THE SUPREME COURT OF APPEAL OF SOUTH AFRICA

JUDGMENT

Case No 386/2010

In the matter between

ABSA BANK LIMITED **APPELLANT**

and

KERNSIG 17 (PTY) LTD **RESPONDENT**

Neutral citation: *Absa Bank v Kernsig 17* (386/2010) [2011] ZASCA 97 (31 May 2011)

Coram: **CLOETE, CACHALIA, SHONGWE, MAJIEDT and SERITI JJA**

Heard: **4 MAY 2011**

Delivered: **31 MAY 2011**

Summary: Company Law – Section 38 – Allegation that the loan agreement contravenes s 38 of the Companies Act 61/1973 – Section 38 enquiry is fact based – Generally allegation must be pleaded or all facts must be before court for the court to make a determination.

ORDER

On appeal from: Western Cape High Court (Cape Town), (Traverso AJP, Fourie and Yekiso JJ, sitting as a full court):

(a) The appeal succeeds with costs which will include the costs consequent upon the employment of two counsel.

(b) The order of the court a quo is set aside and replaced with the following:

'The appeal is dismissed with costs, which costs will include the costs consequent upon the employment of two counsel.'

JUDGMENT

SERITI JA (CLOETE, CACHALIA, SHONGWE, MAJIEDT JJA concurring):

[1] The respondent (Kernsig) approached the Western Cape High Court, Cape Town, by way of motion proceedings seeking an order cancelling six covering mortgage bonds registered against the title deed of its immovable property (Karoovlakte farm) in favour of the appellant (Absa). The court of first instance (Meer J) dismissed the application with costs. With leave of the court of first instance, Kernsig appealed to the full bench of the Western Cape High Court (the court a quo).

[2] The court a quo (Fourie J; Traverso AJP and Yekiso J concurring) reversed the decision of the court of first instance and granted the order sought by Kernsig. The matter is before this court after this court granted Absa special leave to appeal.

[3] Messrs P J Greyling and J A Greyling are the sole directors and shareholders of Kernsig. Kernsig owns an immovable property known as Karoovlakte farm situated in the district of Klawer, Western Cape. P J Greyling and J A Greyling formed a partnership known as Karoovlakte Boerdery (the partnership) and the partnership conducted farming activities on Karoovlakte farm which they leased from Kernsig.

[4] Absa, through its Vredendal branch, was the banker of the partnership. Absa granted the partnership an overdraft facility on the partnership's cheque account and short-term loans. As security for the facilities granted to the partnership, six covering mortgage bonds were registered against the title deed of Karoovlakte farm in favour of Absa. The total amount secured by the mortgage bonds was R1.11 million. As I have said, the bonds were covering bonds and each provided:

'Voortdurende Dekkingsverband

Hierdie verband sal van krag bly as 'n voortdurende dekkende sekuriteit vir die hoofsom – die rente daarop en die bykomende bedrag, ondanks enige tussentydse skuldvereffening en, ondanks enige tussentydse skuldvereffening, sal hierdie verband van volle krag en effek bly as 'n voortdurende sekureits- en dekkingsverband vir enige en elke bedrag wat die Verbandgewer nou of hierna aan die Bank verskuldig mag wees voortspruitend uit welke oorsaak ookal tot die bedrag van die hoofsom, die rente daarop en die bykomende bedrag.'

[5] Mr Johan Brand (Brand), the relationship manager of the Vredendal branch, was not happy about the manner in which the Greylings were conducting the two accounts. The limit of the overdraft facility was frequently exceeded and the loan repayments were not made timeously.

[6] Attorney Visser (Visser), Kernsig's attorney of record, and a sister of P J Greyling, was known to Brand as her law practice operated an account at the Vredendal branch of Absa. Visser and P J Greyling discussed the possible sale of Karoovlakte farm with Brand over several months.

[7] On 6 September 2005 the Greylings entered into a written sale agreement of Karoovlakte farm with Mr Lionel Patrick Barnard and his wife Christine Barnard (the Barnards). The transaction was structured in such a manner that the Barnards would buy the Greylings' entire shareholding in Kernsig and as part payment of the purchase price, take over the partnership's financial obligations towards Absa.

[8] Brand, as a result of his discussions with Visser and the Greylings, was aware of the fact that it was a term of the sale agreement that the Barnards would, in the name of Kernsig, take over the financial obligations of the partnership towards Absa. That entailed that the debts of the partnership would be consolidated and be paid by Kernsig with the proceeds of a loan that Kernsig would obtain from Absa. The Barnards, in their own names, would not have qualified for a loan.

[9] The 6 September 2005 agreement of the sale of Kernsig was replaced by an almost identical sales agreement dated 30 November 2005. Clause 3 thereof reads as follows:

'3. Koopprys

Die koopsom is die bedrag van R2 000 000.00 (twee miljoen rand) betaalbaar deur die koper aan die verkoper as volg:

3.1 'n Bedrag van R150 000.00 (een honderd en vyftig duisend rand) reeds betaal;

3.2 Die oorname van alle skulde van die maatskappy insluitend die Landbou kredietlening ten bedrae van R57 750.00, asook die verbande wat oor die eiendom van die maatskappy geregistreer is in naam van Karoovlakte Boerdery. In totaliteit die bedrag van R1 137 750.00.

3.3 Die balans van die koopsom naamlik R712 250.00 word in 12 jaarlikse paaiemente afbetaal waarvan die eerste betaling op 1 Augustus 2006 sal geskied en daarna jaarliks voor of op die einde van Julie . . .'.

[10] The shares of Kernsig were not transferred into the name of the Barnards and in order for Kernsig to apply for a loan, Brand required the Greylings to give authority to Barnard to apply for the loan in the name of Kernsig. Barnard applied on behalf of Kernsig for a loan of R1.1 million and

same was approved or granted on 8 December 2005. The covering mortgage bonds already registered against the title deed of Karoovlakte farm referred to earlier, served as security for the loan granted to Kernsig.

[11] On the day that the loan was approved, Visser telephoned Brand enquiring about the progress of Kernsig's loan application. The proceeds of the loan were paid to Kernsig and they were utilised to pay off the loan and overdraft facility of the partnership on 25 January 2006, and Kernsig remained with a debt of R1.1 million.

[12] The Barnards, who had taken possession and occupation of the farm during September 2005, vacated the farm in February 2008 and returned the keys of the farm to the Greylings. The Greylings accepted the Barnards' repudiation of the sale agreement, and cancelled it.

[13] In May 2008, after Kernsig sold Karoovlakte farm to another buyer, Visser wrote a letter to Absa wherein she demanded that Absa cancel the mortgage bonds registered against the title deed of Karoovlakte as, according to her, the partnership's debts for which the mortgage bonds served as security, had been liquidated. Absa refused to do so, alleging that the mortgage bonds served as security for the loan granted to Kernsig. Absa required payment of R1.25 million before it would cancel the mortgage bonds.

[14] In the founding affidavit, the deponent (P J Greyling) stated that he together with his co-director and co-shareholder were not aware of any further loan given to Kernsig and referred to a letter written to Absa requesting details of the authority of the applicant for any such loan. Their case was that the debt of the partnership had been extinguished and consequently the mortgage bonds should be cancelled. In the answering affidavit Absa alleged that the loan agreement had been entered into by Absa and Kernsig with the full knowledge and authorisation of the directors and shareholders of Kernsig, and that consequently, the mortgage bonds served as security for the new loan granted to Kernsig. This was disputed in the replying affidavit. Before the court of first instance Kernsig elected, despite the dispute of fact, to have the matter adjudicated upon on the papers without a referral for oral evidence.

[15] The court of first instance found that the loan agreement had been concluded between Absa and Kernsig and dismissed the application. It is unlikely that the court of first instance was invited to determine whether the loan agreement contravened the provisions of s 38 of the Companies Act 61 of 1973 as the judgment makes no mention of such an argument. It was only mentioned as part of the court's recordal of allegations made on behalf of the respondent which are set out below.

[16] The case that the loan agreement contravened s 38 was not raised in the founding affidavit in any shape or form. In the replying affidavit the section was referred to in three passages.

(a) In the first, the deponent said:

'Ek ontken dat Applikant op 22 September 2005 deur bemiddeling van die Vredendal tak van Respondent, aansoek gedoen het vir 'n termynlening en dra geen kennis van sodanige aansoek nie.

. . .

Applikant voer respekvol aan en grond sy aansoek hierop, naamlik dat

- L P & C Barnard op geen stadium direkteure van Applikant was nie.
- Hul op geen stadium deur die bestaande direkteure van Applikant van 'n volmag, hetsy skriftelik of mondeling of by implikasie, voorsien is om in die naam van Applikant op te tree nie.
- Daar op geen stadium 'n resolusie deur die direkteure van Applikant geneem is om 'n termynlening van R1.1 miljoen met Respondent aan te gaan nie of wat Barnard magtig om in naam van Applikant so 'n termynlening aan te gaan nie.
- Daar op geen stadium toestemming deur die direkteure van Applikant verleen is dat die bates van Applikant as sekuriteit vir 'n termynlening van R1.1 miloen gebruik kon word nie.
- Die aandele nooit op enige stadium aan Barnard oorgedra is nie.
- Die doel van die koopooreenkoms was dat Barnard uit persoonlike finansies die koopsom aan Applikant moes vereffen en as deel daarvan, die skulde van Applikant en/of Karoovlakte Boerdery moes oorneem. Daarna moes sekuriteitsverbande geregistreer word oor Wildernis Eiendomme waarna die aandele van Applikant aan Barnard oorgedra word.

- Applikant is nie regtens toelgelaat om eie bates te beswaar ten einde behulpsaam te wees om die verkoop van aandele te finansier nie.'

(b) In the second, the deponent said:

'Applikant ontken ten sterkste dat dit 'n term van die transaksie was dat Barnard in die naam van Applikant bestaande verpligtinge van Karoovlakte Boerdery teenoor Respondent moes oorneem deurdat die oortrokke tjekrekening en die termynlening-skuld gekonsolideer word en deur die Applikant betaal sou word deur middel van 'n nuwe fassiliteit wat aan die Applikant toestaan sou word.

Applikant verwys met respek na die aanhef van die vermelde koopkontrak (aanhangsel PJG 2 tot Kennisgewing van Mosie) waaruit dit duidelik blyk dat die ooreenkoms tussen Applikant en L P & C Barnard was en dat lg die aandele van Applikant gekoop het.

Verder wys Applikant die Respondent ook respekvol na die bepalings van Art 38 van die Wet op Maatskappye wat impliseer dat Barnard nie Applikant se bates kon beswaar ter verkryging/bekomming van die aandele nie. Dit was dus deurentyd die bedoeling tussen die partye dat Barnard in sy persoonlike hoedanigheid finansiering sou bekom ten einde die koopsom te delg. Soos die Respondent tereg opmerk, is beide Visser en ekself regsgeleerdes. Nie een van voormelde twee persone sou ooit toestem dat die koper die bates van die Applikant kon beswaar ten einde die aandele van Applikant te bekom nie. In elk geval is die aandele nooit aan Barnard oorgedra nie.'

(c) In the third, the deponent said:

'Hierdie beweringe van Respondent word onomwonde ontken. Daar was nooit enige sprake dat 'n termynlening aan die Applikant toegestaan moes word ten einde Karoovlakte Boerdery se skuld af te los nie. Dit sou sinneloos wees aangesien dieselfde vennote in Karoovlakte Boerdery ook die direkteure en aandeelhouers Applikant was en sou dit slegs 'n verskuiwing van skuldverpligtinge wees. Verder sou so 'n transaksie ook nie regtens toelaatbaar wees nie. Die direkteure van Applikant is ook nooit sedert September 2005 gekontak rakende betalings en/of die gebrek aan betalings van die premies van 'n termynlening nie.'

[17] In the first passage, the section is not mentioned specifically and the allegation at the end would not have served to alert Absa that its provisions were being relied upon as an independent cause of action for the cancellation of the bonds. In the second passage, the section was not relied upon for an argument that the loan of 8 December 2005 was void and that the bonds

should be cancelled for that reason. Rather, the section was relied upon to support Kernsig's version that the Barnards were not authorised to act on behalf of Kernsig to apply for the loan or to agree that the existing bonds would remain to secure it. The same applies to the third passage. The alleged invalidity of the loan is there put forward to support an argument that the Barnards were not authorised to represent Kernsig in obtaining the loan, not an argument that if such a loan had been granted, Kernsig would contend that it was invalid because of the provisions of s 38.

[18] The allegation that the loan agreement contravened s 38 was apparently raised squarely for the first time in the application for leave to appeal which served before the court of first instance. When granting leave to appeal, the court of first instance stated, inter alia:

'I am of the view that another Court could well come to a different decision as to whether Respondent disclosed a defence, and as to whether the loan was improper in the light of section 38 of the Companies Act 1993. This being so, I must find there to be a reasonable prospect of success on appeal.'

[19] The court a quo found that the loan agreement contravened s 38(1) of the Companies Act. The court reasoned that it cannot be said that the direct object of the loan agreement of 8 December 2005 was to enable Kernsig as mortgagor to take over the partnership's debt.

[20] The sole question raised by Kernsig in the appeal before this court was whether the loan agreement contravened s 38. That section reads as follows:

'No financial assistance to purchase shares of company or holding company ─

(1) No company shall give, whether directly or indirectly, and whether by means of a loan, guarantee, the provision of security or otherwise, any financial assistance for the purpose of or in connection with a purchase or subscription made or to be made by any person of or for any shares of the company, or where the company is a subsidiary company, of its holding company.'

[21] The main purpose of s 38 is to protect the creditors and minority shareholders of a company. A person who purchases shares in a company must do so out of his or her own funds, because using the company's

resources to buy shares of that particular company may prejudice the creditors and minority shareholders of that company. As Nicholas AJA said in *Lewis v Oneanate (Pty) Ltd & Another* 1992 (4) SA 811 (A) at 818A-B:

'The object of a provision such as s 38(1) is the protection of creditors of a company, who have a right to look to its paid-up capital as the fund out of which their debts are to be discharged . . . The purpose of the Legislature was to avoid that fund being employed or depleted or exposed to possible risk in consequence of transactions concluded for the purpose of or in connection with the purchase of its shares.' See also *Gardner & Another v Margo* 2006 (6) SA 33 (SCA) at para 45.

[22] The section is drawn in very wide terms. It prohibits a company from giving financial assistance to any person for the purpose of or in connection with the purchase of its shares, or in the case of a subsidiary company for the purchase of shares of its holding company. There has therefore been a tendency to give the section a narrow interpretation. In *Gardner & Another v Margo* supra at para 47 Van Heerden JA said:

'In *Lipschitz NO v UDC Bank Ltd* this Court appears to have accepted the distinction drawn by Schreiner JA in *Gradwell (Pty) Ltd v Rostra Printers Ltd* between the "ultimate goal" of the transaction in question and its "direct object", and to accept that it is only the direct object of the transaction that is relevant. If the direct object is not the provision of financial assistance by the company for the purpose of or in connection with a purchase of its shares, then it is irrelevant that the ultimate goal of the transaction was to enable a person to purchase such shares. Moreover, financial assistance within the meaning of s 38(1) is given only when the direct object of the transaction is to assist another financially – the s 38 prohibition is not contravened when the direct object of the transaction is merely to give another that to which he or she is already entitled.'

Furthermore, In *Gradwell (Pty) Ltd v Rostra Printers Ltd and Another* 1959 (4) SA 419 (A) at 425E Schreiner JA said:

'The question whether it was to give financial assistance would depend not on how it obtained the money – by loan, secured or not, by realising assets or otherwise – but on what it was to do with the money when available.'

[23] It is clear from the above that s 38 is fact-based and that without the necessary facts a court cannot make a finding on whether s 38 was contravened or not. In *Transnet Ltd v Rubenstein* 2006 (1) SA 591 (SCA) at para 28 Cloete JA said:

'In motion proceedings the affidavits constitute not only the evidence, but also the pleadings.'

See also *Minister of Land Affairs & Agriculture v D & F Wevell Trust* 2008 (2) SA 184 (SCA) at 200D-E and *Eskom Holdings Ltd v New Reclamation Group (Pty) Ltd* 2009 (4) SA 628 (SCA) at 638C-F. In *Yannakou v Apollo Club* 1974 (1) SA 614 (A) at 623G-H Trollip JA said:

'And if his defence is illegality, which does not appear ex facie the transaction sued on but arises from its surrounding circumstances, such illegality and the circumstances founding it must be pleaded. It is true that it is the duty of the court to take the point of illegality mero motu, even if the defendant does not plead or raise it; but it can and will only do so if the illegality appears ex facie the transaction or from the evidence before it, and in the latter event, if it is also satisfied that all the necessary and relevant facts are before it.'

See also *F & I Advisors (Edms) Bpk v Eerste Nasionale Bank van SA Bpk* 1999 (1) SA 515 (A) at 525H-526A and 526D-E, and *Middleton v Carr* 1949 (2) SA 374 (A) at 385-386.

[24] In this matter, it is plain that all the facts are not before court to enable the court to determine whether or not s 38 has been contravened. The court a quo, for example, itself said:

'Die betrokke verbandaktes, gelees met die res van die stukke voor die hof, toon ook nie dat enige bedrag daarkragtens opeisbaar en betaalbaar was deur appellant aan respondent nie. Klousule 6 van die verbandaktes bepaal voorts dat die terugbetaling van enige bedrag wat deur appellant aan respondent verskuldig is uit hoofde van die betrokke verbande, moet geskied ooreenkomstig sodanige skriftelike ooreenkoms(te) as wat van tyd tot tyd deur appellant en respondent aangegaan mag word. Respondent steun egter nie op enige sodanige ooreenkoms(te) om te toon dat appellant enige bedrag uit hoofde van die dekkingsverbande aan respondent verskuldig is nie. Dit volg dus dat appellant, as verbandgewer, geen skuld teenoor respondent gehad het om te vereffen nie.

In die omstandighede kan dit nie bevind word dat die direkte doel (of minstens die mede-direkte doel) van die termynleningsooreenkoms van 8 Desember 2005, was om appellant se skuld as verbandgewer teenoor respondent te vereffen nie.'

Without having the relevant facts before it, it was incorrect for the court a quo to find that the loan agreement contravenes s 38; nor could it have been expected of Absa to produce documents relevant to the question whether there had been such a contravention, as this was not the case Absa was called upon to meet.

[25] My view is that the order of the court of first instance was correct and Absa's appeal should succeed.

[26] In the court a quo, Absa was represented by two counsel and I believe that they are entitled to the costs of the two counsel.

[27] The following order is made:

(a) The appeal succeeds with costs which will include costs consequent upon the employment of two counsel.

(b) The order of the court a quo is set aside and replaced with the following:

'The appeal is dismissed with costs, which costs will include the costs consequent upon the employment of two counsel.'

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W L SERITI
JUDGE EOF APPEAL

APPEARANCES:

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