THE SUPREME COURT OF APPEAL OF SOUTH AFRICA

JUDGMENT

Case No: 562/09

In the matter between:

JOHN LOUIS CARTER FOURIE NO First Appellant
JOHANNES FREDERICK KLOPPER NO Second Appellant
JUANITO DAMONS NO Third Appellant
KAREN KEEVY NO Fourth Appellant

and

JOHN DENIS NEWTON Respondent

Neutral citation: *Fourie NO v Newton* (562/09) [2010] ZASCA150 (29 November 2010).

Coram: CLOETE, PONNAN, MHLANTLA and LEACH JJA and

EBRAHIM AJA

Heard: **1, 2 NOVEMBER 2010**

Delivered: **29 NOVEMBER 2010**

Summary: Companies ─ s 424 of Companies Act 61 of 1973 ─ reckless trading ─ personal liability of directors.

ORDER

On appeal from: Western Cape High Court (Cape Town) (Desai J sitting as court of first instance):

The appeal is dismissed with costs, including the costs of two counsel.

JUDGMENT

CLOETE JA (PONNAN, MHLANTLA and LEACH JJA and EBRAHIM AJA concurring):

Introduction

[1] The CNA became an iconic brand in South Africa after it was established in 1886. It came to have an enormous national 'footprint' and an annual turnover exceeding a billion rand. In mid-2002 companies in the CNA group were liquidated. One such company was Consolidated News Agencies (Pty) Ltd ('Consolidated'), the liquidators of which are the present appellants. The liquidators brought an action in the Western Cape High Court based on s 424 of the Companies Act 61 of 1973 in which they sought to hold the respondent, Mr Newton, who was on the board of Consolidated, liable for Consolidated's debts and liabilities without limitation The amount in issue is about R256 million. Desai J dismissed the claim but subsequently granted leave to appeal to this court.

[2] I wish to emphasise at the outset that the reason why the liquidators have proceeded only against Newton is not because there is any suggestion that his conduct was any different from the remainder of the directors of Consolidated, but (apparently) because he was the only director that carried director's and officer's liability insurance. There is nothing improper in such a course: s 424 empowers a court to declare any person, who was knowingly a

party to the carrying on of the business of a company recklessly or with intent to defraud creditors, personally responsible for the debts of the company. The persons who have locus standi to bring s 424 proceedings (who include liquidators) can therefore choose whom they wish to sue.

Chronology of Principal Events

[3] The record and the heads of argument exceed 10 000 pages. It would therefore be convenient to give an overview of the important events before analysing in detail the law and evidence relevant for the determination of the appeal.

[4] In about 1997 the Gallo Group of companies sold the business of the CNA to Consolidated, the company used for that purpose by Wooltru Ltd. The structure adopted by Wooltru was to place an intermediate holding company, Consolidated News Agencies Holdings (Pty) Ltd ('Holdings'), between itself and Consolidated. Newton was appointed a director of Consolidated and Holdings. He was also a director of Wooltru and the managing director of the latter's wholly owned subsidiary, Wooltru Finance (Pty) Ltd, the internal banker to the Wooltru group.

[5] Consolidated's business was loss-making at the time of acquisition. It was financed by long-term interest free shareholder's loans from Wooltru made via Holdings; by short-term 'bank' finance from Wooltru Finance (that was obtained from other cash flush companies in the group) which was repayable with interest; and a bank facility with First National Bank.

[6] After the sale, the management of Consolidated was instructed to adopt a ten point plan to turn its fortunes around. Central to the plan was an information technology (IT) system intended to enable management to get the right stock to the right place at the right time ─ a management tool that, until then, had been lacking. Another aspect of the ten point plan was that 55 new shops, mainly in rural areas, were opened.

[7] In April 1999 Consolidated and M-Tel (Pty) Ltd concluded a retailer agreement ('the RA') in terms of which Consolidated was appointed the exclusive retailer of MTN cellular telephone products, and M-Tel warranted that Consolidated would earn specified minimum commissions on the sale of those products for three years from June 1999 until June 2002.

[8] During the latter part of 2000 it became apparent to management that two strategic mistakes had been made in the ten point plan. First, the IT system was far too sophisticated and expensive; and second, many of the new shops that had been opened were not profitable.

[9] On 15 August 2000 Newton informed a supervisory board meeting of Consolidated[1] that the audit committee (a sub-committee of the supervisory board) thought that Consolidated 'was not a going concern and that the shareholder [Wooltru] kept it going'; that Consolidated's 'viability as a going concern was a real issue and that Wooltru needed to address this issue as a shareholder'; and 'that the audit committee would approve [Consolidated's trading] results as long as Wooltru stands behind the business and Wooltru views [Consolidated] as a going concern'.

[10] In August/September 2000 Wooltru decided to 'unbundle', ie to dispose of its holdings in certain (but not all) of its subsidiaries. Wooltru retained Casenove, a leading merchant banker based in London, to supervise the process, which became known as 'Project Springtime'. Newton was one of the two persons (the other being Mr Rabb) who, at meetings of Project Springtime, represented Wooltru, which was assisted by a number of professional advisors: apart from Casenove, there were firms of attorneys, being Mallinicks and Edward Nathan Friedland, and accountants, being Ernst & Young and Nkonkwe Sizwe.

[1]Whilst Wooltru owned Holdings and Consolidated, the executive board of Consolidated met monthly and the supervisory board, on which Newton sat, met quarterly.

[11] On 22 November 2000 the board of Wooltru decided to dispose of Consolidated as it presented an obstacle to the unbundling process. Casenove was given a mandate to find a buyer.

[12] On 1 March 2001 Consolidated's management circulated to the directors of Consolidated the 100-day plan it had drawn up. The stated purpose of the document was to act 'as a thought starter that should be robustly debated and changed in order to achieve the desired levels of commitment' and the plan was said to identify 'those actions that are required to Stabilise and Energize CNA prior to the implementation of a more fundamental re-positioning exercise'.

[13] On 14 March 2001 the Wooltru board resolved to sell Consolidated and Holdings to a shelf company, Gordon Kay & Associates (Pty) Ltd ('GKA') in which, as the name suggests, Messrs Gordon and Kay owned shares. A sale of shares agreement was concluded between these parties the following day. The relevant provisions of the agreement were the following:

(a) the subject matter was Wooltru's shares in Holdings and the 'sale claims' ie all amounts owing to Wooltru as at the effective date (1 March 2001);

(b) the purchase price was R150 million, and an 'agterskot' being the amount by which the cost of stock of Consolidated as at 1 March 2001 exceeded its trade creditors plus R138 250 million;

(c) the purchase price was payable as to R15,4 million on closing date (when the conditions precedent were fulfilled) which became 1 June 2002 (the month before liquidation) and the balance 455 days after 1 March 2001;

(d) GKA undertook to provide guarantees for payment of R30 million and R54,6 million;

(e) GKA undertook to establish a subsidiary of Holdings and to transfer to the subsidiary all assets and liabilities of Consolidated except the top performing 50 stores. (Ultimately, this provision was not implemented. What happened was that the top performing 61 stores were housed in a company other than Consolidated but also in the CNA group; the approximately 110

loss-making 'entertainment' stores were sold; and the plan was to franchise the remaining stores);

(f) Holdings undertook to bind itself as surety for the obligations of GKA and to pledge 25 per cent of the shares in Consolidated to Wooltru; and

(g) the subsidiary of Holdings would provide a suretyship to Wooltru.

After the sale of shares agreement, Newton remained a director of Wooltru and Consolidated.

[14] Also in March 2001, GKA and the corporate banking division of Absa concluded a mandate agreement in terms of which Absa Corporate was to act as a merchant banker to GKA to advise it on the disposal of all or part of its interest in the CNA group. The following month the retail banking division of Absa granted the CNA group a general banking facility of R40 million.

[15] On 26 March 2001 an amended retailer agreement ('the ARA') was concluded by various parties, including Consolidated, Holdings, Wooltru, M-Tel and MTN. The effect of the agreement was that Consolidated waived the amounts guaranteed to it by M-Tel under the RA; MTN agreed to provide Wooltru with the guarantees required by Wooltru from GKA for R30 million and R54,6 million payable on 30 June 2002 for part of the purchase price of the shares of, and claims in, Holdings under the sale of shares agreement; and Consolidated agreed to reimburse MTN.

[16] On 25 April 2001 the sale of shares agreement was amended and it was agreed that as a condition precedent to the sale, Consolidated would become a surety and co-principal debtor with GKA. Pursuant to the agreement, Consolidated executed a deed of suretyship in favour of Wooltru as surety and co-principal debtor with GKA for payment under the sale of shares agreement.

[17] At the beginning of May 2001 GKA paid R15 million to Wooltru as part payment of the purchase price. The payment was made using cash which GKA had withdrawn from Consolidated in reduction of that part of the loan

claim (R120 million) which GKA had against Consolidated, which was unsubordinated and which it had acquired from Wooltru.

[18] On 30 October 2001 Consolidated sold the assets and stock of the 112 'entertainment' stores to Biz Africa (Pty) Ltd for what was ultimately agreed at R50,9 million with effect from 1 March 2001. The price was to be credited by Biz Africa to Consolidated on loan account to become payable when Consolidated in its discretion decided that Biz Africa was in a financial position to pay.

[19] On 8 November 2001, but with effect from March 2001, Consolidated sold its 61 top performing stores to a company incorporated into the CNA group which later changed its name to Central News Agency (Pty) Ltd ('Central') for what was subsequently fixed at R133 million. The whole of the purchase price was to be credited by Central to Consolidated on loan account to become payable when Consolidated decided, in its discretion, that Central was in a financial position to pay.

[20] On 13 November 2001 Absa Retail Bank approved a R10 million facility to be used for letters of credit over and above the R40 million general banking facility which had already been granted in March of that year.

[21] On 4 January 2002 Consolidated, with the permission of Absa Retail Bank, transferred R15 million from its bank account to Wooltru in further reduction of the purchase price due by GKA to Wooltru under the sale of shares agreement.

[22] On 25 January 2002 Holdings pledged 45 per cent of its shares in Central to Wooltru as security for GKA's obligations to Wooltru under the sale of shares agreement and the sale of shares agreement was amended to provide for payment of R15 million on 31 December 2001 and R74 million on 31 May 2002.

[23] On 16 April 2002 Consolidated and Central signed an addendum to the sale of the 61 top performing stores to provide that Holdings could appropriate the purchase price of R133 million by setting it off against the shareholder's loan of R859,748 million.

[24] On 31 May 2002 GKA failed to pay Wooltru the balance of R74 million due in terms of the (amended) sale of shares agreement. Newton had already been alerted to this possibility by Gordon of GKA at the beginning of the month, and had reported it to the board of Wooltru.

[25] On 20 June 2002 Absa retail bank increased the CNA group's general banking facility temporarily (until September) from R40 million to R70 million.

[26] On 9 July 2002 Newton resigned as a director of Consolidated. Six days later, on 15 July 2002, Absa retail bank unexpectedly called up the overdraft facility. On 27 July 2002, Consolidated was provisionally wound up as unable to pay its debts, which amounted to some R328 million. The order was made final on 2 October the same year.

The Law

[27] Section 424(1) of the Companies Act provides:

'When it appears, whether it be a winding-up, judicial management or otherwise, that any business of the company was or is being carried on recklessly or with intent to defraud creditors of the company or creditors of any other person or for any fraudulent purpose, the Court may, on the application of the Master, the liquidator, the judicial manager, any creditor or member or contributory of the company, 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.'

[28] The case against Newton is based on recklessness. The test for recklessness has both objective and subjective elements. It is objective, to the extent that the defendant's actions are measured against the standard of

conduct of a notional reasonable person.[2] Accordingly, a defendant's honest but mistaken belief as to the prospects of payment of a claim by the company when due is not determinative of whether he was reckless; if a reasonable person or business in the same circumstances would not have held that belief, the defendant's bona fides is irrelevant.[3] The test is subjective, to the extent that it must be postulated that the notional person belongs to the same group or class as the defendant, moving in the same sphere and having the same knowledge or means of knowledge.[4]

[29] Acting 'recklessly' consists in 'an entire failure to give consideration to the consequences of one's actions, in other words, an attitude of reckless disregard of such consequences'.[5] In the context of s 424, the court should have regard, amongst other things, to the scope of operations of the company, the role, functions and powers of the directors, the amount of the debts, the extent of the company's financial difficulties and the prospects, if any, of recovery.[6] If when credit was incurred a reasonable man of business would have foreseen that there was a strong chance, falling short of a virtual certainty, that creditors would not be paid, recklessness is established.[7]

[30] A s 424 enquiry is typically one into commercial insolvency, as opposed to factual insolvency. As it was put by Goldstone JA in *Ex parte De Villiers & another NNO: In re Carbon Developments (Pty) Ltd (in liquidation)*:[8]

'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.'

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[2] *Philotex (Pty) Ltd & others v Snyman & others*; *Braitex (Pty) Ltd & others v Snyman & others* 1998 (2) SA 138 (SCA) at 143G.
[3] *Philotex* at 147E.
[4] *Philotex* at 143G-H and 148E-H.
[5] *S v Dhlamini* 1988 (2) SA 302 (A) at 308D-E, applied in the corporate context in *Philotex* at 143F-G and *Ebrahim & another v Airport Cold Storage (Pty) Ltd* 2008 (6) SA 585 (SCA) para 14.
[6] *Fisheries Development Corporation of SA Ltd v Jorgensen & another; Fisheries Development Corporations of SA Ltd v A W J Investments (Pty) Ltd & others* 1980 (4) SA 156 (W) at 170B-C, approved in *Philotex* at 144B-D.
[7] *Philotex* at 147C.
[8] 1993 (1) SA 493 (A) at 504E-F.

And the question whether a company is unable to pay its debts when they fall due:

'[I]s always [a] question of fact to be decided as a matter of commercial reality in the light of all the circumstances of the case, and not merely by looking at the accounts and making a mechanical comparison of assets and liabilities. The situation must be viewed as it would be by someone operating in a practical business environment. This requires a consideration of the company's financial condition in its entirety, including the nature and circumstances of its activities, its assets and liabilities and the nature of them, cash on hand, monies procurable within a relatively short time, relative, that is, to the nature and demand of the debts and to the circumstances of the company including the nature of its business, by the sale of assets, or by way of loan and mortgage or pledge of assets, or by raising capital.'[9]

As will appear from what is said hereunder, the passage just quoted is of particular significance in the present case.

The Liquidators' Case

[31] The liquidators' case, in essence, was that from the period March 2001 until the date of its liquidation, Consolidated continued to trade and incur debts which it could not repay and its board, in permitting it to do so, acted recklessly.

[32] Prof Wainer was called by the liquidators to give expert evidence on their behalf. Wainer is a chartered accountant, a practising accountant and auditor registered with the Public Accountants and Auditors Board, a past member of the Auditing Standards Board, the chairman of the monitoring panel for the application of Generally Accepted Accounting Principles for the Johannesburg Securities Exchange and a visiting professor at the faculty of commerce of the University of the Witwatersrand. He also undertakes forensic work which is a major part of his practice. He expressed the view, as an accounting expert, that Consolidated should have been liquidated by no later than March 2001. In argument before this court, the submission in the alternative on behalf of the liquidators was that Consolidated should have been liquidated not later than March 2002 and that the directors of

[9]Blackman et al *Commentary on the Companies Act*, vol 3 14-130, relying on Australian authority.

Consolidated had acted recklessly right up until the date of its provisional liquidation. I do not propose being detained by a debate as to whether the alternative contentions are open to the liquidators in the light of the pleadings. I shall assume that they are.

[33] In his expert report, which he amplified in his evidence, Wainer pointed out that in each month from March 2001 until its liquidation Consolidated recorded losses (except for December 2001 and January 2002); in general, budgeted profit (loss) had not been achieved; there were material negative deviations from the budgets (even after the budgets were revised to be less optimistic in July 2001); and the results were as bad, or worse, than in prior years. This appears from the following table prepared by Wainer:

	Profit (Loss)	Prior year	Budget
March 2001	(5 788)	(6 038)	(4 917)
April 2001	(12 856)	(10 700)	(6 448)
May 2001	(9 430)	(10 564)	(5 215)
June 2001	(14 084)	(8 250)	(4 149)
July 2001	(1 356)	(11 520)	(7 746)
August 2001	(9 404)	(7 976)	(7 972)
September 2001	(10 977)	(7 829)	(6 851)
October 2001	(10 746)	(7 141)	(1 797)
November 2001	(1 196)	(1 925)	(1 309)
December 2001	17 843	38 766	26 165
January 2002	5 565	7 432	10 567
February 2002	(810)	Unavailable	Unavailable
March 2002	(2 631)	(5 789)	(7118)
April 2002	Unavailable	Unavailable	Unavailable
May 2002	(5 407)	(9 491)	(5 882)
June 2002	Unavailable	Unavailable	Unavailable
Apr – July 2002	(35 552)	(37 758)	Unavailable

[34] Wainer pointed to the fact that Consolidated made payments totalling R31,4 million (being two payments of R15 million, one in May 2001 and one in January 2002, a payment of R1 million in June 2001 and a further payment of R400 000 in September 2001) in reduction of the purchase price due by GKA to Wooltru. But both Mr Bird of Casenove and Newton expected GKA to do this and although the payments reduced the cash available to Consolidated, they were not of themselves of particular significance. The suggestions that GKA was intent on an asset stripping exercise and that Newton was looking after Wooltru's interests in breach of the fiduciary duty he owed to Consolidated, are both without foundation. GKA wanted to keep Consolidated going, not strip out its assets and leave it for dead, and Newton's attitude towards the fiduciary duties he owed Consolidated as a director appears from his conduct at the meeting of the board on 28 March 2002 which I shall deal with when I conclude the discussion of his evidence.

[35] Wainer singled out the conclusion of the ARA for particular criticism. He said that it 'had no real value to Consolidated and was clearly contrary to its interests and needs'. The provisions of the ARA highlighted by Wainer and the liquidators' counsel were the following:

(a) Consolidated waived the R40 million which it expected to earn from the RA for the second period ended June 2001.

(b) The income warranty for the third period, 1 July 2001 to 30 June 2002, was to remain in force, but the period was to be extended by some three months so that it would run from 1 April 2001 to 30 June 2002.

(c) MTN in its turn would provide the guarantees required by Wooltru from GKA. The guarantees were for R30 million and R54,6 million respectively, and were payable on 30 June 2002.

(d) The agreement made it plain that it was the intention of the parties that MTN would in fact be reimbursed by Consolidated and a company styled Newco.

(e) The mechanism by which this was to occur was via a trust account opened by attorneys Webber Wentzel Bowens.

(f) Consolidated was obliged to pay all of its future income earned pursuant to the ARA into the trust account. It was allowed to withhold only R15 million per month up to a maximum withholding of R20 million.

(g) This meant that the shortfall under the third income warranty, which was expected to be R40 million, would be discharged by M-Tel paying that amount into the trust account instead of to Consolidated.

(h) If, by June 2002, the monies in the trust account were insufficient to repay MTN, M-Tel would make up the difference; but with one crucial qualification. If what it had to pay exceeded the amount due to Consolidated under the third income warranty, then Consolidated would have to repay it.

(i) Consolidated's ability to find future investors, if it ever had any such ability, was choked off by a provision that from any investment made the amount withheld by Consolidated from the trust account would have to be paid into the trust account.

(j) Consolidated and Newco bound themselves as sureties and co-principal debtors with GKA for all of the latter's obligations to MTN to refund to it any amount paid under the guarantees.

(The wording of the preceding sub-paragraphs is taken from the heads of argument.)

[36] Wainer said that the ARA would have had a profound impact upon the cash flow of Consolidated in the period from March 2001 in that the guaranteed income amount accrued up to February 2001 and further shortfalls on guaranteed income would not be received. The anticipated further cash receipts in respect of the year ended June 2001 (anticipated by the directors at about R14 million) and expected in about September 2001, would not arise at all. Moreover, in respect of the period to 30 June 2002, a lower amount would be received from M-Tel in respect of the minimum income warranty as the period for the measure of the actual income was extended from 12 to 15 months ─ without changing the original amount of the warranted minimum income. In addition, from 1 April 2001 cash flow would be negatively affected in respect of actual sales of the M-Tel products as the proceeds had to be deposited into a trust account and that could not be used (except to the limited extent provided for in the agreement, ie up to R20 million) for the

business of Consolidated. The amounts accumulated in the trust account would not be released to Consolidated but, the commercial reality was, these amounts would be taken by MTN to cover the guarantees to Wooltru by MTN of R84,6 million.

[37] Wainer calculated the negative cash flow effect of the ARA on Consolidated at R135 million. He concluded on the ARA that as at the date of its conclusion and significantly as a result of it, it was clear that the future liquidation of Consolidated was virtually certain; and that this would or should have been clear to any chartered accountant or 'experienced businessman'.

[38] An assumption underlying Wainer's evidence is that but for the ARA, the RA would have resulted in the CNA receiving payment under the income warranties from MTN. The validity of the assumption is, to put the position at its lowest, questionable. The RA required the CNA to have at least 250 stores. Management contemplated closing stores which would put the CNA in breach of this obligation. That apart, according to Newton, Mr Jenkins (an executive director of Johncom which held shares in the ultimate holding company of M-Tel) told him and Rabb of Wooltru that M-Tel was dissatisfied with the CNA's performance under the RA, was not intending to pay any money in terms of the profit warranty provisions which it contained and was intending to litigate. Jenkins confirmed that he had met with Newton and Rabb to tell them that M-Tel was unhappy about the relationship with Consolidated. I see no reason to reject Newton's evidence on this point.

[39] According to Jenkins, he also told Gordon that he should not rely on receipt of a cheque for R14 million for the first guaranteed period under the RA. At the same time, Jenkins realised the importance of the relationship between the CNA and companies in the Johnnic group. So did Gordon, who told Jenkins (according to Jenkins): that the CNA had lost its way; that the fact that the deficit in the revenue margins was so large, was an indication of non-performance in the business; that management needed a new lease on life and that the business needed new vision; that he understood why MTN would be unhappy; that his position was not dependent on extracting money for the

past; that he needed customers and that he wanted the relationship with MTN and Johncom 'because that was the most important and critical success factor'. This was music to Jenkins' ears. He explained his own commercial approach to the breakdown of the relationship between MTN and the CNA and his reasons for concluding the ARA as follows:

'[I]t was the right commercial thing. There's always more value in business in the future than there is in the past. And very often things don't go according to plan, and they go wrong, but the biggest question in business is: How do you fix them? And that, you know, for both Johncom and MTN, we needed retail outlets, we needed channel to market, and what CNA needed, was they needed product, and they needed customers. They needed feet through their stores, and that the synergistic benefits of a co-operative relationship between this massive retailer with 300 stores, and the might of MTN with its telecommunications product, which was a big magnet for customers, and, ja, the ability to expose for sale the rest of the Johncom product, this was a very, very – to my mind, a very, very good synergistic business model.'

When the view of Wainer, that the ARA had no real value to Consolidated, was put to Jenkins, he replied: 'I think in my mind the agreement had inestimable value'; and when asked for his opinion as a businessman, he went so far as to say that, from CNA's perspective, the conclusion of the ARA was 'probably . . . a sine qua non for the success of CNA'.

[40] It is for these commercial reasons that the ARA was concluded. They were ignored by Wainer and the liquidators. So was the co-operation agreement concluded at the same time between Johncom, GKA and the CNA that recognised that the success of the CNA and Johncom was intertwined, that constituted companies in the Johncom group preferred suppliers to the CNA group and that recorded that the purpose of the agreement was to facilitate co-operative dealings between the Johncom Group and the CNA group to enhance their respective businesses. Wainer said in cross-examination that he considered the ARA as containing 'vague-ish references to possible benefits', and that he found 'nothing of any moment' in the agreement. This attitude may be contrasted with the view expressed in an Absa document dated 8 April 2001 recommending the granting of the R40

million facility to the CNA which, after the provisions of the ARA were summarised, continues:

'The company [Consolidated] does not have a strong holding company, however the strategic partnership which has been formed with Johnnic, will provide comfort to suppliers, bankers and possible future investors.'

Despite being aware of this viewpoint, Wainer said that he had made nothing of it.

[41] It seems to me that the evidence about the conclusion of the ARA shows businessmen with conflicting interests finding a mutually beneficial commercial solution to their differences, rather than a reckless carrying on of the business of Consolidated. The terms of the ARA and the co-operation agreement also evince a genuine belief on the part of those who concluded these agreements that the CNA would not be liquidated. If that were not so, the conclusion of the agreements would have been a pointless exercise in cynicism. More importantly, MTN would hardly have undertaken a liability to pay R85 million to Wooltru on 30 June 2002 and nor would Consolidated have undertaken to repay that amount, had the prospect of an intervening liquidation of Consolidated remotely crossed their corporate minds. I am accordingly not prepared to find that the conclusion of the ARA on its own constitutes, or is even evidence in a wider context of, reckless trading by the board of Consolidated.

[42] Another important ─ and in fact critical ─ theme in Wainer's evidence was that during the period 1 March 2001 to the date on which Consolidated was provisionally liquidated (I quote from his expert report):

'There was no clarity and commitment regarding the source, extent and term of future funding for Consolidated.'

The phrase 'clarity and commitment' cropped up many times in Wainer's evidence. It was argued on behalf of the liquidators as a matter of law that absent clarity and commitment as to future funding, it was reckless to carry on the business of a company ─ in casu, Consolidated ─ which was predicted to make losses in the future; and Wainer discounted much of the evidence relied upon by the defence as justifying the continued trading of Consolidated, on

the basis that such evidence did not measure up to this standard. It was in these two cardinal respects, in law and in fact, that the case of the liquidators was misconceived. I shall deal first with the law and then the evidence disregarded by Wainer.

[43] As far as the law is concerned, the phrase 'clarity and commitment' is not an accounting term. It was culled from the judgment of this court in *Philotex*.[10] In that matter, the question was whether directors of a company called Wolnit had carried on the business of that company recklessly. Wolnit was part of a group of companies. Howie JA, writing for a unanimous court, said:[11]

'Wolnit's inability to trade and pay its debts without group support would, in my view, have prompted reasonable businessmen standing in the shoes of respondents and their co-directors to obtain clarity on certain basic questions before deciding against liquidation and in favour of incurring the credit necessary for the continued operation of the business. Those questions would have been: *(a)* What financial support will the group provide? *(b)* For how long will that support be available? Without clarity and the group's commitment on those crucial enquiries it was neither responsible nor reasonable for the Wolnit board to have taken the risk, knowingly or not, that trade creditors might not be paid.'

It is quite apparent from the passage quoted that Howie JA was dealing with the situation where a company could not trade and pay its debts without group support. It is equally apparent from the Accounting and Auditing Guide 'Trading Whilst Factually Insolvent'[12] referred to by Wainer that the inquiry (clarity and commitment) arises in the context of a company which is dependent on group support. Para .19 of the guide says:

'Other factors which might be considered relevant in the context of an entity's trading while factually insolvent and which are highlighted in the *Philotex* judgment are:

• in determining whether a company can continue to trade and pay its debts with group support, clarity should be obtained on the following basic questions before credit is incurred:

– What financial support will the group provide?

– For how long will that support be available?'

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[10]Above, n 2.
[11]At 175F-H.
[12]Issued in July 1999 by the South African Institute of Chartered Accountants.

[44] If an essential (and I do not mean sole) source of funding of a company is intra-group support, and that support has been or may be withdrawn, that would be a factor, or it may be decisive,[13] in considering whether the actions of the board in continuing to trade were reckless as contemplated in s 424. But where there are sufficient other potential or existing sources of funding it does not follow that where group support is or may be withdrawn, the members of the board would immediately have to shut up shop on pain of contravening s 424. The essential question is whether the board would be acting recklessly in seeking to exploit the other sources of funding. The answer to that question would in the first place depend on the amount of funding required, for how long it would be required, and the likelihood of it being obtained ─ whether timeously or at all; and in the second place, on how realistic the possibility is that the company's fortunes will be turned around. The second consideration will materially depend on whether there is a credible business plan or strategy that is being or could be implemented to rescue the company. A business that may appear on analysis of past performance to be a hopeless case, may legitimately be perceived as a golden opportunity for a turnaround strategy.

[45] In evaluating the conduct of directors, courts should not be astute to stigmatise decisions made by businessmen as reckless simply because perceived entrepreneurial options did not in the event pan out. What is required is not the application of the exact science of hindsight, but a value judgment bearing in mind what was known, or ought reasonably to have been known, by individual directors at the time the decisions were made. In making this value judgment, courts can usefully be guided by the opinions of businessmen who move in the world of commerce and who are called upon to make these decisions in the performance of their functions as directors of companies, and by experts who advise businessmen in the making of such decisions or who evaluate them at the time they are made. And that is the second and factual shortcoming in the liquidators' case. Because of the narrow view taken of the law, they relied only on the evidence of Wainer.

[13]The question was left open in *Philotex* at 185F.

Wainer is an accountant ─ a very highly qualified and experienced accountant, whose views have been of assistance to many courts in the past, as the law reports demonstrate ─ but he is nevertheless an accountant, not a businessman; and, as he was constrained to concede in cross-examination, he is not an expert on what would be obvious to a businessman. No witness was called on behalf of the liquidators to fill this lacuna, to say in his or her opinion as a person of business what the board of Consolidated was or was not able to do and what a reasonable director might have expected to happen given the circumstances known or which should have been ascertained or anticipated. Of course, the ultimate conclusion as to whether a director acted recklessly or not is a decision for the court.

[46] Evidence was led by the defence which supports a conclusion that Newton did not act recklessly in the circumstances which prevailed from time to time after March 2001. Without going into detail at this stage, the evidence can be summarised as follows:

(a) Mr Bird of Casenove believed that there was a huge opportunity in Consolidated in terms of the management plan in place at the time GKA purchased the shares.

(b) Mr Jenkins said that the CNA was perceived by its competitor in the Johnnic Group, Exclusive Books, as a 'slumbering giant'.

(c) Mr Norman of Absa Corporate testified that there was great interest in the market place both to acquire equity in the company Central, which housed the 61 best performing stores, and also in the franchising of other stores.

(d) Mr Meisenholl served on a committee of Absa Retail Bank that on 1 April 2001, after considering detailed reports in respect of the business of the CNA, granted the CNA a loan facility of R40 million and in June 2002 increased the facility to R70 million (until 1 September 2002).

(e) None of the experts retained by Wooltru to assist it in its unbundling suggested liquidation as a serious option, and Newton considered that there were several funding opportunities available to CNA once it lost the financial backing of Wooltru in February 2001, some of which (although diluted) were still there until his resignation from the board on 9 July 2002.

I propose now dealing in turn with the evidence of the witnesses called on behalf of the defence.

Bird

[47] Bird was in charge of the local arm of Casenove, the merchant banker which, as I have said, was retained to oversee Project Springtime, the unbundling of Wooltru. For that purpose he and Newton met with the other professional advisors retained by Wooltru on a weekly basis from October 2000 to October 2001. As part of the unbundling process the directors of Wooltru would be required in terms of the rules of the Johannesburg Securities Exchange to put out a circular, approved by shareholders, that there would be sufficient resources left behind to finance the working capital requirements of what remained undistributed. That required considerable work in analysing the cash requirements and cash flow profiles of Consolidated and making recommendations as to its future.

[48] Bird expressed the view in an internal report dated October 2000, which was never placed before the board of Consolidated, in which he said (I have inserted the names of the companies in the place of the noms de plume):

'Wooltru has undertaken to its own shareholders, that no further cash will be invested in Consolidated. Consolidated is regarded as a going concern only if Wooltru continues to provide financial support.[14] In the event that the support for Consolidated is formally withdrawn, Consolidated would technically be trading under insolvent circumstances (being both insolvent and unable to pay its debts) and this would have severe implications on the directors of Consolidated, who could be prosecuted under s 424 of the Companies Act. The implications are that the directors are not only guilty of an offence, but also become personally liable for the debts of Consolidated. Wooltru therefore needs to consider its commitment to Consolidated very carefully.'

Bird explained this passage as follows. Wooltru was owed R290 million, which 'technically' (Bird's expression) was on call. If Wooltru withdrew its support, which from a legal perspective it was entitled to do, Consolidated would have gone insolvent. The reason why s 424 was mentioned was to focus attention

[14]This view accords with what Newton told the supervisory board meeting of Consolidated held some two months previously, on 15 April 2000 – see para 9 above.

on the issues and draw the attention of his seniors in London to the statutory provisions in South Africa which differ from those in the United Kingdom. Bird said that Wooltru never seriously considered liquidating Consolidated nor did Casenove ever propose this as a serious option, and nor did he himself consider it ─ it was mentioned for the sake of completeness.

[49] It was Bird's opinion that there was tremendous potential in Consolidated. R350 million had been invested by Wooltru in a new IT system to improve the problems with stock, and a lot of inefficiency at Consolidated had been associated with stock. He had a number of meetings with the management of Consolidated; they were excited about the advent of the new stock control system. Bird always thought that the high level of stock represented an opportunity to release substantial amounts of cash into the business. There was also the possibility of franchising stores. He pointed out that Consolidated had a turnover of a billion rand a year, which he explained was 'a huge positive' inasmuch as small changes (for example, the improvement of buying power by a small percentage) would have a substantial impact on profits.

[50] Bird said that in attempting to find a buyer for Consolidated, he would 'very definitely' look at a private equity investor that, typically, would look for assets in the business to fund the acquisition; and according to Bird, Consolidated's business lent itself to that possibility. But he emphasised that there had to be a credible turnaround strategy for two reasons: first, so that a buyer could have regard to what had been done already and come up with further ideas; and second, as a negotiating tactic so that a prospective purchaser would not regard the seller as being 'stuck in a corner' and the seller could legitimately contend that it was keeping the business because it was viable ─ which, Bird said, Consolidated's business was. He was asked in cross-examination:

'Well, had you had a solvency statement on the 1st of March 2001, what would it have looked like? Would the CNA be insolvent, or would it be solvent?'

and he replied:

'I have no idea, because I haven't seen ─ you know, the new management who came in, had a plan. They believed that they could, amongst other things, franchise; they could split the business, restructure the business; they could raise equity in a new entity which was going to hold the top 50 stores. All of those have cash flow implications and funding implications. . . .'

He was also asked in cross-examination:

'And isn't it important to look historically at where a company is in order to forecast a future or do you do it in a vacuum?'

and he replied:

'I wouldn't say you do it in a vacuum, but the past is not necessarily a good predictor of the future, particularly where you are in a turnaround situation. You are changing the way in which the business was run.'

These exchanges encapsulate the difference in approach between, on the one hand, the liquidators and Wainer, and on the other, the businessmen called on behalf of the defendant.

[51] Bird presented a paper to the Wooltru board at a meeting on 14 February 2001, which represented his views and advice at the time. He said, amongst other things, that if Wooltru were to continue to hold the CNA, it would have to put a further R100 million to R150 million at risk in order to realise an amount of R135 to R150 million. But that related to the Wooltru business plan and whereas Wooltru had adopted what Bird termed a 'one size fits all' approach to the stores, Bird said that GKA appreciated that there were differences between the three categories of stores that provided the potential for a different strategy, particularly franchising.

[52] On 9 April 2001 Bird drafted a document which dealt with security for the purchase price to be paid by GKA to Wooltru, where the possibility that Consolidated might be put into liquidation by, or be unable to make payment on, 30 August 2002, was mentioned. Bird again said, however, that he did not expect Consolidated to go into liquidation and that, although it was a theoretical possibility, he did not consider it to be a probability.

[53] Bird dealt with Wainer's view that it should have been obvious to a reasonable businessman that the CNA should have been liquidated in March 2001 and he was asked whether this was obvious to him from Casenove's perspective. His reply was:

'Absolutely not. We thought there was value in the business, hence our valuation. If we felt that the business should have been liquidated, well actually we would have been concluding that there was little, if any, value in the business. We had valued on the basis of a going concern and we felt that there was value in the business. What was clear is that the business needed to be run in a different way. So certainly it was never seriously contemplated and it was not something which I expected to happen imminently.'

In cross-examination he said:

'If you are operating a business which is consuming cash, you have options. You can do other things. You can change the way in which the business is run. You can sell down stock, reduce your stock levels. There are a number of things which management of businesses can do to change the path on which they're on. They can secure additional financing, they can sell assets. They can do all sorts of things to help the cash flow.'

Indeed, Bird said in re-examination that given what he himself knew about Consolidated's business, 'it might well have been a curious thing' for Newton to have suggested liquidation of Consolidated in February 2001.

Jenkins

[54] Jenkins, who, as I have said, facilitated the conclusion of the ARA, said that CNA's competitor in Johncom, Exclusive Books:

'[A]lways perceived that the CNA had a huge amount of, let's call it retail and buying muscle, and that, if they were able to get their logistics right and their ordering right, and get their, let's call it their model right, they would be a fearsome competitor in the books environment . . .'.

[55] When asked the question 'did you think that CNA should be liquidated at that time March/April 2001', Jenkins answered with a categoric 'no'.

Norman

[56] The evidence established that Absa is one of the largest commercial banks in South Africa. Absa was involved with Consolidated on two fronts: Absa Corporate looked for an equity partner for the CNA and the retail banking division lent money to the CNA. Mr Norman was employed in Absa Corporate, which was given a mandate by GKA contained in a letter written by the latter on 26 March 2001 in the following terms:

'2. MANDATE

2.1 We are delighted to confirm the appointment of Absa Corp. to act as merchant bank to Gordon K & Associated (Pty) Ltd ("the mandator") in relation to advising on the potential disposal of all or part of the CNA Group (Pty) Ltd ("CNA Group"), and the structuring and strategy of the Group going forward.

2.2 In terms of the mandate Absa Corp. undertake to:

2.2.1 assess all available information and produce a report outlining the various alternatives open to the shareholders of CNA Group;

2.2.2 provide any financial and strategic advice regarding the future disposal and/or strategy for the CNA Group; and

2.2.3 assess and advise the mandator on offers received by potential acquirers of all or part of the CNA Group's operations/business units.

2.3 The mandator, in terms of this letter, grants to Absa Corp. (Investment Banking Department) a call option offering it the opportunity to acquire up to 20% of the existing issued ordinary shareholders equity of the CNA Group at a price of R80 million for 20%.'

Wainer said that he ignored the interest shown by Absa in itself acquiring equity in the CNA for R80 million as it lacked both clarity and commitment.

[57] After the mandate had been granted, Norman met the executive management of the CNA and attended both board and management meetings. Information was obtained from those meetings and from management reports.

[58] On 23 April 2001 at a meeting held at the CNA, Gordon presented to management a new proposed structure for the CNA. This structure involved separating the CNA stores into three categories: the top 50 stores, termed the 'destination' stores; the bottom 150 stores, termed 'entertainment' stores

which were to be sold to a Johnnic consortium; and the remaining stores which were to be franchised or closed. Norman said that, as a merchant banker, he considered this to be a viable plan. Indeed, to implement it, Absa Corporate prepared a detailed weekly timetable which commenced on 13 August 2001 and which was due to be completed by 31 October 2001. Although implementation was delayed, the sale of the top stores to Central was concluded on 8 November 2001 and according to Norman, by April 2002 some stores had already been franchised and there was ongoing interaction with Absa franchise which, he said, 'I think . . . is the biggest franchise division of all the banks. It is their business to really roll out these plans I think ten stores had been done'. According to Norman, the CNA had retained Mr Eric Parker, whom he described as 'the guru of franchising', to assist it in this regard. He took issue with the suggestion in cross-examination that the franchising was a 'hope', insisting that it was a 'plan'.

[59] From April 2002 a document prepared by Absa Corporate (which was continuously updated) was shown to prospective purchasers of equity in Central. The document showed that it was anticipated that profit after sale of the whole CNA group would not become possible even in 2005. Despite that, Norman testified, substantial interest was shown by various different parties including Sanlam, Old Mutual, Shoprite, Ackermans and merchant banks. The problem, however, was that the operational separation of the top 61 stores sold to Central had not been effected, due to the fault of a very senior individual in the CNA group (whom it is not necessary to name) who gave repeated assurances that everything was in hand, but failed to perform his mandate. There is no suggestion that Newton was aware of this problem.

[60] In re-examination, Norman's evidence was to the following effect:

'It was put to you that the fact that Consolidated was losing money was none of your concern? --- None of my concern in relation to what we wanted to achieve. We have to . . . put together a plan that undoes that situation. That is the whole point of us being involved, to come in, put in a plan, implement, turn it around, and everybody is happy about it. That is the game. It is of concern in relation to the ongoing business,

but it wasn't of concern to us in relation to our strategic plan. We knew it was making losses.

And would the prospective purchasers or the people interested in the business, would they have been aware of that, or not aware of that? --- Absolutely they'd be aware of it. That's part of the attraction. They're getting an asset. It's going to be substantially below what the value is. If it's a loss making business, you can get it cheaper and you can turn it around.

In a similar context it was put to you that the risk of turn around was extremely high and to which you answered, it was high. Now be more specific? --- It's a relative concept. I mean we did a deal where people bought 45 hospitals which were totally in liquidation. And that's now the Netcare Group. So who is to say whether that was a high risk when they did it, or extremely high risk, but they turned 45 hospitals, which owed Absa R100 million, into the Netcare Group.

Your client is highly successful? --- To say the least, yes.'

Meisenholl

[61] Meisenholl, a chartered accountant with over 26 years experience in banking and the managing executive of the credit risk management organization of Absa Retail Bank, gave evidence on the banking facilities granted by Absa to the CNA.

[62] At the end of March 2001 the CNA group applied to Absa for a R40 million general banking facility. In accordance with ordinary practice, the application was first considered by a business banker and a business analyst in the Sandton business centre who would have interacted with senior personnel of the CNA. It was then checked by risk management and the general manager of the business centre. From there it went to the credit department where it was reviewed by a credit analyst. Ultimately, because the facility requested exceeded R30 million, it came before the lending committee of which Meisenholl was a member.

[63] On 30 April 2001 the lending committee declined the application pending receipt of further information. Once the information had been provided, and after Meisenholl, Mr Emsley (the managing executive of the business bank) and Mr Human (the general manager of credit risk at Absa)

had consulted with senior management of the CNA (Gordon and Holden), the facility was granted by the lending committee on 10 April 2001. Present were Mr van der Merwe, the executive director responsible for credit; Mr Emsley; Meisenholl; Mr du Preez, a general manager in the business bank; and Mr Human, who dissented. I do not propose setting out the detail of the investigations made by Absa. It suffices to say that the application by the CNA was considered thoroughly and the recommendations at every level of the process were carefully motivated.

[64] The facility of R40 million was temporarily exceeded from time to time by the CNA, the excesses subsequently being approved by Absa, and on 13 November 2001 it was extended to include a R10 million letter of credit facility – again after a detailed investigation by Absa at the various levels I have mentioned. In March 2002 the CNA applied for an additional R20 million. That was refused by the lending committee on 30 April 2002, but a temporary bridging facility of R10 million was allowed and subsequently extended to 15 May 2002.

[65] On 16 May 2002, the lending committee noted that the R10 million had been repaid and that Absa's exposure was within R30 million. On 31 May 2002 Dr Booysen (the executive director responsible for the credit risk management organisation within Absa) and Meisenholl met with Newton, who gave them the assurance that Wooltru would not demand that the outstanding purchase price due by GKA be taken out of the CNA. It appears that the Absa representatives understood that Wooltru might again become a shareholder of the CNA, although no definite answer was given as Newton undertook to revert. At the end of May or early June 2002, a round robin resolution of the lending committee approved a temporary increase in the general banking facility granted by Absa to the CNA by R21,6 million to R60 million, subject to a reduction to R38 million on 20 June; and before 20 June, the facilities were increased to R70 million until September 2002.

[66] Newton was aware of the fact that Absa had granted the facilities to which I referred in the previous paragraphs. The attitude of Absa would hardly

have prompted him to consider the liquidation of Consolidated. On the contrary, as late as 30 May 2002 he met with Meisenholl, who said:

'So that was the discussion with Mr Newton it was not in terms of the R70 million term facility it was really what is the best way to keep CNA group operating and trading as a going concern. . . .'

[67] Meisenholl justified the extension of banking facilities to the CNA for essentially three reasons:

(a) first, the operation made business sense: the CNA had changed its business model from a news agent to a retail outlet with a diversified product and there was a demand for the product the CNA was selling;

(b) second, the group was debt free (ie no debts were owing outside the group), the CNA was a strong brand with over 300 branches and a new IT system to control stock had been introduced, with the result that 'from a whole business case perspective, we considered that it is viable'; and

(c) third, and most critically, Absa, having met with top management, had confidence that management would be able to make a success of the group.

Therefore, concluded Meisenholl, the lending committee 'considered it a fair decision, R40 million trading facility versus turnover of one billion rand at that stage' — even although, as pointed out in cross-examination, the risk of the CNA's inability to repay the loan to Absa was described as 'high' to the lending committee. Meisenholl also said in connection with the second point to which I have just referred that although Absa would have had regard to financial statements of the CNA, 'financial statements . . . reflect a picture of what happens in the past, they do not give a view of what is going to happen in the future'. This view stands in stark contrast to the position adopted by Wainer, as does the following statement, made by Meisenholl in cross-examination:

'If I knew what I knew twelve months later, in terms of what happened with management, how the cash flows panned out, etc we would have said no [to the CNA's application for credit facilities] but I haven't got the luxury when I take a credit decision to work on hindsight.'

Newton

[68] It is now necessary to examine the evidence of Newton himself. Newton never seriously considered liquidating Consolidated, and nobody proposed this option:

(a) The merchant banker (Casenove), the firms of attorneys (Mallinicks and Edward Nathan Friedland) and the firms of auditors (Ernst & Young and Nkonkwe Sizwe) who were retained by Wooltru to advise on its unbundling, and participated in the weekly meetings with Newton representing Wooltru when the affairs of Consolidated were considered in detail, did not suggest that Consolidated should be liquidated. Newton was entitled to rely on this multi-disciplinary array of talent for advice that Consolidated should be liquidated, if that was the view held by any of them.

(b) Deloittes, who audited the financial statements of both Consolidated and Holdings at February 2001, expressed an unqualified audit opinion, which meant, as Wainer readily conceded, that their view was that Consolidated was a going concern for the foreseeable future, ie for at least the next 12 months. In addition, on 4 September 2001, Deloittes advised the management of Consolidated, after reviewing management reports, that both before and after the restructuring in the CNA group, the assets of the companies in the group, fairly valued, exceeded the liabilities and that the companies were therefore technically (ie factually) solvent. Wainer disagreed with all of the conclusions reached by Deloittes. But the point is not who is correct. The point is that Newton was entitled to rely on the views of a reputable firm of auditors in performing his duties as a director of Consolidated.

(c) The corporate and retail banking divisions of Absa, which each conducted in depth investigations into the affairs of the companies in the CNA group, did not suggest liquidation. I have already dealt with the evidence of Norman and Meisenholl. Again, the question is not whether Wainer was correct in stating that 'many of them [ie bankers] do not have high level skills' or justified in saying that 'It appears from the files [Absa retail bank] didn't have the full story. From my experience with these banks, they certainly wouldn't have the appropriate expertise at the advances level to analyse it anyway, and they got critical pieces of information which were materially incorrect.' The point is that the ongoing actions of both divisions of Absa, in

continuing to provide and extend overdraft facilities after careful consideration and in attempting to find an equity partner, of all of which Newton was well aware, would have made liquidation of Consolidated the remotest possibility present to his mind.

(d) The management of Consolidated, in their monthly reports after the sale of shares agreement in March 2001 to which Newton had access at least after January 2002, and in their monthly reports before the sale of shares agreement to which Newton did have access, far from mentioning liquidation as a possibility, were consistently positive. Newton was entitled to accept and rely upon the judgment, information and advice of management, unless there were proper reasons for querying such.[15] It was submitted in argument on behalf of the liquidators that those in management were simply seeking to protect their jobs. But that cannot explain why management proposed a management buyout on two occasions. The first was between October and December 2000 when it was known that Wooltru was looking for a buyer for Consolidated; and the second was as late as mid-June 2002. There can be no stronger expression of confidence by management in a business than a proposed management buyout. Wainer could not explain why it was that management did not see that liquidation was inevitable in and after March 2001, and he did not address the continuously positive outlook by management which continued at least until shortly before Consolidated was liquidated.

[69] Newton dealt succinctly with the funding opportunities available to Consolidated, and the liquidators' touchstone of clarity and commitment, as follows:

'As at 1 March [2001] there was no shareholder . . . interest bearing debt, and CNA had a huge raft of possible sources of funding available to it. It had creditor funding, it had the ability to sell down stock, it had the ability to raise bank debt. It had the ability to sell off equity and inject funds. There was absolutely no need to have clarity about which of those sources it was going to utilise and certainly it was not necessary to have commitment from any of those sources at that time. The company's assets exceeded its liabilities and it could trade and it could rely in the normal course of

[15] *The Fisheries Development Corporation* case, above, n 4, at 166C, approved in *Philotex*, above, n 2, at 144I.

events to acquire funding from one or other of those sources. So I don't think this term "clarity and commitment" is of any application to any business situation other than where it is relying solely on a shareholder to provide the funding.'

As a matter of law, I disagree with the last sentence: clarity and commitment are required not only where a company relies solely on a shareholder to provide funding, but also where shareholder funding is essential for the company to survive even though other funding is available.

[70] Newton quantified the sources of funding as at 1 March 2001 as follows:

(a) Stock: As at 28 February 2001 stock was in the books at R318 million. Said Newton, one could assume that the CNA was overstocked by R180 million. As a matter of fact, the CNA ran down stock by even more than R180 million ─ at cost. Had stock been sold at the normal margin of 40 per cent, it would have realised R300 million in cash.

(b) Creditors: Creditors had been paid down from R220 million at the end of January 2001 to R100 million at the end of February. There was accordingly R120 million available in the form of creditor finance.

(c) Cash: There was cash in the bank of R10 million.

(d) Overdraft: Bank overdraft facilities of R70 million were ultimately granted.

(e) MTN: The RA was capable of renegotiation for R85 million. That is what happened when the ARA was concluded.

(f) Investors: If 50 per cent of the shares in Central were sold, the outstanding purchase price due to Wooltru could have been paid.

(g) Franchising: There were 160 stores in the franchising division. 100 stores could have been franchised at a price of R500 000 per store realising a minimum of R50 million. (As will appear from para 71(b) below, the 100 day plan anticipated that 150 stores would be franchised.)

Newton was not cross-examined on the figures he put to the various funding opportunities. He repeatedly tendered in cross-examination to provide those figures, which he had calculated during an adjournment after he had been led in chief, but that opportunity was denied him. The figures were accordingly

given in re-examination and the objection by the liquidators' counsel to this evidence was correctly overruled.

[71] As at March 2002, the financing opportunities had diminished and some had been utilized to their full extent. In addition, I agree with the liquidators' counsel that because of Consolidated's obligations to MTN under the ARA and GKA's obligations guaranteed by Consolidated to pay the balance of the purchase price to Wooltru, it is unlikely that any cash inflow from an equity partner (assuming that one could be found because of these very obligations) would have gone to Consolidated ─ although the debt due to Wooltru by GKA would have been discharged. But there was still the prospect of overdraft finance, and the plan to franchise stores was being implemented.

(a) Overdraft: In June 2002 the overdraft was increased from R40 million to R70 million until 1 September of that year. It was submitted on behalf of the liquidators that it was reckless for the board to have applied for this facility. I cannot agree. Although as a matter of law an overdraft is repayable on demand, it was not reckless for Newton to assume that once Absa retail bank, after due consideration, had granted an overdraft for a fixed term, it would not, shortly after it had been increased (again after due consideration), and before that term had expired, unexpectedly call it up. The expected cash flow of the business presented to Absa in June 2002 by the management of the CNA showed that cash in the bank/overdraft would fluctuate (overdraft figures in brackets) from about (R40 million) in March to bottom out at (R70 million) in August 2002, gradually recovering to between (R50 million) and nil to November, becoming positive in December and exceeding R100 million in January and R150 million in February 2003. Traditionally, the Christmas and back to school period (December and January) was the only period in the year that the CNA made a profit and that was well known to the board of the CNA and to Absa. At the board meeting on 28 March 2002, which Newton attended, Holden, the senior member of management present, said (and I quote the minutes):

'Tim Holden reported on the financial results, and indicated that the business was tracking ahead of the initial plan as presented to ABSA with expenses being well contained and the business achieving better margins. The loss for the trading year is

approximately R52 million. Plans for next year have already taken out R40 million of costs which implies that CNA should break even. CNA requires approximately R30 million cash injection to enable the double-digit growth and smooth operation of the business going forward. The down side is the upward fluctuation of interest rates.'

The increase in the overdraft granted by Absa was precisely the cash injection which management sought.

(b) Franchising: The 100 day plan envisaged that 150 stores would be franchised. It read:

'The current owners [GKA] have taken the decision to begin the process of franchising with the objective of having the first fully operational franchise stores up and running by October 1, 2001. It is anticipated that a total of 150 stores will be franchised during the 24 month period beginning in October 2001 and ending in October 2003. This being said, the target is to convert ten stores per month starting in February 2002.'

There was a delay in implementing the franchising plan but the report given to the CNA board at its meeting held on 28 March 2002, far from giving cause for concern, was positive. The minute in this regard reads:

'Franchising update: The first five franchise stores are up and running. The system is now in, once all the minor problems are resolved the balance of the franchise stores can be sold in earnest. Anton Hingeston has completed another presentation that has again sparked interest. Banks are processing and finalising the loans, as no payments have been received yet.'

As a matter of fact, the list of creditors of Consolidated reflects that R1,82 million was paid as a deposit for franchising rights on 30 April 2002, and that two other deposits were paid on 1 March. Counsel for the liquidators submitted that the franchising plan ended up as a debacle. But the argument again loses sight of the fact that the conduct of Newton does not fall to be evaluated with the benefit of hindsight.

[72] No particular event occurring after March 2002, apart from the application for the increased overdraft which I have dealt with, was relied upon in argument on behalf of the liquidators as constituting reckless conduct. The unchallenged evidence of Newton was that the CNA was paying trade creditors in June 2002. The liquidation of Consolidated in July was precipitated by Absa unexpectedly reducing the overdraft facility, which it had

granted until September, apparently because it realised that Wooltru was not interested in again becoming a shareholder in the CNA.

[73] On Newton's evidence alone, which I see no reason to reject, he was not guilty of reckless trading. On the contrary, he was well aware of the fiduciary responsibility he owed to Consolidated and, as is quite apparent from the clash between himself and Gordon at the CNA board meeting of 28 March 2002, he was prepared to exercise it. At that meeting Gordon suggested that over and above the overdraft facilities already obtained from Absa, a further R70 million overdraft should be obtained by Central. That money was intended by Gordon to be taken out of the CNA group and used to reduce the purchase price GKA owed to Wooltru. The minutes record that a 'heated discussion' then ensued. Newton agreed with Holden who expressed the view of management that the business of the CNA could not sustain the additional loan burden of R70 million. The minute records:

'Responding to a question from Brian Leroni [a director], John Newton said that whilst he could not express the view of Wooltru, his view as a Director of CNA was that he recognises the upcoming "cash squeeze" and that should debt be incurred in CNA to repay Wooltru, the Directors should be mindful of their fiduciary responsibilities should this put CNA in a potential insolvent position.'

Conclusion

[74] I am quite unable to find that the board of Consolidated, or Newton in particular, in any way conducted the business of Consolidated in or after March 2001 with an attitude of reckless disregard for the consequences. Nor in my judgment would a reasonable man of business in the position of Newton have foreseen, when credit was incurred, that there was a strong chance that creditors would not be paid. Several witnesses, including Newton, gave entirely acceptable evidence that they saw no reason to consider liquidating Consolidated. Save in regard to the possibility of an outside investor, which Wainer considered improbable after the conclusion of the ARA, no-one gave evidence that the funding opportunities available to Consolidated, to which Bird and Newton in particular testified, had no reasonable prospect of being realised and no-one testified that these funding opportunities were inadequate

to turn the CNA around. Wainer's evidence, constituting an accountant's view based on the management accounts alone, was not sufficient to counter the evidence given by and on behalf of Newton; and the liquidators' case in any event rested on a misinterpretation of this court's decision in *Philotex*.

[75] The appeal is dismissed with costs, including the costs of two counsel.

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T D CLOETE
JUDGE OF APPEAL

APPEARANCES:

APPELLANTS:	H Z Slomowitz SC (with him E A Limberis SC) Instructed by Werksmans, Cape Town; Lovius Block Attorneys, Bloemfontein.
RESPONDENTS:	S F Burger SC (with him I P Green) Instructed by Webber Wentzel Bowens, Cape Town; Matsepes Attorneys, Bloemfontein.