222/92

IN THE SUPREME COURT OF SOUTH AFRICA

(APPELLATE DIVISION)

720/91

In the matter of:

MICHAEL LEO DE VILLIERS N.O.

PETRUS JACOBUS MARYN VAN STADEN N.O. Appellants

CORAM: CORBETT CJ, VAN HEERDEN, GOLDSTONE JJA,

NICHOLAS et HARMS AJJA.

DATE HEARD: 2 NOVEMBER 1992

DATE DELIVERED: 27 NOVEMBER 1992

J U D G M E N T

GOLDSTONE JA:

The appellants are the joint liquidators of Carbon Developments (Pty) Limited ("the Company"). They applied unsuccessfully to the Witwatersrand Local Division (Stegmann J) for leave to convene meetings of the creditors and members of the Company to consider an offer of compromise between the Company and its creditors and members proposed by Mr K. M. MacDonald pursuant to the provisions of s 311 of the Companies Act 61 of 1973 ("the Act"). Its terms are contained in a written contract between MacDonald and the appellants which is dated 17 July 1991. The judgment of Stegmann J has been reported at 1992(2) SA 95 (W).

Clause 3.2 of the contract provided that the offer would remain irrevocable until 30 September 1991. In terms of a deed of amendment dated 28 September 1992, MacDonald has undertaken that the offer will now remain irrevocable until 31 January 1993 or until sanction or rejection thereof, whichever is the earliest. This Court has also been informed by the joint liquidators that some of the assets whose value was only estimated at the time of the application have now been realised and their value has been established. The result is that the projected dividend to concurrent creditors under the offer of compromise will now be 1,78 cents in the rand and not 1,48 cents as earlier estimated. All the financial and other information furnished to the Court a quo is, we are told, still correct. It follows that if the appeal succeeds, the offer of compromise remains capable of implementation. The appellants accordingly seek an order substantially in the terms sought in the Court a quo.

The Company was incorporated in 1986. It had an authorized share capital of R10 000 comprising 2500 ordinary shares of R1 each and 750 000 12% redeemable cumulative preference shares of 1 cent each. Initially it issued 132 ordinary shares of R1 each and during 1989 it issued a further 300 000 redeemable cumulative preference shares of 1 cent each.

The company was formed in order to carry on business as a manufacturer of activated carbon. The technology which it was to employ was experimental and complex. If the technical difficulties were surmountable then it was expected by the founders that the business would become very profitable and of considerable strategic importance for South Africa in the light of the economic sanctions which were then applied to this country. In the result, however, the technical difficulties proved insoluble, the Company failed, and it was placed under a provisional winding-up order which was made final on 15 January 1991.

At its inception the Company incurred considerable expenses on fixed and movable assets. The earliest balance sheet of the company which is contained in the record is that for the year ending 30 September 1989. It is there reflected that the value of fixed assets as at the end of the preceding (1988) financial year was R2 217 890. The Company's stock was then valued at R495 675. It had not yet begun to trade.

The small issued share capital of the Company was obviously insufficient to provide it with the funds which it required, especially as it must have been contemplated that trading, and hence income, would only follow a substantial time after the preliminary expenses had been incurred. Accordingly, the major shareholders lent considerable sums of money to the Company. At the time of its provisional liquidation on 20 September 1990, Camms Services and Finance Corporation (Pty) Limited ("Camms") had lent to the Company the amount of approximately R1,8 million. UAL Merchant Bank Limited, (acting through Strategic Capital Investment Trust) ("UAL"), had advanced to the Company approximately R3,5 million.

In their founding affidavit, the appellants referred to the loans as "capital" contributed by the shareholders. They did so on the basis that:

> "All of the aforesaid loans were subordinated by the grantors thereof in favour of the other creditors of the Company until such time as the assets of the Company, fairly valued, exceeded its liabilities and notes to that effect were contained in the annual financial statements of the Company."

The notes in question record that the loans had been:

> "... subordinated in favour of the other creditors until such time as the assets of the company, fairly valued, exceed its liabilities."

It is clear that for some years prior to its liquidation the Company's liabilities (including the subordinated loans) substantially exceeded its assets. On liquidation the financial position was aggravated by reason of the difference between the valuation of the assets of the Company on a going concern basis and the amount they would realise on a forced sale. The directors had valued the assets in an amount in excess of R3 million. After liquidation they realised only R369 000.

In the result, on liquidation, the Company's financial position was such that the assets were insufficient to yield any dividend for the concurrent creditors. The claims of trade creditors amounted to R213 357. The remaining concurrent creditors were the Industrial Development Corporation in an amount R1 485 944 and Nedbank Limited in an amount R342 687. As already mentioned, if the offer of compromise is accepted and implemented, there will be a small dividend of 1,78 cents in the rand available for concurrent creditors.

Stegmann J refused to grant the order sought by the appellants because he was of the view that they had failed to gather and furnish to the creditors of the Company sufficient information to enable them -

> "to assess the relative merits of the proposal and of the alternatives to the proposal" (at 103 F - G).

The concern of the learned judge, and the only question in respect of which he concluded there was insufficient information, related to the possible personal liability of the directors of the Company under s 424(1) of the Act, ie for knowingly being parties, inter alia, to carrying on the business of the Company recklessly or with intent to defraud creditors or for any fraudulent purpose. In such a case, the court is empowered by the sub-section, on the application inter alia of a liquidator or a creditor, to 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."

More particularly, the Judge a quo held that -

1. The effect of the offer of compromise, if duly sanctioned, would be to preclude proceedings against directors under s 424(1) of the Act. He came to that conclusion because, in his view, s 424 may

not be invoked at all unless, at the time of the application, the company has creditors. And, in the case of an application brought by a creditor, he would be required to establish a debt owing to him at the time of the application. Consequently, a judicial exercise of the court's discretion to grant an order convening meetings under s 311 requires it to be satisfied that the creditors' prospects of recovery unders 424(1) have been appropriately investigated by the liquidators.

2. In the present case there was a reasonable prospect of establishing that the directors of the Company, at material times, were conducting the business of the Company in a manner which rendered them liable to an order under s 424(1).

3. The question of such personal liability of the directors had not been sufficiently investigated and therefore the appellants had failed to gather the information required to inform the creditors of a relevant alternative to the offer of

> compromise and, in particular, information which would enable them to assess their prospects in proceedings against the directors.

There was no other reason given by Stegmann J for refusing the order to convene meetings. Indeed, on substantially the same papers such an order had been granted some weeks earlier in the same court by Flemming DJP. That order fell away because the appellants did not summon a meeting of secured creditors. Furthermore, additional information had come to the attention of the appellants which required a fresh application to be made. It is this application which came before Stegmann J.

The application before the Court _a quo_ was brought _ex parte_. It followed that in the appeal to this Court there was no respondent. Because of the importance of the issues raised, Mr M Tselentis SC and Mr P Boruchowitz were appointed to act as _amici curiae_ and

Nathan Friedland Inc were appointed as attorneys to assist them. This Court is indebted to them for the considerable assistance which they rendered by way of full and helpful heads of argument and counsel's submissions during the hearing of the appeal.

It was the submission of counsel for the appellants, and the amici curiae agreed, that a duly sanctioned offer of compromise, which has the effect of extinguishing the company's debts, does not preclude a declaration being made by the court under s 424(1) of the Act. It was argued that the reference to "debts" in the subsection is to debts which were incurred by the company at the time of the alleged wrongful conduct, and not necessarily to debts which were still owing by the company at the time of the application under the subsection: cf. Pressma Services (Pty) Ltd v Schuttler and Another 1990(2) SA 411(C). In the view I take in this matter, it is not necessary to decide this interesting and difficult question. I shall assume that the effect of the offer of compromise, on sanction by the court, would be to preclude relief under s 424(1) at the instance of a creditor.

The refusal by Stegmann J to grant an order convening meetings of creditors and members of the Company to enable them to consider the offer of compromise was based upon his conclusions (150 B - F) that:

(a) As a probability the directors of the Company were knowingly dealing dishonestly with trade creditors when they purchased goods on credit without disclosing the "disastrously insolvent condition" of the Company as known to them.

(b) They were also aware that the subordination agreements did not serve to protect the directors from the consequences of their awareness that they were not dealing honestly with the trade creditors of the Company.

(c) There were substantial grounds for believing that a "purposeful search for the relevant facts" would reveal that the trade creditors would have good prospects of recovering their losses in full from the directors of the Company.

It is necessary to examine each of those conclusions.

Trading under insolvent circumstances.

Stegmann J referred to two forms of insolvency which have been recognised by our law for many years, viz. factual insolvency where a company's liabilities exceed its assets, and commercial insolvency, viz. a state of illiquidity where a company is unable to pay it debts even though its assets may exceed its liabilities.

Commercial insolvency is expressly recognised in the Act as a circumstance which would entitle a court to make a winding-up order: s 344(f) read with s 345. However factual insolvency is not expressly referred to as a circumstance justifying the grant of a winding-up order. Whether the words of s 345, and especially having regard to ss (2) thereof, are sufficiently wide to include factual insolvency is a question of interpretation which, as far as my researches reveal, has not been judicially determined. It is not necessary to decide it in the present case. Even if factual insolvency is not, <u>per se</u>, a circumstance entitling a court to make a winding up order, it would clearly be a relevant and material factor in deciding whether it should exercise a discretion to grant an order under s 344 of the Act.

With regard to this question, the provisions of ss 222 and 223 of the English 1948 Companies Act were indistinguishable from their South African counterparts. However, the matter was dealt with explicitly by the provisions of the 1986 English Insolvency Act. It is there provided that:

> "A company is deemed unable to pay its debts if it is proved to the satisfaction of the court that the value of the company's assets is less than the amount of its liabilities, taking into account its contingent and prospective liabilities."

For the purpose of this judgment I shall assume that Stegmann J was correct in deciding that factual insolvency is *per se* a circumstance which would entitle a court to make a winding-up order.

The learned Judge *a quo* criticised and held to be erroneous the statement in *Ex parte Strydom NO: In re Central Plumbing Works (Natal) (Pty) Ltd* 1988(1) SA 616(D) at 623 D - E to the effect that:

> "From a commercial point of view, however (and this is recognised in many ways in the Companies Act), the true test of a company's solvency is not whether the company's liabilities exceed its assets but whether it is able to pay its debts. (See Rosenbach & Co (Pty) Ltd v Singh's Bazaars (Pty) Ltd 1962(4) SA 593 (D) at 596 F - 597 H).

A more detailed criticism of that passage by the same learned Judge is to be found in Ex parte Lebowa Development Corporation Ltd 1989(3) SA 71(T) at 95 B - 97 J.

In my opinion, the learned Judges (Friedman and Wilson JJ) who delivered the judgment in Ex parte Strydom did not purport to suggest that actual insolvency was not a ground for a winding-up order. Indeed, in the passage immediately preceding that quoted by Stegmann J they said.

> "It is true that the company which the Court 'sends back into business' is insolvent in the sense that its liabilities (all of which are owing to its new controller) exceed its assets. Any company which has accumulated losses in excess of its share capital is insolvent in this sense. And there are undoubtedly very many companies operating exceedingly successfully in the real business world in this position."

In context, the statements in Ex parte Strydom are unexceptionable.

The real question, which arises for decision in this case, however, is not whether the Company was liable, during the relevant period, to be wound up. It is whether, on the assumption that it was liable to be wound up, its directors were acting unlawfully in allowing it to do business and incur credit. The conclusion reached by the Court a quo was the following (at 127 A - C):

> "It therefore appears that, apart from a judicial management order, there is no source of lawful authority for anyone, whether a member, or a director, or a creditor of a company, to cause the company to trade when its liabilities exceed its assets. Since there can be no source of lawful authority to do so, it must always be an 'irregularity' for the directors of a company to cause it to trade when its liabilities exceed its assets. I find it difficult to envisage circumstances in which it could convincingly be argued that such an irregularity was not 'material'. Usually, it would be a material irregularity."

The learned Judge went on to hold (at 127 E - G) that such a material irregularity would by its nature be likely to cause financial loss to the company's creditors and that therefore a company's auditor would be obliged to act in accordance with the provisions of s 20(5) of the Public Accountants' and Auditors' Act 80 of 1991, i.e. to report the irregularity to the company and, if not remedied, to the Public Accountants' and Auditors' Board.

If the view taken by Stegmann J in this regard is correct, it would follow that for decades in South Africa the officers of a vast number of private companies (unbeknown to them and notwithstanding the generally accepted practice in the commercial world), have acted unlawfully and dishonestly. It is a common occurrence for a private company to embark on trading with a nominal paid-up share capital and to finance its business operations by way of members' loans. Frequently, those loans are treated as if they were part of the capital of the company. This reality was recognised in Ex parte Strydom NO (supra) at 623 E - F.

In R v Latib 1973(3) SA 982 (A) at 984 G - H, Steyn JA said:

> "In a transaction on credit, the representation as to ability to pay is a representation by the purchaser of a present belief that he will be able to pay when payment falls due, rather than a representation as to what his financial condition will in fact be at a future date. If his belief is genuine, even though somewhat optimistic, the representation is not false, whatever his financial position may turn out to be at the due date. His ability to pay at the time of purchase and his prospects in relation to the date of payment, would, of course, be relevant to show whether or not he did in fact entertain such a belief, but what is placed in issue is a state of mind rather than a financial condition."

That statement of our law with regard to the fraudulent incurring of credit is consistent with the following statement by Buckley J in an unreported judgment quoted in Palmer's Company Law 24 ed at 1463:

> "In my judgment, there is nothing wrong in the fact that directors incur credit at a time when, to their knowledge, the company is not able to meet all its liabilities as they fall due. What is manifestly wrong is if directors allow a company to incur credit at a time when the business is being carried on in such circumstances that it is clear that the company will never be able to satisfy its creditors. However, there is nothing to say that directors who genuinely believe that the clouds will roll away and the sunshine of prosperity will shine upon them again and disperse the fog of their depression are not entitled to incur credit to help them to get over the bad time."

See, too Ozinsky NO v Lloyd and Others 1992(3) SA 396 (C) at 415 I - 418 D.

There is nothing in the Act or in the Insolvency Act 24 of 1936 which is inconsistent with those statements of the law and, in my view, they reflect what our courts have stated over the years. They reflect, furthermore, the commercial reality and practice of honest men of business in this country and, I dare say, in other Western trading nations. To the extent that the judgments of Stegmann J in Ex parte Lebowa Development Corporation Ltd (supra), Ex parte De Villiers NO: In re MSL Publications (Pty) Ltd (In Liquidation) 1990(4) SA 59(W) and in the present matter are inconsistent with what is stated above, they are not correct.

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.

The Subordination Agreements

The essence of a subordination agreement, generally speaking, is that the enforceability of a debt, by agreement with the creditor to whom it is owed, is made dependent upon the solvency of the creditor and the prior payment of its debts to other creditors.

Subordination agreements may take many forms. They may be bilateral i.e. between the debtor and the creditor. They may be multilateral and include other creditors as parties. They may be in the form of a stipulatio alteri, i.e. for the benefit of other and future creditors and open to acceptance by them. The subordination agreement may be a term of the loan or it may be a collateral agreement entered into some time after the making of the loan.

Save possibly in exceptional cases, the terms of a subordination agreement will have the following legal effect: the debt comes into existence or continues to exist (as the case may be), but its enforceability is made subject to the fulfilment of a condition. Usually the condition is that the debt may be enforced by the creditor only if and when the value of the debtor's assets exceeds his liabilities, excluding the subordinated debt. The practical effect of such a condition, particularly where, for example, the excess is less than the full amount of the subordinated debt, would depend upon the terms of the specific agreement under consideration and need not now be considered.

In the event of the insolvency of the debtor, sequestration would normally mean that the condition upon which the enforceability of the debt depends will have become incapable of fulfilment. The legal result of this would be that the debt dies a natural death (see De Wet and Yeats, Kontraktereg en Handelsreg, 5 ed, vol 1, at 153; Christie The Law of Contract in South Africa 2 ed, at 169; Kerr, The Principles of the Law of Contract, 4 ed, at 341). The result would be that the erstwhile creditor would have no claim which could be proved in insolvency. To the extent that it may have been suggested in Cooper v A & G Fashions (Pty) Ltd: Ex parte Millman NO 1991(4) SA 204, at 207 G - 208 D that on insolvency a value should be placed upon such a debt, this is not correct. The debt would not normally survive sequestration. A contingent liability can only be valued and proved in insolvency where at the time the condition upon which the liability depends is still capable of fulfilment.

As indicated earlier in this judgment, the fact that the liabilities of a company exceed its assets does not necessarily mean that the incurring of further debts would constitute fraudulent or reckless conduct. In that context, the existence and terms of a subordination agreement would be material and relevant in deciding whether the persons conducting such business incurred the debts with the reasonable expectation of their being paid in the ordinary course. The fact that a major creditor has subordinated its claim, and to that extent created a moratorium for the benefit of other creditors, is obviously relevant in determining the subjective state of mind of the debtor or those conducting its business.

Stegmann J held that the liquidator of a company would not be entitled to have any regard to the terms of a subordination agreement because to do so would entail a rearrangement of the statutory ranking of claims. For that conclusion, the learned Judge relied on the judgment of Feetham J in Lind v Lefdal's Pianos Ltd (In Liquidation) and Others 1929 TPD 241. In that case the company in question had entered into an agreement with certain of its creditors in terms whereof, on liquidation, the claim of one creditor would be preferent to the claims of certain other creditors. To give effect to that agreement was held to be contrary to the statutory requirement that creditors be paid pari passu.

In my judgment, the Lind case is distinguishable. There certain creditors attempted to rearrange the order in which they would be paid by the liquidator. In the case of debt subordination, the creditor has no claim unless other creditors receive payment in full. There is no question of a rearrangement of the claims of the creditors who are to be paid out of the unencumbered assets of the company. The position would be no different in principle from the case of a debtor who, for whatever reason, decided not to prove a claim with the liquidator. Indeed, where there is a probability of a contribution being levied upon creditors, it is a common occurrence for creditors to refrain from proving a claim. That can hardly be categorised as interfering with the pari passu payment of creditors by the liquidator. The opinion of the House of

Lords in British Eagle International Airlines Ltd v Compagnie Nationale Air France [1975] 2 All ER 390 (HL) referred to by Stegmann J, is similarly distinguishable.

In my opinion, the liquidator of a company would be obliged to have regard to a subordination agreement which was valid and in force as at the date of winding-up.

Stegmann J raised other difficulties with regard to the efficacy of a subordination agreement. He suggested that, if bilateral, it could at any time be cancelled by the parties thereto i.e. the company and the creditor. This problem, I would suggest, would be a rare occurrence. In any event it only arises when such a cancellation has occurred.

Yet a further difficulty raised by the learned Judge was the effect upon a subordination agreement of the insolvency of the creditor. Would the subordination agreement, for example, constitute a disposition without value? This, again, as was recognised by Stegmann J (at 122 C - D) is not a matter of principle. The financial position of the creditor is a matter which might have to be taken into consideration by the debtor in a relevant case.

In the present matter the appellants placed very little before the Court a quo concerning the details of the subordination agreements: there is no indication of the dates on which they were concluded; their precise terms are not furnished; and it does not appear whether they were recorded.

It must be accepted, nonetheless, that Camms and UAL subordinated their claims in favour of the other creditors until such time as the assets of the Company, fairly valued, exceeded its assets. That appears from the balance sheets of the Company which were duly certified, without qualification, by the auditors. Furthermore, those subordination agreements were still operative when the Company was placed under a winding-up order and, in terms of the offer of compromise, the claims will not be recognised. There is nothing to suggest that the subordination agreements were not what they were stated to be or that they were not fully effective and in force at all relevant times. There was certainly no basis upon which the appellants were entitled, let alone obliged, to ignore them.

Valuation of the Assets.

Stegmann J sharply criticised the directors of the Company for having overvalued the company's assets by more than R3 million. In his affidavit filed in anwer to queries raised by Stegmann J, one of the appellants stated:

> "The reason for the loss to the trade creditors is that the assets in the liquidation did not realise the values which had been placed on them in the balance sheet and which values, in

> my opinion, reflected a 'going concern' basis. I humbly submit that in a liquidation a situation often arises where assets which have a clear value on a 'going concern' basis cannot be sold for that value and accordingly a lesser value is realised by liquidators."

The learned Judge referred to that statement as an "excuse" and suggested that if put forward by the directors themselves -

> "may very well be exposed as an instance of apparently wilful self-deception on their part." (at 143 B - C).

I do not agree. It would appear that until the shareholders decided to cease lending further monies to the Company it was trading. Indeed, in its last year of trading UAL lent to it a further amount in excess of R1 million. In 1988, 1989 and 1990 it owned stock of considerable value and it had substantial amounts owing to it by its debtors. It was, on the face of it, a going concern. There is no indication that the directors continued to trade at a time when they knew the Company was to be wound up and that the valuation of assets in the balance sheet was grossly inflated. On the assumption that the Company would prosper and continue to trade there is nothing to suggest that the assets had been overvalued. It would appear that the Company was the only manufacturer in South Africa of activated carbon and that might well explain the substantial difference between the value of the assets on the basis of a going concern and the amount realised at a forced sale.

Stegmann J said (at 143 F - G) that:

> "Prima facie, the only honest way to value the company's assets was on a basis which took account of the fact that the company was liable to be wound up at any time at a moment's notice."

Again, I do not agree. The shareholders were investing millions of rands in the Company. They would hardly have done so if they and the directors did not believe that the Company would ultimately succeed. Any inferences drawn must take into account all the relevant facts.

In their draft statement under s 312(1) of the Act (to which I shall refer again later) the appellants stated:

> "The Company from the outset was financed by way of loan capital which was utilised for the regeneration and manufacture of carbon products. This development took 15 months to complete and the Company was only in a position to produce in October 1989. No further loans were available from September 1990 and the business was immediately closed.
>
> From the audited financial accounts of the Company for 1988 and 1989 as well as the draft accounts for 1990, it is apparent the directors made an effort to ensure the success of the Company and a large percentage of the money

> raised was in an effort to commission the activation unit for the manufacture of activated carbon."

In this case I am of the view that it is not a reasonable inference that the directors acted dishonestly or recklessly when they valued the assets on the basis that the Company was a going concern.

Having regard to what is stated above, I am of the opinion that there is no evidence indicating even prima facie that the directors of the Company carried on its business recklessly or with intent to defraud its creditors or for any fraudulent purpose. There is nothing to support a conclusion that the directors are likely to be declared personally responsible for all or any of the debts of the Company.

<u>The Application for Leave to Convene Meetings</u>.

At the stage of an application for leave to convene meetings the court is primarily concerned with the probable response to the offer of the creditors.

> "If the Court, on a consideration of all the information at its disposal, comes to the conclusion that there is a reasonable probability that the requisite majority of the creditors of the company may accept the offer, it will generally speaking order a meeting of creditor to be convened; on the other hand, if it is not so satisfied, it will refuse to make such an order."

Per Trengove J in <u>Ex parte Bruyns NO: In re Mammoth Construction & Drilling Co (Pty) Ltd (Under Provisional Liquidation</u>) 1973(3) SA 721 (T) at 722 B - C.

While that is the primary question, the court is also concerned that the offer, on the face of it, appears to be made in good faith and honestly, and that its terms are unambiguous and understandable.

Over a century ago, Fry LJ posed the question as to the circumstances in which a court should sanction a resolution approving a compromise or arrangement under the relevant provisions of the 1870 Joint Stock Companies Arrangement Act. He said the following in In re Alabama, New Orleans, Texas and Pacific Junction Railway Company [1891] 1 Ch 213 at 247:

> "I shall not attempt to define what elements may enter into the consideration of the Court beyond this, that I do not doubt for a moment that the Court is bound to ascertain that all the conditions required by the statute have been complied with; it is bound to be satisfied that the proposition was made in good faith; and, further, it must be satisfied that the proposal was at least fair and reasonable, as that an intelligent and honest man, who is a member of that class, and acting alone in respect of his interest as such a member, might

> approve of it. What other circumstances the Court may take into consideration I will not attempt to forecast."

I would respectfully adopt that formulation. It is clearly the proper approach at the sanction stage. Although compliance with the statutory conditions will not be relevant at the stage of convening meetings, the other considerations referred to by Fry LJ are no less appropriate. They strike a balance between the duty of the court to be satisfied that the offer appears to be fair and honest and the recognition that it should not dictate to men of business what is in their own interests.

It would be inappropriate to attempt to formulate a more precise rule in a matter of discretion and in a context where the variety of facts and circumstances is endless.

The court considering such an application should also be satisfied that sufficient information has been gathered and can be furnished to the creditors to enable them to assess the relative merits of the proposal and of the alternatives thereto. Indeed, section 312(1) of the Act requires that where meetings are summoned under s 311, every creditor or member must be sent a statement containing the information set out in sub-paragraph (a) thereof. A draft of that statement need not be placed before the court at the stage of an application for leave to convene meetings. At the sanction stage it must clearly be before the court in order that it may satisfy itself that the provisions of s 312(1) have been observed.

In the present case Stegmann J requested the appellants to place the s 312(1) statement before him. That was done. In my opinion, it would be a salutary practice, in all such applications, for a draft of the statement to be placed before the court at the convening stage. This would not cause duplication as much of the information usually contained in the founding affidavit would have to set out in the s 312(1) statement. That information could be incorporated into the founding affidavit by an appropriate reference to the draft statement.

I am satisfied in the present case that the offer of compromise is, prima facie, fair and reasonable and that it should be placed before the creditors and members of the Company for their consideration. However, having regard to the particular facts and circumstances of this case, apart from any other relevant information, they should be informed -

(a) of all the relevant facts relating to the subordination agreements. If relevant and material detail in that regard is not obtainable by the appellants, the reason for such unavailability should be set out in the statement;

(b) that the Company was trading in a state of factual insolvency virtually from its inception;

(c) that the assets of the Company were valued on the basis of a going concern at an amount in excess of R3 million and that on winding-up they realised only R369 499;

(d) that the effect of the sanction of the offer of compromise may be to extinguish proceedings under s 424(1) of the Act;

(e) the date, if it can be established, when it became clear that no further loans would be forthcoming.

In my judgment, the appellants are not required to furnish information other than that which is in their possession or readily available to them. If, on the basis of such information, the creditors require further investigations to be conducted, that is their affair, and the costs thereof should be payable out of their pockets.

With regard to the draft s 312(1) statement furnished by the appellants, I have the following comments:

1. In the first sentence of para. 13 it is stated that:

> "The Company, on the fact of it, appears to have been trading in insolvent circumstances since May 1990."

That is not necessarily correct. As already mentioned, depending on the terms and effect of the subordination agreement, the Company was factually insolvent virtually from its inception. In any event, the significance of the above mentioned date (May 1990) should be explained.

2. The concluding sentence of para 13 reads as follows:

> "As a result of the subordination of the loan claim it is felt that the Company did not trade in insolvent circumstances and that any claims against the directors in terms of Section 424 of the Companies Act to declare them personally responsible for the liabilities of the Company."

The sentence, as presently worded, is incomplete and meaningless. However, apart from that, for the reasons indicated in this judgment, the effect thereof would not have been to make the Company solvent.

It would also be appropriate to inform creditors that in the light of the subordination agreements, the directors, *prima facie*, were able reasonably to trade in the belief that trade creditors would be paid in the ordinary course.

At this stage of seeking leave to convene meetings under s 311(1), the absence of all the relevant circumstances and terms of the subordination agreements is not a bar to the success of the application. It would be an unnecessary waste of costs to compel the appellants to launch a fresh application incorporating that information. The information should be obtained to the extent that is possible. It should be placed before the creditors and members and they should decide for themselves whether they require further investigations to be made prior to voting on the offer of compromise.

In no way should this Court be understood as having approved of the draft s 312(1) statement which is part of the record. Whether it so complies and whether it furnishes all the relevant information to the creditors and members of the Company is something to be considered by the court at the sanction stage in the event of the requisite majority of creditors and members voting in favour of the offer of compromise.

Camms and UAL have no interest in the offer of compromise. They have no claims and are not entitled to vote at the meetings of concurrent creditors.

In the result the appeal succeeds. The following order is made:

1. The order made by the Court *a quo* is set aside and the following order is substituted therefor:

"It is ordered that:

1.1 Meetings in terms of section 311 of the Companies Act, No 61 of 1973, as amended, ("the Act"), of:

1.1.1 the secured creditors;

1.1.2 the preferent creditors;

1.1.3 the concurrent creditors, including contingent creditors;

1.1.4 the members,

of CARBON DEVELOPMENTS (PROPRIETARY) LIMITED (under winding-up order) ("the Company"), be summoned by the chairman, who shall fix the time and place thereof for the purpose of considering the scheme of arrangement as set forth in annexure "D" to the founding affidavit dated 21 August 1991, as amended, and, if deemed fit, accepting the said scheme of arrangement with or without modification.

1.2 Michael Leo de Villiers and failing him, Charles Garth Foot, be and he is hereby appointed chairman of the meetings with authority to adjourn the same from time to time should such adjournment prove necessary.

1.3 A notice convening the said meetings be published by the chairman at least two weeks before the date of the said meeting in two weekly newspapers, namely The Sunday Times and Rapport. The said notice shall state:

1.3.1 the time and place of the said meetings;

1.3.2 that the said meetings have been summoned for the purpose of considering and, if deemed fit, of accepting the scheme of arrangement, with or without modification;

1.3.3 that a copy of this order, the terms of the scheme of arrangement, a list of creditors of the Company and a statement of the assets of the Company with their estimated values may be inspected during business hours at any time prior to the said meetings at the offices of:

Mr Michael Leo de Villiers
c/o Deloitte Pim Goldby Trust
(Proprietary) Limited
10th Floor, Diamond Corner,
68 Eloff Street,
Johannesburg, 2001;

1.3.4 that the said meetings have been summoned in terms of this Order; and

1.3.5. that a copy of the statement required by section 312(1) of the Act may be obtained by any creditor entitled to attend the said meetings at the time and place mentioned in 1.3.3. free of charge on written application to the chairman.

1.4

1.4.1 A notice showing:

1.4.1.1 the time and place of the meeting;

1.4.1.2 the amount owing to preferent and secured creditors;

1.4.1.3 the amount owing to concurrent creditors;

1.4.1.4 the amount claimed by the directors and shareholders of the Company as owing to them and the validity of such claims;

1.4.2 a copy of the statement required by section 312(1) and (2) of the Act;

1.4.3 a statement of the assets of the Company with their estimated values;

1.4.4 a copy of the scheme of arrangement;

1.4.5 a copy of this Order; and

1.4.6 a copy of the form of proxy being Annexure 'E' to the founding affidavit dated 21 August 1991,

be sent by the chairman by registered post at least two weeks before the date of the said meetings to every creditor and member of the Company to whom the scheme of arrangement is submitted, at the usual address of such creditor or member of the Company.

1.5 The chairman is to report the results of the said meetings to this Honourable Court on TUESDAY, 19 January 1993.

1.6 With respect to the report required by the Court from the chairman, details should be given of:

1.6.1 the number of creditors present in person;

1.6.2 the number of creditors represented by proxy with information as to the number represented by him in terms of the proxies which were annexed to the scheme documents;

1.6.3 the values of each of their claims;

1.6.4 any proxies which have been disallowed;

1.6.5 all resolutions passed at the meeting, with particulars of the number of votes cast in favour and against each such resolution and of any abstentions, indicating how many votes were cast by him in terms of proxies which were annexed to the scheme documents;

1.6.6 all rulings made and directions given by the chairman at the meetings;

1.6.7 the main points of any other schemes of arrangement which were submitted at the meeting.

1.7 The notices of the meetings which are published and sent to creditors shall include a statement that a copy of the chairman's report to the

Court will be available to any creditor on request for at least 1 week before the date fixed by the Court for the chairman to report back to it.

1.8 Any creditor wishing to vote by proxy should tender as his proxy the form of proxy referred to in paragraph 1.4.6 of this Order.

1.9

1.9.1 All creditors who received the papers referred to in paragraph 1.4 above, shall cause their claims to be filed with the chairman in accordance with the provisions of section 366(1)(a) of the Act not later than 24 hours prior to the meetings.

1.9.2 A creditor who did not receive the aforementioned papers, may before the meeting commences, hand to the chairman an affidavit in which he confirms that he did not receive these papers and that he is a creditor, stating the amount and the nature of his claim."

2. The statement required by section 312(1) of the Act is to include all relevant information concerning the subordination agreements of Camms Services and Finance Corporation (Pty) Ltd and UAL Merchant Bank Ltd and is not to contain the incorrect or incomplete statements referred to in this judgment.

R J GOLDSTONE
JUDGE OF APPEAL

CORBETT CJ)
VAN HEERDEN JA)
NICHOLAS AJA) CONCUR
HARMS AJA)