmarin (10 shares), Sacks (10 shares) and Eagle (20 shares). The business and affairs of Vivaldi were managed in the same way as those of Neugarten. Although Eagle was also a director he was essentially a salaried employee, whose function it was to buy and sell merchandise. Neugarten and Vivaldi shared the same premises, and had the same personnel, the same shippers and bankers and the same bookkeeper and auditors. Their businesses were similar in character: the main difference was that Neugarten dealt in ladies', and Vivaldi in men's,

clothing.

On 2 July 1982, Hirschowitz, H Neugarten, Sacks, Rosmarin and Eagle executed a guarantee for the repayment of all sums of money which the Vivaldi company might thereafter owe to the Standard Bank. This was in connection with an application for overdraft facilities by Vivaldi to the bank. Vivaldi did not in the result make use of the overdraft facilities which were granted: its finances were provided by Neugarten. By September 1982 it had become plain to the Standard Bank that Neugarten was financing Vivaldi, and that Neugarten was becoming increasingly indebted to the bank in consequence. The bank accordingly informed Hirschowitz that unless Vivaldi provided a guarantee for Neugarten's indebtedness to the bank, Neugarten's credit facilities would be curtailed. As a result Vivaldi executed a guarantee ("the Vivaldi guarantee"), which was signed on its behalf by H Neugarten and Hirschowitz, for the repayment of all sums of money which Neugarten might thereafter owe to

the bank. Attached to the guarantee were two documents. One was in the following terms:

> "CONSENT in terms of Sec 226(2)(a) of the Companies Act, 1973.
> PAUL VIVALDI FASHIONS (PROPRIETARY) LIMITED
> Registration no. 82004475/07
> We being all the members of the Company, hereby consent to the Company signing a guarantee for an unlimited amount in favour of The Standard Bank of South Africa Limited, Kine Centre Branch guaranteeing the obligations of NEUGARTEN FASHIONS (PROPRIETARY) LIMITED in respect of such banking facilities as the bank may in its sole discretion deem fit (either by way of the continuation of any existing facilities and/or provision of new or further facilities).
> We further consent to the Company providing the Bank with such securities in support of the aforesaid guarantee as the directors may from time to time in their discretion deem fit.
> This done and signed at JOHANNESBURG on the 28th day of SEPTEMBER 1982.
> Signed:
> . . . . . ."

The signatories to this document were H Neugarten, Sacks, Rosmarin and Hirschowitz. It was not signed by Eagle, or specifically by MHFI.

On 10 March 1986, by which date Neugarten

and Vivaldi had both been placed in liquidation, the Standard Bank brought an application in the Witwatersrand Local Division against H Neugarten, Sacks and Rosmarin as first, second and third respondents respectively. It claimed payment of R2 755 242,31 and other relief, alleging that this was an amount owing by Neugarten; that payment had been guaranteed by Vivaldi; and that the respondents were liable for Vivaldi's indebtedness to the bank under the guarantee signed inter alios by them. As proof of the alleged indebtedness the bank relied on a certificate issued in accordance with the provisions of the Vivaldi guarantee and the guarantee signed by the three respondents. In their answering affidavit, the respondents contended that the Vivaldi guarantee was invalid, and challenged the correctness of the certificate. The alleged ground of invalidity of the guarantee was that its provision was contrary to s.226 of the Companies Act, 1973 inasmuch as Eagle had not consented thereto.

The matter first came before FLEMMING J who, in a considered judgment, made an order directing that oral evidence be heard to determine (a) whether Eagle did consent in terms of s.226(2) of the Companies Act, 1973 and to determine questions (b) and (c), which related to the certificate and the amount of Neugarten's liability. The judgment is reported: Standard Bank of S A Ltd v Neugarten & Others, 1987(3) S A 695(W).

Subsequently evidence viva voce was heard before GOLDBLATT AJ.

No evidence was led in regard to questions (b) and (c) set out in the order of FLEMMING J, because Mr Henderson, a manager employed by the Standard Bank, produced and identified a new certificate (which excluded interest) reflecting Neugarten's indebtedness as R1 363 157,64. Henderson was not cross-examined and the amount of the indebtedness ceased to be in contention.

Eagle was the only other witness called.

His evidence related to the validity of the Vivaldi guarantee. In his judgment (which is reported: Standard Bank of S A Ltd v Neugarten & Others, 1988(1) S A 652(W)), GOLDBLATT AJ summarized Eagle's evidence (at 656 D - 657 J). He held (at 660 E) that "all the directors of Vivaldi consented, as provided for in s.226(2) of the Act, to the provision of security by Vivaldi to the applicant for the debts of Neugarten." (The word "directors" is plainly a slip of the pen for "members"). He accordingly granted judgment against the three respondents for the sum of R1 363 157,64, interest and costs.

With the leave of the Court a quo H Neugarten, Sacks and Rosmarin now appeal to this court. The only matter in issue is the validity of the Vivaldi guarantee.

The relevant provisions of s.226 of the Companies Act, are ss (1), (1A), (2)and (4). They are set out hereunder. (The words in ss (2) which I have underlined

are those which directly relate to the present matter.)

"226 (1) No company shall directly or indirectly make a loan to -

(a) any director or manager of -

(i) the company; or

(ii) its holding company; or

(iii) any other company which is a subsidiary of its holding company; or

(b) any other company or other body corporate controlled by one or more directors or managers of the company or of its holding company or of any company which is a subsidiary of its holding company;

or provide any security to any person in connection with an obligation of such director, manager, company or other body corporate.

(1A) For the purpose of subsection (1) -

(a) .....

(b) .....

(c) 'security' includes a guarantee.

(2) <u>The provisions of subsection (1) shall not apply</u> -

(a) <u>in respect of</u>

(i) the making of a loan by a company to its own director or manager,

(ii) the provision of security by a company in connection with an obligation of its own director or manager;

(iii) the making of a loan by a company to any other company or other body corporate controlled by one or more

of the directors or managers of the first-mentioned company; or

(iv) the provision of security by a company in connection with an obligation of any other company or other body corporate controlled by one or more of the directors or managers of the first-mentioned company,

with the consent of all the members of the company or in terms of a special resolution relating to a specific transaction; or

. . . . . .

(4) Any director or officer of a company who authorizes, permits or is a party to the making of any loan or the provision of any security contrary to the provisions of this section, shall -

(a) be liable to indemnify the company and any other person who had no actual knowledge of the contravention, against any loss directly resulting from the invalidity of such loan or security; and

(b) be guilty of an offence. "

The first questions which arise are, what is the purpose of s.226, and in whose interest was it enacted?

GOLDBLATT AJ said (at 658 F - G):

"The clear purpose of s 226 of the Act is to prevent directors or managers of a company acting in their own interests and against the interests of

> shareholders by burdening the company with obligations which are not for its benefit but are for the benefit of another company and/or for the benefit of its directors and/or managers."

FLEMMING J expressed a similar view.

I respectfully agree. Ss.(2), by providing that ss.(1) shall not apply where the transactions specified are concluded "with the consent of all the members of the company or in terms of a special resolution relating to a specific transaction", makes it clear that the prohibition in ss.(1) is solely for the benefit of the members of the company.

The next question is whether, in order to be effective to render ss.(1) inapplicable, the consent referred to in ss.(2) must be given prior to the transaction concerned. FLEMMING J considered (see p. 707 C) that "consent may be effectively granted to remedy the deficiency in a transaction previously invalidly concluded", and GOLDBLATT AJ was of the view (658 J- 659 A) "that if the shareholders consent at any stage to what the company has

done, that would be sufficient to comply with s.226(2) and to validate the acts of the company ..." Counsel for the appellants challenged these views.

This much is plain. Where a transaction referred to in s.226(1) has been concluded without the necessary consent, a subsequent consent "in the air" (that is, one not relating to the specific transaction and directed to its validation) is not sufficient.

It is not the rule that in all cases where the consent of some person is a prerequisite (whether at common law or by virtue of a statutory provision) to the validity of a transaction, it must be a prior consent. A statute may indeed so provide. So, in Incorporated Law Society of Natal v Van Aardt, 1930 NPD 69, a by-law provided for a consent "previously had and obtained". It was held that these words clearly meant that the consent must be obtained beforehand (see p. 76). Generally speaking, however, consent may be given ex post facto by subsequent

ratification.

In ordinary parlance the word ratification "is used to express the giving of consent by one without whose consent a transaction entered into by others would be incomplete or invalid ..." (See Stewart v Kennedy, (1890) 15 App Case (HL) 75 (at 99 per Lord WATSON). The meaning in our law is not essentially different. In Edelstein v Edelstein NO & Others 1952(3) S A 1(A), VAN DEN HEEVER JA said (at p. 10 G -H):

> "By ratihabitio or confirmare a Latin author does not mean to convey the reinforcement of something tainted with less than the absolute degree of voidness (whatever that may mean) but to give a legal basis to something which hitherto had no legal foundation at all. Accordingly inanis obligatio confirmatur (D.46.3.95.3) and legitima conventio est quae lege aliqua confirmatur (D.2.14.6; 50.16.130)"

Ratification is equivalent to prior authorization and confirms the transaction concerned with retroactive effect. Omnis ratihabitio retrotrahitur et mandato priori aequiparatur.

In practice, no doubt, the consent of members under ss.(2) will ordinarily be asked for, and given, prior to the conclusion of the transaction concerned. But it does not follow that the transaction is incapable of ratification if for any reason prior consent is not given.

It might be argued that a transaction hit by s.226(1) to which prior consent was not given is incapable of ratification, for the reason that

> "ratification relates back to the original transaction, and there can be no ratification of a transaction which is prohibited and made illegal by statute."

(Cape Dairy & General Livestock Auctioneers v Sim, 1924 AD 167 at 170 per INNES CJ).

I do not think that that argument could be sustained. There is a fundamental distinction to be drawn. The dictum of INNES CJ was in the context of a transaction which was absolutely prohibited and illegal per se; consent was not an issue. (The transaction in the Cape Dairy case was a contract made on a Sunday which was

prohibited and made illegal by Transvaal Law 28 of 1896.) The transactions set out in ss.(1) of s.226 are prohibited and illegal only in the absence of the consent of all the members. The question in any specific case is whether such consent has been given: if it has, the transaction is not prohibited or illegal. Consequently, to postulate that the transaction is prohibited and illegal is to beg the question. If the requisite consent is given to the transaction in initio, it is a valid transaction. If the transaction is subsequently ratified by the non-consenting members, the ratification relates back to the original transaction and the position is the same as if consent had originally been given.

I do not think that any assistance in the solution of the problem is to be obtained from decisions on other statutes which prohibit the doing of acts without the permission, or consent or authorization of some third person. Each case depends on the terms of the particular statute.

During the argument there were debated a

number of questions relating to problems which might arise in the application of ss.(4) of s.226 if subsequent ratification is sufficient to render ss.(1) inapplicable. What effect would ratification have on criminal liability under ss.4(b)? What would be the effect of ratification on the liability to indemnify under ss.(4)(a)? And various conundrums were posed which, it was suggested, showed that consent ex post facto would give rise to anomalies.

FLEMMING J briefly referred to such questions in his judgment. He said at 707 C - D:

> "Uncertainty may arise about the resultant extent of retrospective consequences but, assuming that criminal liability already incurred cannot be erased and contemplating other possibilities, I can envisage no difficulties which indicate that my conclusion is wrong."

It is unnecessary for the purposes of this appeal to express any firm opinion on the question of the effect of ratification on criminal responsibility, but my impression is that it does not raise any serious problem. An offence under ss.(4) is committed when a director or officer

of a company authorizes, permits or is a party to a prohibited transaction. Thus in the present case, if H Neugarten, Sacks, Rosmarin and Hirschowitz signed the consent knowing that the guarantee was to be given to the Standard Bank without the consent of Eagle, the offence was committed, and it would not matter, so far as criminal liability was concerned, if Eagle subsequently ratified the transaction.

The other conundrums were directed at showing that recognition of consent ex post facto would give rise to anomalies of a kind which the legislature could not have intended to create. In this connection reference may be made to what STEYN CJ said in Aetna Insurance Co v Minister of Justice, 1960(3) S A 273(A) at 278 B - C:

> "Wat ongerymdhede betref, sou ek wil opmerk dat by wetgewing van hierdie aard, wat by welke uitleg ook, in mindere of meerdere mate ongerymdhede kan oplewer, dit gevaarlik kan wees om veel gewig aan anomalieë te heg. Tog sou ek meen dat daar 'n verskil te trek is tussen anomalië wat ontstaan uit vergesogte of seldsame gevalle aan die een kant, en dit wat ontstaan uit meer gewone en voorsienbare gevalle aan die ander kant. Dat die wetgewer ten

> aansien van voor-die-hand-liggende gevalle ongerymdhede sou wil skep, is minder waarskynlik dan die aanvaarding deur die wetgewer van die meer uitsonderlike, wat buite die onmiddelike gesigsveld lê."

(Cf. Bowes-Lyon v Green, 1963 AC 420 at 436 per Lord REID).

While anomalies such as those debated are possible in theory, they would in my opinion arise but rarely, and are not likely to arise in more usual and foreseeable cases.

On the other hand, there are, in my view, strong reasons for holding that the legislature could not have intended in ss.(2) to exclude consent by way of subsequent ratification.

It is a rule of interpretation that statutes should generally be construed in the light of the common law. At common law ratification is equivalent to prior consent.

There is no reason, in logic or principle, for interpreting ss.(2) so as to exclude consent

by way of ratification. No interest can be served thereby: on the contrary it might operate to cause injustice to persons in the position of the Standard Bank in the present case, which was assured, incorrectly, that all the members of Vivaldi had consented to the guarantee.

In my opinion, therefore, in reference to transactions such as those referred to in s.226(1), subsequent ratification is the equivalent of prior consent, and I proceed to consider the case on that basis.

The following propositions are trite. It is a requisite that the party ratifying shall have the intention to confirm or adopt the act in question. As a general rule, he must have knowledge of all the material circumstances. The onus of proving ratification is on the person alleging it. Ratification may be express, or it may be tacit, that is, implied by conduct from which it is to be inferred that the person alleged to have ratified intended to adopt or confirm the act.

It is not in dispute that the Vivaldi guarantee is a security provided by Vivaldi in connection with the obligations of another company, namely Neugarten; and that Neugarten was a company controlled by one or more of the directors or managers of Vivaldi. The question is, therefore, whether the security was provided with the consent of all the members of Vivaldi in terms of ss.(2). If it was not, the Vivaldi guarantee is void, with the result that the Standard Bank had no enforceable claim against H Neugarten, Sacks and Rosmarin.

Eagle gave evidence that he did not sign the consent. That evidence was not challenged. Prima facie, therefore, the Vivaldi guarantee was invalid.

It was submitted on behalf of the Standard Bank, however, that Eagle's conduct showed that he consented to the furnishing of the Vivaldi guarantee: he allowed Hirschowitz and Sacks carte blanche in conducting the financial affairs and the day-to-day management of Vivaldi,

and by so doing he gave a general consent to their concluding, on Vivaldi's behalf, whatever transactions they thought fit to conclude.

GOLDBLATT AJ rejected this submission (see 659 E - G). In my view he was correct in so doing.

It is clear from the evidence that Eagle did not control the running of Vivaldi's business and had no power to control it. He was a young man in his middle twenties, with limited business experience. His directorship appears to have been nominal only: the object of his appointment was to give him the status of a director in the eyes of persons with whom he dealt; and no formal directors' meetings were held. He did not, qua shareholder (and it is his consent as a member which is in issue), have any say in the administration of the company, and his so-called acquiescence cannot be regarded as a consent to the giving of the Vivaldi guarantee.

Then, as proof of consent by Eagle, the

bank relied on two documents dated 21 June 1983. One (MRH6) reads as follows:

> "PAUL VIVALDI FASHIONS (PROPRIETARY) LIMITED
> RESOLUTIONS PASSED BY THE DIRECTORS ON 21 JUNE 1983
> RESOLVED THAT:
> The following entries in the books of the company and transactions in the financial year ended 31 December 1982 are approved and confirmed:
> . . . . . .
> APPROVAL OF ANNUAL FINANCIAL STATEMENTS
> The annual financial statements and reports are approved in terms of section 298(1) of the Companies Act, 1973, as amended."

On the financial statements were a number of notes, including,

> "8. CONTINGENT LIABILITY
> There is a contingent liability in respect of the company's unlimited guarantee of the bank overdraft of Neugarten Fashions (Proprietary) Limited. Neugarten Fashions (Proprietary) Limited is controlled by Messrs H Neugarten and H M Hirschowitz who are directors of this company. The amount of the overdraft at 31 December 1982 was R222 753."

The other document (MRH7) reads as follows:

"PAUL VIVALDI FASHIONS (PROPRIETARY) LIMITED
CONSENT TO LOANS AND PROVISION OF SECURITY TO DIRECTORS AND MANAGERS AND COMPANIES CONTROLLED BY THEM.
We, the undersigned, being all members of the company, consent in terms of section 226 of the Companies Act, as amended, to the company making loans to and providing security in connection with the obligations of its directors and managers and any other company or other body corporate controlled by one or more of the directors or managers of the company."

It was signed by all the members of Vivaldi, including Eagle.

GOLDBLATT AJ said (at 659 H) that by signing these two documents, Eagle in his view, "...consented twice to the provision of such security."

In my opinion, Eagle's signature of MRH6 did not amount to a ratification of the provision of the Vivaldi guarantee, the validity of which did not come into question until 1985. Eagle said in his affidavit, and repeated in his viva voce evidence, that at that stage he had not read s.226 of the Companies Act, and was not aware of its provisions. He could not, therefore, have had any intention

to ratify. The resolution in MRH6 was passed in pursuance of the duty imposed on the directors by s.298(1) of the Act, which requires that the annual financial statements of a company other than the auditor's report shall be approved by its directors. Such approval is a signification by the directors that the annual financial statements comply with the requirements of the Act, including those set out in s.286(3), namely, that the annual financial statements shall, in conformity with generally accepted accounting practice, fairly present the state of affairs of the company and its business at the end of the financial year concerned. Plainly the approval of the directors should not be construed as a consent in terms of s.226(2) of the Act by members qua members.

Similarly the consent embodied in MRH7 is not to be construed as a ratification of the Vivaldi guarantee. It was signed by all the members including those who had signed the consent dated 28 September 1982. It is in

general terms, and does not refer specifically to the Standard Bank or the Vivaldi guarantee. It is a consent to loans to be made and security to be provided, not a confirmation of prior acts. Although GOLDBLATT AJ held (at 660 C) that it was not a retrospective consent but a consent to future acts by Vivaldi, he said (at 660 C - D) that the suretyship furnished by Vivaldi was a continuing suretyship for both the past and future debts of Neugarten, and that

> "Accordingly, whilst Vivaldi left the suretyship with the applicant, it continued to provide security for Neugarten, and thus, by leaving it with the applicant after 21 June 1983, it continued to provide security to the applicant on behalf of Neugarten."

In my respectful opinion the learned judge was in error. In the absence of the consent of all the members of Vivaldi, the Vivaldi guarantee was void. It did not "provide security" in initio, and it could not "continue to provide security".

The conclusion is, therefore, that the

learned judge a quo erred in finding that all the members of Vivaldi consented, as provided for in s.226(2) of the Act, to the provision of security by Vivaldi to the Standard Bank for the debts of Neugarten. In the result the order made must be set aside.

The appeal is upheld with costs, including the costs of two counsel. The order of the court a quo is set aside, and there is substituted therefor the following:

> "The application is dismissed with costs including the costs reserved by FLEMMING J (See 1987(3) S A 695 at 709 E - F). The costs are to include the costs of two counsel."

NICHOLAS AJA

SMALBERGER, JA - CONCURS